

**HB 2595,
HD1, SD1
Testimony**



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-FIFTH LEGISLATURE, 2010**

ON THE FOLLOWING MEASURE:

H.B. NO. 2595, H.D. 1, S.D. 1, RELATING TO GENERAL EXCISE TAX.

BEFORE THE:

SENATE COMMITTEE ON WAYS AND MEANS

DATE: Wednesday, March 31, 2010 **TIME:** 9:30 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): WRITTEN COMMENTS ONLY. For more information, call
Mary Bahng Yokota, Deputy Attorney General, at 586-1470.

Chair Kim and Members of the Committee:

The Department of the Attorney General provides these comments regarding legal problems in this bill.

This bill (1) disallows general excise tax benefits unless the taxpayer obtains a general excise tax license, files a tax return by a specified date, and expressly and properly claims the general excise tax benefit ("Requirements"); (2) creates a personal trust fund liability for businesses that use the general excise tax as the basis for increasing their prices and ensure those funds are paid to the State; (3) requires the Department of Taxation to conduct periodic reviews of housing projects certified for a general excise tax exemption; and (4) provides that county housing projects are entitled to general excise tax and use tax exemptions.

This bill may be challenged as being unconstitutional because it appears to embrace more than one subject. Article III, section 14, of the Constitution of the State of Hawaii in part provides:

Each law shall embrace but one subject, which shall be expressed in its title.

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The title of this bill is "A BILL FOR AN ACT RELATING TO GENERAL EXCISE TAX." This bill relates to general excise tax but it also attempts to provide that county housing projects are entitled to use tax exemptions (p. 9, lines 11 and 14). Use tax appears to be beyond the scope of the title of this bill.

This bill provides, in part, that the new section setting forth the Requirements (p. 4, line 6, through p. 6, line 9) shall not apply to any "amounts, persons, or transactions as determined by the director in the best interest of tax administration made by official pronouncement" (p. 6, lines 1-3). The term "official pronouncement" is not defined and is ambiguous.

We respectfully request that the Committee consider our comments and make appropriate amendments before passing this bill.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



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**SENATE COMMITTEE ON WAYS & MEANS
TESTIMONY REGARDING HB 2595 HD 1 SD 1
RELATING TO GENERAL EXCISE TAX**

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

DATE: MARCH 31, 2010

TIME: 9:30AM

ROOM: 211

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.

As amended, this measure requires the Department of Taxation to conduct periodic reviews of all housing projects claiming the general excise tax exemption for construction of low-income housing.

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

I. STRONG SUPPORT FOR THE GET PROTECTION ACT.

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 supports the amendments made by the Committee on Judiciary & Government Operations. These amendments accomplish an important objective, which is to avoid unwarranted disallowance of tax benefits in cases involving unintended taxpayers that are not the target of this measure. These transactions include those involving 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.

Furthermore, the Department suggests additional amendments that are taxpayer-friendly. This simple amendment will allow taxpayers that inadvertently forget to claim a tax benefit the ability to enjoy the benefit if discovered on audit. For example, if under examination, the Department determines that a taxpayer would be entitled to the tax benefit but the taxpayer inadvertently forgot to claim the benefit, the Department would be allowed to adjust the audit and provide the benefit.

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; and

(2) Files [a] the annual general excise tax reconciliation 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

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.

II. OPPOSED TO REQUIREMENT TO AUDIT LOW-INCOME HOUSING PROJECTS

This measure, as amended, requires the Department of Taxation to conduct periodic reviews of all housing projects claiming the general excise tax exemption for construction of low-income housing.

The Department) **opposes** these amendments.

THE DEPARTMENT SUPPORTS COMPLIANCE REVIEWS GENERALLY—As a general matter, the Department supports the compliance function of auditing and reviewing taxpayers who enjoy favorable tax treatment. However, audits and compliance reviews should be prioritized against all other obligations of the Department.

THE DEPARTMENT OPPOSES THIS MANDATE, WHICH WILL EFFECT COLLECTIONS AND REDUCE PRODUCTIVITY—The Department opposes this measure, which requires it to focus its already limited auditing resources on one specific tax exemption. The Department does not have the resources to ensure a periodic review on the basis provided in this measure. The Department believes that, if required to audit each low-income housing project every three years, the general fund will suffer if these reviews do not generate money. Productive auditors would be pulled off of revenue generating cases, with detriment to the general fund. The Department would prefer to direct its resources where the least amount of effort generates the greatest amount of revenue for the general fund.

THE DEPARTMENT IS NOT AN EXPERT IN LOW-INCOME HOUSING PROJECTS—The Department also opposes this measure because it is not an expert in low-income housing development projects. The Department's reviews of these exemptions would take an excessive amount of time for the first reviews in order to learn the industry. The Department believes that the Hawaii Housing Finance and Development Corporation is better suited to handle this task.

LOSS OF REVENUE—This provision will have a direct negative impact on revenue collections if not removed or amended to allow discretion to audit these projects. At a minimum, the Department projects that approximately \$3 million per year in general fund revenues will be lost due to assigning productive auditors to these cases. The Department suggests eliminating these provision or amending the measure to provide that the Director "may" conduct these reviews.

REVENUE GAIN—As amended, this measure will result in revenue gain to the general fund as follows, which takes into account a \$3 million loss per year from the requirement to audit

low-income housing projects.

FY11: \$12 million

FY12: \$27 million

FY13: \$27 million

FY14: \$27 million

FY15: \$27 million

March 30, 2010

The Honorable Donna Mercado Kim, Chair
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, Hawaii 96813

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

DECISION MAKING: Wednesday, March 31, 2010 at 9:30 a.m.

Aloha Chair Kim, Vice Chair Tsutsui and Members of the Committee:

I am Craig Hirai, Chair of the Subcommittee on Taxation and Finance, commenting 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, S.D.1, Relating to General Excise Tax, which among other things: (a) precludes a taxpayer from using a general excise tax benefit, including exemptions, deductions, lower rates, or income splitting, unless the taxpayer follows all administrative requirements, subject to exemptions, and (b) creates trust fund liability for revenues collected by a business as a tax recovery whether such amount is separately stated or not.

Proposed HRS §237- (a)(3) in Section 2 of H.B. 2595, H.D.1, S.D.1, requires a taxpayer to expressly claim a "general excise tax benefit" on forms prescribed by the Director of Taxation. Under proposed HRS §237- (g), the term "general excise tax benefit" is defined to include "the exclusion of a taxable amount." The "sale of land in fee simple" is excluded from the definition of "gross income" under HRS §237-3(b), and the General Instructions for Filing the General Excise/Use Tax Returns state at page 20 that "Gross proceeds from the sale of land in fee simple are generally exempt and do not have to be reported." [Emphasis added.]

HAR therefore believes that it is only fair to taxpayers that the definition of "general excise tax benefit" in proposed HRS §237- (g) be amended to read as follows so that taxpayers can be assured that if reporting or disclosing on a prescribed form is not required, a taxpayer cannot violate proposed HRS § 237- (a)(3) in Section 2 of H.B. 2595, H.D.1, S.D.1.

(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 **which is required to be reported or disclosed on forms prescribed by the director of taxation.**

Mahalo for the opportunity to submit comments.