

**HB2595,**

**HD1**

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**SENATE COMMITTEE ON JUDICIARY & GOVERNMENT OPERATIONS  
TESTIMONY REGARDING HB 2595 HD 1  
RELATING TO GENERAL EXCISE TAX**

**TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)**

**DATE: MARCH 12, 2010**

**TIME: 9:30AM**

**ROOM: 016**

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This measure modifies the general excise tax law by disallowing a general excise tax benefit (*i.e.*, reduced rate, deduction, splitting, etc.) unless the taxpayer first registers to do business in Hawaii; files a timely return; and claims the benefit expressly on the proper returns. This measure also shores up general excise tax collections by creating "trust fund liability" for those that collect taxable receipts.

The Department of Taxation (Department) **strongly supports** this measure and **suggests amendments**.

**GENERAL FUND PROTECTION IS IMPORTANT**—This legislative session, when the economy is sliding and state revenues are declining, it is important that the general excise tax collection tools be strengthened.

Of all sources of state revenues, the general excise tax accounts for over 50 % of state realizations.

**DISALLOWING TAX BENEFITS FOR FAILURE TO PROPERLY CLAIM IS APPROPRIATE**—The general excise tax contains dozens of favorable benefits, including exemptions, reduced rates, and income splitting. A majority of these benefits allow businesses that are otherwise very profitable to avoid paying the general excise tax altogether. Because some businesses pay no tax, they often do not register to do business in Hawaii or file tax returns. Furthermore, out-of-state businesses that claim exemption from the general excise tax also fail to register, file, or otherwise expressly declare the exemption. This lack of data on businesses operating in Hawaii greatly undermines the Department of Taxation's ability to gather information on what businesses are claiming which tax benefits. Requiring businesses to be "on the radar" of the Department of Taxation will greatly assist in tax administration by providing valuable information that the government may use in compliance efforts.

Disallowing any general excise tax benefits unless basic information is filed is rational and justifiable, especially when tax benefits are a matter of legislative grace. In a time when tax incentives are reviewed with scrutiny by policymakers and administrators, it is important to ensure businesses do not avoid government tax benefit oversight by assuming that filing is unnecessary when no tax is due as a result of tax benefits. Even when no tax is due, officials should have all necessary data and information about persons conducting business in Hawaii in order to test the effectiveness of the tax system, and accurately account for those that enjoy exemptions from it.

**SUPPORT FOR REASONABLE CAUSE EXCEPTION**—The House Finance Committee amended the measure to allow an exception for reasonable cause, as determined by the Director. The Department supports this amendment to allow for flexibility on a case-by-case basis, depending upon the facts.

**SUGGESTED AMENDMENT TO LIMIT IMPACT ON UNINTENDED TAXPAYERS**—The Department suggests amending the measure to ensure that unintended taxpayers are not inadvertently denied a tax benefit. The unintended taxpayers that are not the target of this measure would include small nonprofit organizations, wage earners, and others that are not exposed to the general excise tax on a regular basis. By clarifying that those who are not exposed to the general excise tax as a regular matter are excluded, this measure becomes more workable from a policy standpoint.

Suggested language is as follows:

§237- General excise tax benefits; mandatory denial of tax benefits for failure to properly claim. (a) Notwithstanding any other law to the contrary, a person shall not be entitled to any general excise tax benefit under this chapter unless the person claiming the general excise tax benefit:

- (1) Obtains a license to engage in and conduct business as required under section 237-9;
- (2) Files a tax return as provided under this chapter or chapter 231 not later than twelve months from the due date prescribed for the return; and
- (3) Expressly claims general excise tax benefit on forms prescribed by the director of taxation.

(b) The director may require any taxpayer to furnish information to ascertain the validity of any general excise tax benefit and may adopt rules pursuant to chapter 91 necessary to effectuate the purposes of this section.

(c) A taxpayer shall not be denied a general excise tax benefit for failing to comply with subsection (a) if:

- (1) The provisions of the United States Constitution or laws of the United States prohibit the requirements; or
- (2) The State does not otherwise have the power to impose the requirements.

(d) The director may waive the denial of the general excise tax benefit under subsection (a) if the failure to comply is due to reasonable cause and not to the wilful neglect of the taxpayer.

(e) Nothing in this section shall be interpreted as limiting the application of section 237-22 in computing the tax imposed under this chapter.

(f) This section shall not apply to:

(1) Amounts received that are exempt under section 237-24(1) through (7);

(2) Amounts received by persons exempt under section 237-23(a) (3) through (6); provided that such person is exempt from filing federal Internal Revenue Service Form 990 or Form 990-EZ; and

(3) Any other amounts, persons, or transactions as determined by the director in the best interest of tax administration made by official pronouncement.

(g) For purposes of this section, "General excise tax benefit" means any tax exemption, exclusion of a taxable amount, a reduction from the measure of a tax imposed, a tax deduction, a tax credit, a lower rate of tax, a segregation or division of taxable amounts between multiple taxpayers involved in the same transaction, or any income splitting allowed under this chapter

As amended, this measure will not apply to:

- Amounts received under certain life insurance contracts, certain insurance payouts, gifts, bequests, or inheritance, certain tort damages, wages, and alimony. The Department supports not subjecting these transactions and taxpayers to this law because these transactions are not inherently entered for profit and are ordinarily not regularly exposed to the general excise tax;
- Certain nonprofit organizations, including churches and small charities with gross receipts of less than \$25,000. The Department supports not subjecting these persons to the requirements because of their size and lower likelihood of having general excise tax liabilities; and
- Any other situation as determined by the Director. The Department understands that this provision is broad and further understands there are situations that may not merit its application. Having the ability to determine exceptions as they arise will benefit tax administration because the Director can balance the needs of tax administration with the reality of the transaction in any given circumstance.

The Department believes this proposed amendment will have a nominal impact on the revenue gain.

**CREATING TRUST FUND LIABILITY IS IMPORTANT TO ENSURE THE GOVERNMENT IS PAID FOR INCREASES IN PRICE TO RECOVER THE TAX—** Additionally, though the general excise tax is a tax on businesses, Hawaii businesses are allowed by law to pass on their general excise tax costs to customers as a cost recovery. However, as the economy has declined, more businesses have failed to pay their general excise tax, even though the tax is still visibly passed on to Hawaii consumers under the guise that it would be paid to the government. Businesses that do not timely remit the tax recovery amount are known to use these funds to pay operating expenses, and some disreputable businesses pocket these funds with no intent on paying their taxes. In short, the practice of increasing consumer costs under the pretext of tax recovery now becomes a consumer protection matter, and businesses should be liable for paying those tax recovery amounts owed to the government. Especially since more businesses are keeping these tax recovery amounts to cover costs during this economic downturn, the government inevitably becomes the last creditor to be paid.

**REVENUE GAIN—**This measure will result in a revenue gain to the general fund of:

FY11: \$15 million  
FY12: \$30 million  
FY13: \$30 million  
FY14: \$30 million  
FY15: \$30 million

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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SUBJECT: GENERAL EXCISE, General excise tax benefits

BILL NUMBER: HB 2595, HD-1

INTRODUCED BY: House Committee on Finance

**BRIEF SUMMARY:** Adds a new section to HRS chapter 237 to provide that a person shall not be entitled to any general excise tax benefit unless the person claiming the general excise tax benefit shall: (1) be licensed to engage and conduct business as required; (2) file a tax return as provided under this chapter or HRS chapter 231 no later than twelve months from the due date prescribed for the return; and (3) make a claim for the general excise tax benefit on the forms prescribed by the director of taxation. Permits the director of taxation to waive the denial of the general excise tax benefit if a taxpayer's noncompliance was due to a reasonable cause rather than wilful neglect. The director of taxation may require the taxpayer to furnish information to ascertain the validity of any general excise tax benefit and may adopt rules necessary to effectuate the purposes of this section.

Defines "general excise tax benefit" as any exemption, exclusion of amount, reduction from the measure of tax imposed, deduction, credit, lower rate, segregation or division of amounts amongst multiple taxpayers involved in the same transaction, or income split allowed under this chapter.

Adds a new section to HRS chapter 237 to provide that there shall be personal liability for the taxes imposed under this chapter for the following amounts of gross income or gross proceeds: (1) any amount collected as a recovery of the taxpayer's liability under the GET, where the amount is passed on as the tax owed by the taxpayer for the transaction and is separately stated or accounted for in a receipt, contract, invoice, billing, or other evidence of the business activity; or (2) an amount equal to an imputed tax liability on a transaction where a taxpayer does not separately state or account for the amount as a tax recovery. The amount of the imputed tax liability is the result of multiplying the gross income or gross proceeds received in the transaction by the tax rate. The amounts in paragraphs (1) and (2) shall be held in trust for the state and for the payment to the tax collector as required.

The personal liability applies to any officer, member, manager, or other person having control or supervision of gross proceeds or gross income collected and held in trust, or who is charged with the responsibility for the filing of returns or the payment of gross income or gross proceeds collected and held in trust. Such persons shall be personally liable for any unpaid taxes and interest and penalties on those taxes, if such officer or other person wilfully fails to pay or to cause to be paid any taxes due from the taxpayer. Stipulates that "wilfully fails to pay or to cause to be paid" shall be construed in accordance with judicial interpretations given to similar provisions of Title 26 of the United States Code; consistent therewith, the term "wilfully" shall mean a voluntary, intentional violation of a known legal duty.

**EFFECTIVE DATE:** July 1, 2020; applicable to gross income received on or after its effective date

STAFF COMMENTS: This was an administration measure submitted by the department of taxation TAX-07(10). This measure underscores the importance of the requiring businesses to register to do business in Hawaii in order to “enjoy” the benefits of the general excise tax. While the measure extols the virtue of being registered as it provides valuable information that may be used for compliance efforts by the department of taxation, it is questionable whether the adoption of this measure will ensure the proper payment of taxes. This measure is aimed, no doubt, at those entities which enjoy exemptions or unique treatment under the general excise tax laws. This would include everyone from nonprofit organizations that enjoy exemptions from the tax on related activities, to for-profit entities that are allowed to treat their gross income as provided for by law. In this latter case, these could include travel related entities where the gross income is divided between commissioned sales and the provider of travel related activities other wise known as gross-up to hotel operators who are contracted to manage a hotel on behalf of a hotel property owner where the amounts disbursed as compensation and employee benefits are not subject to tax by the hotel operator as they are viewed as pass-through expenditures.

If the intent of this measure is to catch so-called abusers and scofflaws who enjoy these special provisions, this measure is overkill, creating an administrative and compliance nightmare, enticing businesses who do not have the funds, due to an ailing economy, to pay their fair share of the general excise tax. In this case, this proposal violates one of the principles of a good tax policy, that a tax should be easy to administer and with which to comply insuring that the cost of administration and compliance does not exceed the amount of the tax collected.

*Finally, if the department of taxation believes that every taxpayer should be conscientious and honest about paying their general excise taxes, then the department needs to do its part to insure that it is providing guidance and the tools taxpayers need with which to comply with the law. For example, in recent years, the department has gone in the direction of paperless forms, encouraging taxpayers to download the appropriate forms to file their taxes but offering the option for the taxpayer to request hard paper copies of the forms to be filed. Unfortunately, the department has in many cases not complied with the request for hard paper copies to be mailed to taxpayers. How can taxpayers be expected to comply with the law if it is difficult to secure the necessary forms? Many taxpayers do not have computers or not know how to access the department's forms via the Internet and in many cases have forgotten to file their returns on time, if at all. The turnover of personnel at the department has given rise to inexperienced staff who hand out erroneous information and interpretations of the law leading to confusion and frustration on the part of the taxpayer and the tax practitioner. If the pot is to call the kettle black, that examination needs to begin with the department where customer service has deteriorated in recent years. One cannot expect taxpayers to comply when the department is not doing its utmost to make filing and payment of taxes convenient. Before lawmakers consider approving this proposal, they should consider a management audit of the department and a forum where taxpayers can share their frustrations with how the department has administered the laws.*

While the justification sheet of the measure estimates that the adoption of this measure will result in a revenue gain of \$15 million in fiscal 2011 and increasing to \$45 million in fiscal 2015, such estimates appear to be overly optimistic.

Digested 3/10/10



**Before the Senate Committee on  
Judiciary & Government Operations**

DATE: Friday, March 12, 2010

TIME: 9:30 A.M.

PLACE: Conference Room 016

**Re: HB 2595 HD1 Relating to General Excise Tax**

Thank you for the opportunity to submit our comments.

We oppose HB 2595 HD1 Relating to General Excise Tax in its current form. NFIB Hawaii supports tax responsibility; however we are concerned a possible unintended consequence of such legislation could be that companies will be discouraged from transacting business in the State of Hawaii.

The National Federation of Independent Business is the largest advocacy organization representing small and independent businesses in Washington, D.C., and all 50 state capitals. In Hawaii, NFIB represents 1,200 members and works with and on behalf of employers across the state.





**Testimony to the Senate Committee on Judiciary**  
Conference Room 016, State Capitol  
Friday, March 12; 9:30 a.m.

**RE: HOUSE BILL NO. 2595 HD1 RELATING TO GENERAL EXCISE TAX**

Chair Taniguchi, Vice Chair Takamine, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii. On behalf of the Chamber, I am here to state The Chamber's opposition to House Bill No. 2595 HD1.

The Chamber is the largest business organization in Hawaii, representing more than 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber opposes the bill for the following reasons:

1. The bill would severely penalize taxpayers who inadvertently fail to file general excise tax ("GET") returns, even if those taxpayers would not otherwise owe any tax. It would therefore create an unnecessary technical requirement, violation of which could result in massive tax liability for innocent taxpayers. The taxpayers most likely to unintentionally violate this technical requirement are small businesses, individuals, and non-profit organizations--those who are least likely to have access to sophisticated tax advice, and least able to bear the burden of such severe penalties. This result is contrary to fair tax administration.
2. The bill would create needless administrative complexity both for taxpayers and for the government. It would force even taxpayers who have no GET liability, such as ordinary wage-earners, to obtain a GET license and file periodic GET returns. It may also result in inadvertent attempts to tax income that is beyond the State's power and authority to tax. This could lead to unnecessary and expensive tax audits and litigation, which would be a waste of both taxpayer and government resources.
3. The bill would also impose personal trust fund liability on taxpayers, which is inappropriate for GET. Personal trust fund liability is generally imposed on items such as withholding of employee payroll taxes, which are the liability the employee. Unlike payroll tax withholding, however, businesses do not hold the GET in trust for any other party. Rather, GET is a tax liability of the business itself. The imposition of personal liability for GET is inappropriate in these circumstances.

Thank you for the opportunity to submit comments.



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March 11, 2010

**The Honorable Brian T. Taniguchi, Chair**  
Senate Committee on Judiciary and Government Operations  
State Capitol, Room 016  
Honolulu, Hawaii 96813

**RE: H.B. 2595, H.D. 1, Relating To General Excise Tax**

**HEARING: Friday, March 12, 2010 at 9:30 a.m.**

Aloha Chair Taniguchi, Vice Chair Takamine and Members of the Committee:

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,800 members in Hawai'i. HAR would like to make the following **comments** with respect to H.B. 2595, H.D. 1, which: (a) precludes a taxpayer from using a General Excise Tax ("GET") benefit, including exemptions, deductions, lower rates, or income splitting, unless the taxpayer follows all administrative requirements; and (b) creates trust fund liability for revenues collected by a business as a tax recovery.

GET exemptions for certified or approved housing projects under HRS §§ 46-15.1, 201H-36 and 237-29 are GET benefits covered by H.B. 2595, H.D. 1, which will be enforced prospectively by the Department of Taxation ("DoTax").

HRS §46-15.1(a) allows counties to grant county housing projects an exemption from GET "in the same manner as projects of the Hawaii housing finance and development corporation pursuant to [HRS] section 201H-36; . . ." It is HAR's understanding that since at least 1988, the GET exemptions under HRS §46-15.1(a) have been administered by each of the counties independently of the HHFDC.

S.B. 2593, S.D.1, which recently crossed over to the House, requires the Hawaii Housing Finance and Development Corporation ("HHFDC") to conduct periodic reviews of housing projects certified for a GET exemption under HRS §§ 201H-36 and 237-29 to determine whether the housing projects have met eligibility criteria required by law and rule.

Because of DoTax's enforcement powers under H.B. 2595, H.D. 1, and because the recipients of county exemptions under HRS §46-15.1(a) are required to file their exemption forms with DoTax under H.B. 2595, H.D. 1, HAR believes that it makes much more sense to have DoTax conduct the periodic reviews contemplated in S.B. 2593, S.D.1, and that HRS §237-29 should therefore be amended to read as follows:

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**§237-29 Exemptions for certified or approved housing projects.**

(a) All gross income received by any qualified person or firm for the planning, design, financing, construction, sale, or lease in the State of a housing project that has been certified or approved under section 201H-36 or section 46-15.1 shall be exempt from general excise taxes.

(b) All gross income received by a nonprofit or a limited distribution mortgagor for a low- and moderate-income housing project certified or approved under section 201H-36 or section 46-15.1 shall be exempt from general excise taxes.

(c) The director shall conduct periodic reviews of all housing projects for which a claimant has received a general excise tax exemption. Each periodic review shall occur not less than once every three years following the close of the taxable year for which a claimant received a general excise tax exemption. Each periodic review shall determine whether the housing project has met eligibility criteria under section 201H-36 or section 46-15.1 and other applicable laws and rules for each taxable year for which a claimant received a general excise tax exemption.

(d) The director of taxation and the Hawaii housing finance and development corporation shall adopt rules pursuant to chapter 91 for the purpose of this section, including any time limitation for the exemptions and penalties for claimants who have received a general excise tax exemption without meeting or continuing to meet the appropriate eligibility criteria in every taxable year during which the claimant has received a general excise tax exemption.

HAR also recommends that in order to more effectively enforce and account for all of the GET and Use Tax exemptions under HRS §§ 46-15.1(a), 201H-36, 237-29 and 238-3(j), a provision should be added to H.B. 2595, H.D. 1, amending HRS §46-15.1(a) as follows:

**§46-15.1 Housing; county powers.** (a) Any law to the contrary notwithstanding, any county shall have and may exercise the same powers, subject to applicable limitations, as those granted the Hawaii housing finance and development corporation pursuant to chapter 201H insofar as those powers may be reasonably construed to be exercisable by a county for the purpose of developing, constructing, and providing low- and moderate-income housing; provided that no county shall be empowered to cause the State to issue general obligation bonds to finance a project pursuant to this section; provided further that county projects shall be granted an exemption from general excise or receipts and use taxes in the same manner as projects of the Hawaii housing finance and development corporation pursuant to [section] sections 201H-36, 237-29 and 238-3(j) and the rules thereunder; and provided further that section 201H-16 shall not apply to this section unless federal guidelines specifically provide





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local governments with that authorization and the authorization does not conflict with any state laws. The powers shall include the power, subject to applicable limitations, to:

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.



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**TESTIMONY BEFORE THE SENATE COMMITTEE  
ON JUDICIARY & GOVERNMENT OPERATIONS**

**Re: House Bill 2595, HD 1**

**Friday, March 12, 2010 at 9:30 am  
State Capitol, Conference Room 016**

Chair Taniguchi, Vice-Chair Takamine, and Members of the Committee:

Thank you for the opportunity to testify. My name is Ronald Heller. I am a practicing attorney, and also licensed as a Certified Public Accountant. I oppose House Bill 2595, HD 1.

First, from a legal viewpoint, the concept of a "trust fund" is fundamentally incompatible with the theory that the GE tax is a "privilege" tax based on the privilege of doing business in Hawaii. For example, in a sale of goods, the actual tax liability is imposed on the seller, not the buyer. The seller is the one engaging in business, and the tax applies to that privilege. The seller may pass on the tax by adding it to the price, but legally the buyer does not owe tax to the State; the tax liability is imposed on the seller. That theory is the constitutional basis for many of the decisions upholding the GE tax in various circumstances. If we are going to toss away the legal theory on which the GE tax has been repeatedly upheld, we must be prepared to re-examine decades of previously-settled law.

In some states, the state sales tax is actually imposed on the buyer, and the seller is basically a collecting agent, responsible for collecting the tax and remitting it to the state. In those states, a trust fund concept may make sense. However, from a constitutional viewpoint, a tax imposed on the seller and a tax collected by the seller and held in trust are two very different things. If we are going to change from one to the other, virtually every court decision involving the application of the GE tax to interstate business will be wide open for a whole new challenge.

Also, the trust fund concept is inconsistent with “grossing up” the tax. For example, consider the seller who charges \$100 for a product, and then adds \$4 for the tax, charging a total of \$104. The seller is considered to have gross income of \$104 (because the amount added for tax is included) and the tax due is \$4.16. That is why most sellers actually add on 4.1666% rather than 4.0% (or they add 4.712% on Oahu). However, if the tax collected is a trust fund, then conceptually it is not the seller’s income and should not be part of the tax base. Thus the seller would only owe tax on \$100, not on \$104. The tax due would be \$4.00 and not \$4.16. The State can’t have it both ways – the tax collected from the buyer is either a trust fund or it’s not. If it’s a trust fund, then it can’t be part of the tax base.

I also disagree with the other part of this bill.

The bill would disallow any general excise tax exemption, deduction, exclusion, rate reduction or other tax benefit unless the taxpayer files a Hawaii GE tax return specifically identifying and claiming the tax benefit and including whatever forms, schedules or information the Department of Taxation may choose to require. While there is an exception in cases where federal law prohibits such a requirement, there are at least three categories of taxpayers that are likely to fall into a trap if this bill passes.

The first category is non-profit organizations, where most or all of their gross receipts are exempt from the GE tax. Often, these entities have volunteers serving as officers and directors. Often, the volunteers are not tax experts, and tax forms may not be completed in exactly the technically correct manner. This is not due to deliberate non-compliance, but simply due to the complexity of the tax law. Under this bill, a charitable organization that qualified for a tax exemption could lose the exemption through minor technical errors in filing.

The second category consists of taxpayers based outside Hawaii, or based here but doing business across state lines. Given the extremely complicated nature of the law dealing with multi-state businesses, again it is easy for taxpayers who are sincerely trying to comply with the

law to make a mistake. Again, under this bill, a company that substantively qualifies for a tax exemption or exclusion could lose the tax benefit due to a technical filing mistake.

Finally, the third category consists of small business owners who simply don't have the wherewithal to hire tax professionals. The tax laws are complicated, and this bill could effectively impose a very substantial penalty for minor technical errors, completely taking away a deduction, exemption or other tax benefit that the taxpayer is substantively entitled to claim.

Overall, I think that passing this bill would create a number of serious problems. If we are going to consider changes as drastic as these – and I don't think we should – it ought to be given far more study first.

Respectfully submitted,



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Ronald I. Heller

**TESTIMONY BEFORE THE SENATE  
JUDICIARY AND GOVERNMENT OPERATIONS COMMITTEE**

**Re: House Bill 2595**

**Friday, March 12, 2010 at 9:30 a.m.  
State Capitol, Conference Room 016**

Chair Taniguchi, Vice-Chair Takamine, and Members of the Committee:

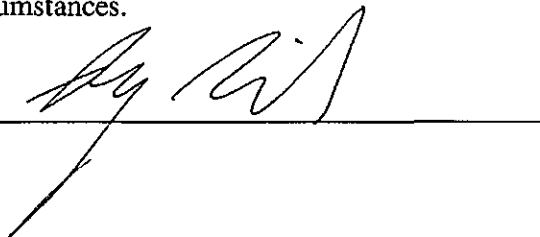
Thank for the opportunity to testify. My name is Ryan Wilson. I am a tax attorney in private practice in Hawaii. I oppose House Bill 2595 for the following reasons:

1. The bill would severely penalize taxpayers who inadvertently fail to file general excise tax ("GET") returns, even if those taxpayers would not otherwise owe any tax. It would therefore create an unnecessary technical requirement, violation of which could result in massive tax liability for innocent taxpayers. The taxpayers most likely to unintentionally violate this technical requirement are small businesses, individuals, and non-profit organizations—those who are least likely to have access to sophisticated tax advice, and least able to bear the burden of such severe penalties. This result is contrary to fair tax administration.

2. The bill would create needless administrative complexity both for taxpayers and for the government. It would force even taxpayers who have no GET liability, such as ordinary wage-earners, to obtain a GET license and file periodic GET returns. It may also result in inadvertent attempts to tax income that is beyond the State's power and authority to tax. This could lead to unnecessary and expensive tax audits and litigation, which would be a waste of both taxpayer and government resources.

3. The bill would also impose personal trust fund liability on taxpayers, which is inappropriate for GET. Personal trust fund liability is generally imposed on items such as withholding of employee payroll taxes, which are the liability the employee. Unlike payroll tax withholding, however, businesses do not hold the GET in trust for any other party. Rather, GET is a tax liability of the business itself. The imposition of personal liability for GET is inappropriate in these circumstances.

Respectfully submitted: \_\_\_\_\_





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**THE SENATE  
THE TWENTY-FIFTH LEGISLATURE  
REGULAR SESSION OF 2010**

**COMMITTEE ON JUDICIARY AND GOVERNMENT OPERATIONS**

**Hearing March 12, 2010  
Testimony on H.B. 2595 HD1  
(Relating to General Excise Tax)**

Chair Tanaguchi, Vice Chair Takamine and members of the Committee:

My name is Peter Fritz. I am an attorney specializing in tax matters. I also serve on the Boards of several nonprofit organizations. I am testifying in opposition to H.B. 2595 HD1.

This Section 2 of this bill denies any tax benefits under the General Excise Tax ("GET") to any person who failed to properly obtain a GET license or file a GET tax return. Any income received by a person would be taxable notwithstanding the fact that the person was qualified for an exemption under the GET law.

In addition, this bill would create a trust fund liability for any amounts deemed to be owed because the person did not obtain a GET license or file a GET tax return within 12 months the time limits in this bill of the due date of the return.

- This bill would create a trap for the unwary. A business that filed all 12 periodic GET tax returns, but failed to file the final reconciliation return would not be entitled to claim the benefit of an exemption or credit for GET returned for an item returned by a customer or an exemption that it is entitled to under law.
  - This bill will deny tax benefits to small nonprofits, volunteer sports teams, PTAs and other similar organizations who fail to dot the I's or cross the T's with no intent to avoid paying taxes.
  - My daughter's hula halau holds a show before the Merrie Monarch each year. Proceeds from the show are exempt from the GET because they are related to the exempt activity of the hula halau. If the hula halau filed all 12 monthly periodic returns, but inadvertently failed to file a reconciliation return, the halau would be taxable on the all of its gross receipts and have trust fund liability for any taxes it could not pay.
- This bill would discourage people coming forward to get GET licenses or who failed to file GET tax return if more than 12 months from the due date of the return. Considering the potential liability, who would come forward and subject themselves

to a denial of GET tax benefits? It will only drive persons further underground or close an existing operation and open a new one in an attempt to avoid these onerous provisions.

- Imposition of trust fund liability is inappropriate because there is no settler trustee relationship. When an employer withholds money from an employee's compensation for the express intention of paying it over to the State to pay the employee's income tax, a fiduciary relationship is created because the employer is expected to pay this money over to the State to on behalf of the employee. When the business visibly passes the tax onto the customer, it is the business that is considered the payer of the tax. According to the Department of Taxation General Excise Tax Memorandum No. 4.

“Whether there is a visible pass on or not, the Department of Taxation will look to the seller for the tax upon the seller's total gross receipts. Any amount added as the tax and collected by the taxpayer must be considered as part of the price received, and will be a part of the gross receipts of the taxpayer and must be reported as taxable income.”

Because the Department of Taxation considers any additional amount part of the seller's gross receipts for calculation of the tax owed by the seller, and not tax paid by the consumer, no fiduciary relationship is created and trust fund liability is unwarranted.

- Imposing trust fund liability could cause hardship for the volunteer soccer coach who holds a fund raiser and fails innocently fails to comply with GET law. The soccer coach would have trust fund liability for gross receipts, which but for this bill could be exempt from the GET. This trust fund liability is not dischargeable in bankruptcy and will follow the coach to the grave.
- The threat of personal liability for contested amounts of GET will cause individuals to refuse to serve as directors of nonprofit organizations or companies.

If the Committee decides to move this bill forward, it should include a section that provides for the imposition of a penalty of 25% of the amount assessed against an individual wrongfully accused of being a responsible person. This deterrent is necessary to prevent the Department from designating every director and officer a responsible person.

Thank you for the opportunity to testify.





CERTIFIED PUBLIC ACCOUNTANTS

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Senate Committee on Judiciary and Government Operations

Senator Brian Taniguchi, Chair

Senator Dwight Takamine, Vice Chair

Subject: House Bill No. 2595

Hearing: March 12, 2010, 9:30 a.m.

My name is Wendell Lee, and I am a certified public accountant and Tax Partner in Charge with Accuity LLP, a Hawaii based full service accounting firm. We OPPOSE this measure and strongly urge you not to pass it out of committee. There are significant flaws with this bill, including the following:

**Section 2:**

**Loss of All Deductions, Exemptions, and Credits:** As written, this section is overly broad. It will cause massive administrative problems incident to requiring hundreds of thousands of Hawaii residents who now do not file GET returns to file upon pain of being taxed at 4% / 4.5% on income that the Department's own GET return instructions say does not need to be reported at all:

- All wage earners would have to file under pain of being subject to GET on their wages. HRS §237-24(6) now provides an exemption for this.

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- Recipients of gifts and inheritances would be taxable on their receipts. HRS §237-24(4). This exclusion is not limited to nonprofit associations.
- All recipients of dividends and distributions, including partners in a partnership that has paid GET, would be exposed. HRS §237-3(b); TIR 97-5.
- All employee benefit plans would have to file under pain of being subject to GET on investment income. HRS §237-24.5(5).
- All persons making casual sales would also have to file. HRS §237-1; HAR §18-237-1.
- All condominium associations or co-operative housing corporations receiving only maintenance fees would have to file. HRS §§237-24.3(3), 237-24(16).

**Section 3:**

**GET As a Trust Fund Tax:** This section seems to be based on IRC §6672, which applies when employers fail to pay withheld payroll taxes over to the government. There, the employee has had taxes taken out of a paycheck and the government is obligated to give credit for those taxes to the employee whether or not the employer pays the taxes over. The GET, on the other hand, is a tax on the privilege of doing business and it is imposed on the taxpayer doing business, by design.

One of the reasons why the GET is imposed upon the seller, rather than the buyer as in states with sales taxes, is so that the tax can be imposed when the buyer is the Federal Government. If trust fund liability or similar features are added to the GET, the State will risk the Federal Government arguing that the GET is really imposed on the purchaser, so that federal purchases will be immune from tax because of the Federal Government's sovereign immunity. This conclusion will be made by the federal courts, irrespective of what state law or the state courts may say. Diamond National Corp. v. Board of Equalization, 425 U.S. 268 (1976) ("The judgment is reversed. We are not bound by the California court's contrary conclusion and hold that the incidence of the

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state and local sales taxes falls upon the national bank as purchaser and not upon the vendors.”); United States v. Board of Equalization, 650 F.2d 1127 (9th Cir. 1981) (“In determining who the legislature intends will pay the tax, the entire state taxation scheme and the context in which it operates as well as the express words of the taxing statute must be considered.” The court then held that because a facially neutral statute created an economic incentive for the seller to pass the tax on, the legal incidence of the tax fell upon the buyer; thus, the Federal Government, as buyer, could invoke its immunity.), affirmed, 450 U.S. 901 (1982). This creates a massive risk that the State cannot afford to take in these troubled economic times.

Thank you for this opportunity to offer comments on the measure.