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HOUSE COMMITTEE ON FINANCE

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING HB SB 1107, SD 1, HD 1 RELATING TO GENERAL EXCISE TAX

TESTIFIER: FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR
DESIGNEE)
COMMITTEE: FIN
DATE: MARCH 31, 2011
TIME: 5:00PM
POSITION: OPPOSES PART I; SUPPORTS PART II

Part I:

Part I of this measure amends Hawaii Revised Statutes (HRS) section 237-24.7 by adding a reference to both HRS section 237-23.5 and section 267 of the Internal Revenue Code (IRC), to expand an existing general excise tax exemption. The Department of Taxation (Department) is **opposed to Part I.**

The Department is not supportive of expanding general excise tax exemptions. If, however, the Legislature desires to broaden the general excise tax exemption to include additional related entities (those defined under HRS § 237-23.5, taking into account the attribution rules of Section 267 of the Internal Revenue Code), the Department recommends amending HRS §237-23.5 to expand the related entities exemption, instead.

Part II:

Part II of this measure clarifies the Department's subpoena authority under HRS § 231-7 for its civil and criminal investigations. The Department **supports Part II.**

Specifically, the bill clarifies HRS § 231-7 in the following ways:

- Clarifies the Department's authority to issue subpoenas in civil and criminal inquiries, investigations or hearings;
- Allows for the subpoena of records which are stored electronically;
- Sets forth the reimbursement rate for the reproduction of records; and

- Clarifies that compliance with a Department-issued subpoena shall not give rise to a civil action for damages.

Adoption of these amendments to HRS §231-7 will further the Department's ability to administer the State's tax laws fairly, consistently and uniformly.

Thank you for the opportunity to provide comments.

TAXBILLSERVICE

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SUBJECT: ADMINISTRATION, GENERAL EXCISE, Clarify subpoena powers; expand common paymaster exemption

BILL NUMBER: SB 1107, HD-1

INTRODUCED BY: House Committee on Economic Revitalization and Business

BRIEF SUMMARY: Adds a new paragraph to HRS section 237-24.7 to exempt from the general excise tax, amounts received by a related entity, as defined under section 237-23.5, taking into account the attribution rules under section 267, Internal Revenue Code, including salaries, wages and related taxes, vacation pay, sick pay, and pensions and insurance paid out to or on behalf of employees of the related management company and reimbursed by the related company for those operating expenses. The amendment made to HRS section 237-24.7 shall not be repealed when that section is reenacted on December 31, 2014 by Act 91, SLH 2010.

Amends HRS 231-7 to clarify the department of taxation's subpoena power for civil and criminal tax investigations.

EFFECTIVE DATE: July 1, 2112

STAFF COMMENTS: Currently the common paymaster general excise tax exemption is applicable to: (1) an affiliated group of corporations within the meaning of section 1504 (with respect to affiliated group defined) of the federal Internal Revenue Code of 1986, as amended; (2) a controlled group of corporations within the meaning of section 1563 (with respect to definitions and special rules) of the federal Internal Revenue Code of 1986, as amended; (3) those entities connected through ownership of at least **eighty** percent of the total value and at least **eighty** percent of the total voting power of each such entity (or combination thereof), including partnerships, associations, trusts, S corporations, nonprofit corporations, limited liability partnerships, or limited liability companies; and (4) any group or combination of the entities described in paragraph (3) constituting a unitary business for income tax purposes. As a result of the reference to "relationships as defined in HRS section 237-23.5" the proposed section becomes redundant as the relationship must still require 80% ownership.

If the intent of this proposal is to extend the common paymaster treatment to related entities that are less than 80% owned, then the reference to HRS 237-23.5 should be deleted and the reference to a definition of relationships should cite paragraph (b) of Section 267 of the Internal Revenue Code. As currently drafted, the two sections are in conflict.

If, in fact, this is a simple reimbursement of costs for payroll and employee benefits without any additional consideration, then the transaction is already exempt under HRS Sec. 237-20, provided there is no additional fee or remuneration for the disbursing paymaster for providing that service. Therefore, it appears that these particular related companies are indeed compensating the paymaster for this service and, therefore, are seeking this special treatment.

Finally, given the current financial situation of the state, this seems hardly the time to establish yet another exemption from the general excise tax. Care should be exercised in adopting this proposal and lawmakers should weigh its revenue impact carefully against the other demands for the state's resources.

The measure also clarifies the subpoena powers of the department of taxation to delineate when such powers may be utilized in criminal cases.

Digested 3/30/11

Darryl P. Wong

1836 Punahou Street, Honolulu, Hawaii 96822 (808) 943-3106

March 29, 2011

House Finance
Marcus R. Oshiro, Chair
Marilyn B. Lee, Vice Chair

**RE: SENATE BILL SB1107 - RELATING TO THE GENERAL EXCISE TAX
HEARING SCHEDULED FOR THURSDAY 3/31/2011 at 5:00 PM. Room 308**

Dear House Finance Chairman Marcus Oshiro, Vice Chair Marilyn Lee and other Committee Members

I am in support of Senate Bill SB1107 to expand the general excise tax exemption for a common paymaster specifically to the amendments related to Section 237-24.7 (10).

(10) Amounts received by a related or indirectly related management entity, as defined under section 237-23.5, taking into account the attribution rules under section 267, Internal Revenue Code, as amended, managing the business of the affiliates, including salaries, wages and related taxes, vacation pay, sick pay, and pensions and insurance paid out to or on behalf of employees of the related management company and reimbursed by the related company for those operating expenses; and

I feel this amendment will clarify the law as it relates to closely related family businesses that function with one payroll as they manage several real estate holdings. By allowing businesses to allocate the appropriate dollar amounts to its affiliates as reimbursement of payroll

it will continue to allow small businesses to operate as efficiently as possible by not requiring each of the related entities maintain a separate payroll from its other affiliates.

I kindly ask for your support and pass this bill.

Sincerely,

A handwritten signature in black ink, appearing to read "Darryl P. Wong". The signature is written in a cursive, flowing style.

Darryl P. Wong