SB 778

EDT

The Chamber of Commerce of Hawaii
The Voice of Business in Hawaii

Testimony to the Senate Committee on Economic Development and Technology
Monday, February 7, 2011 at 1:15 p.m.
Conference Room 016, State Capitol

RE: SENATE BILL NO. 778 RELATING TO TAXATION

Chair Fukunaga, Vice Chair Wakai, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports SB 778 relating to Taxation**, which is part of the Small Business Caucus Package. We appreciate the committee for scheduling this bill.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 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.

SB 778 repeals Act 155, Session Laws of Hawaii 2010, which requires all businesses with excise tax exemptions to register to do business in Hawaii, file their tax returns in a timely manner, and expressly claim their entitlement, and creates a personal trust liability for businesses that use the general excise tax as the basis for increasing their prices and ensures that those funds are paid to the State for the benefit of consumers and businesses.

Act 155 severely penalizes taxpayers who inadvertently fail to file general excise tax ("GET") returns, even if those taxpayers would not otherwise owe any tax. It therefore created 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.

The Act created needless administrative complexity both for taxpayers and for the government. It forces even taxpayers who have no GET liability 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.

The Act also imposed 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.

Because the Act created unfair and unwarranted burdens for businesses, individuals and non-profit organizations, we support the repeal of the Act through SB 778.

Thank you for the opportunity to provide testimony.

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR

FREDERICK D. PABLO
INTERIM DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TECHNOLOGY

TESTIMONY OF THE DEPARTMENT OF TAXATION REGARDING SB 778 RELATING TO TAXATION

TESTIFIER: FREDERICK D. PABLO, INTERIM DIRECTOR OF TAXATION (OR DESIGNEE)
COMMITTEE: EDT
DATE: FEBRUARY 7, 2011
TIME: 1:15PM

POSITION: OPPOSED IN PART

This measure seeks to repeal Act 155, Session Laws of Hawaii 2010. Act 155 added two provisions to Hawaii general excise tax law. The first requires taxpayers to obtain a general excise tax license and file an annual tax return or potentially jeopardize general excise tax benefits. The second component added trust fund liability for those that willfully failed to pay the general excise tax.

The Department of Taxation (Department) **understands the concerns raised** in Section 1 of the bill; however **opposes repeal of personal trust fund liability** for willfully failing to pay general excise tax.

I. DENIAL OF GENERAL EXCISE TAX BENEFITS

The Department understands the concerns raised in SB 778; however believes that it has dutifully and fairly implemented Act 155 with taxpayer concerns taken into account.

After Act 155 was signed into law, the Department issued Tax

Information Release No. 2010-05, which provided substantial guidance to taxpayers on how to comply with—and avoid altogether—the penalties for failing to comply with Act 155. After receiving numerous telephone calls and inquiries regarding Act 155 and its breadth, the Department adopted 10 safe harbor provisions to which Act 155 would not apply.

The following circumstances are deemed to have reasonable cause within the meaning of Act 155 and the Department will not utilize Act 155 to deny a general excise tax benefit in the following situations:

1) The provisions of the United States Constitution or laws of the United States prohibit the Department from imposing the tax;
2) The person is not "engaging" in "business" within the meaning of HRS § 237-2;
3) The amounts involved are not "gross income" or "gross proceeds of sale" as defined in HRS § 237-3(b);
4) The person is a Public Service Company and the gross income or gross proceeds are included in the measure of the tax imposed by Chapter 239, HRS;
5) Amounts received by persons exempt under HRS § 237-23(a)(3) through (6); provided that such person is exempt from filing federal Form 990, *Return of Organization Exempt from Income Tax,* or Form 990-EZ, *Short Form—Return of Organization Exempt from Income Tax*;
6) Amounts received that are exempt under HRS §§ 237-24(1) through (7) (with respect to certain insurance proceeds, gifts, bequests, compensatory tort damages, salaries or wages, and alimony);
7) Amounts received that are exempt under HRS § 237-24.8(a) (with respect to certain amounts not taxable for financial institutions);
8) Amounts received that are exempt under HRS § 237-29.7 (with respect to certain amounts not taxable for insurance companies);
9) Credit unions chartered under Chapter 412, HRS, and exempt from tax as provided in HRS § 412:10-122;
10) Any other amounts, persons, or transactions as determined by the

Director to be made by subsequent Announcement or Tax Information Release.

However, the Department understands the public's concernsregarding Act 155.

II. TRUST FUND LIABILITY IS IMPORTANT TO ENSURE TAX COMPLIANCE

The Department strongly opposes the effort to eliminate personal trust fund liability for willfully failing to pay general excise taxes.

THE STANDARD IS VERY HIGH—The Department finds that much of the rhetoric surrounding trust fund liability is misplaced. The "willful" standard is very high. The Department must prove willful conduct, which is no easy task. To suggest that all taxpayers will be potentially subject to trust fund liability is misleading. Only those taxpayers that willfully choose to pay another creditor over the government are subject to this standard.

WHY SHOULD THE GOVERNMENT BE PAID LAST—The Department also questions why the Legislature would choose to be paid last. The general excise tax is a privilege tax for the right to do business in Hawaii. The tax is paid for the access to courts, paved roads, police, and other public services that businesses enjoy. Businesses too should pay their fair share and should not have a choice whether to pay taxes.

As a practical matter, when a business falls on hard times, they could choose which creditors to pay first. Prior to Act 155, it was acceptable to pay the government last. Act 155 now ensures that the government will at least be "in line" with other creditors and be paid as a priority.

THIS IS A CONSUMER PROTECTION ISSUE—The Department also sees trust fund liability as a consumer protection issue. Businesses take the position that the additional general excise tax passed on visibly is merely an "increase in price," which it is. However, when the pretext for the price increase is as a tax recovery, such funds should go to the state. Why would the government tolerate businesses increasing their prices on the basis that it is for taxes, and then be allowed to pocket the money?

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TESTIMONY BEFORE THE SENATE COMMITTEE
ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
Re: Senate Bill 778
Monday, February 7, 2011 at 1:15 pm
State Capitol, Conference Room 016

Chair Fukunaga, Vice-Chair Wakai, and Members of the Committee:

Thank you for the opportunity to testify. My name is David Carr. I am a licensed Certified Public Accountant in Hawaii and I am the Chair of the Tax Committee of the Hawaii Society of Certified Public Accountants. I am testifying on behalf of that committee. Last year we opposed House Bill 2595, which became Act 155. **We support Senate Bill 778,** which repeals Act 155.

Act 155 changed the Hawaii General Excise Tax (GET) to a "trust fund" tax. A "trust fund" tax is one in which one party receives payment of taxes that are a liability of the second party and remits that second party's taxes to the taxing authority. Unpaid payroll trust fund taxes, at the federal level, can result in personal liability for those individuals responsible for the operation of the business or non-profit organization.

The GET is, under Hawaii statutes, a tax on the seller and is not a tax on the buyer. It was not, until the enactment of Act 155, a "trust fund" tax. The seller's GET liability does not depend upon whether the GET is visibly passed on to the buyer or not. The GET does not operate in the form of a "trust fund" tax.

Act 155 disallowed any general excise tax exemption, exclusion, rate reduction or other tax benefit unless the taxpayer files a GET return, within 12 months of the original due date, specifically identifying and claiming the tax benefit and including whatever forms, schedules or information the Department of Taxation may choose to require. As a result of a missed filing or small error in the required filed return, a large GET could be due, way out of proportion in relation to the error in filing.

The Department of Taxation has tried to alleviate some of the difficulties in the law through its Tax Information Release (TIR) 2010-5. This TIR does not have the force of law and places much of the enforcement of the law at the discretion of the director of taxation. It is better law to have Act 155 repealed.

For these reasons, our committee supports Senate Bill 778 to repeal Act 155.

Respectfully submitted,

David M. Carr, Chair
Tax Committee of the Hawaii Society of Certified Public Accountants

HAWAI'I COMMUNITY FOUNDATION

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February 4, 2011

The Honorable Carol Fukunaga, Chair
Committee on Economic Development & Technology
Hawaii State Senate
Honolulu, Hawaii 96813

Dear Chairwoman Fukunaga and Committee Members:

SB 778 – Relating to Taxation

Hawai'i Community Foundation appreciates the intent of Act 155 passed by the state Legislature and enacted into law in 2010. We appreciate that in these tough economic times, the state's approach to balancing the budget must be to "leave no stone unturned." However, Act 155, while well intended, imposes disproportionate penalties for simple filing oversight. In addition, the threat of personal liability for responsible persons raises yet another barrier to recruiting qualified volunteer board members. These issues, taken together, raise serious concern for nonprofit organizations, particularly small, all volunteer organizations. Therefore, we support repeal as set forth in the proposed SB 778, "Relating to Taxation."

We understand that the state Department of Taxation has attempted to address some of the undue harshness of the Act by issuing Tax Information Release No. 2010-05 (July 29, 2010). Although we appreciate that effort, it leaves discretion for enforcement in the hands of an already overburdened Tax Department and as an Information Release, it can be changed at any time by the Department without notice.

We appreciate your favorable consideration.

Sincerely yours,

Katharine P. Lloyd
General Counsel & Vice President of Operations

SUBJECT: GENERAL EXCISE, Repeal Act 155, SLH 2010

BILL NUMBER: SB 778; HB 375 (Identical)

INTRODUCED BY: SB by Fukunaga and 4 Democrats; HB by McKelvey

BRIEF SUMMARY: Repeals Act 155, SLH 2010.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: Last year Act 155, SLH 2010, required all businesses that enjoy a general excise tax benefit to obtain a general excise tax license and file an annual general excise tax reconciliation tax return. While Act 155 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 Act will ensure the proper payment of taxes. These provisions are 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 otherwise 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.

While the intent of this Act is to catch so-called abusers and scofflaws who enjoy these special provisions, it appears that its provisions are overkill, creating an administrative and compliance nightmare, in an attempt to 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 Act 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.

While this measure was an administration sponsored measure by the state department of taxation, 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.

Speaking of compliance, Act 134, SLH 2009, is creating grief among small business taxpayers. Act 134 was enacted to address and police the "cash economy" in the state to insure that cash transactions are properly reported and general excise taxes are paid on such transactions. It also provided for the creation of a "goon squad" to police those transactions. Since Act 134 was adopted in 2009, merchant/ taxpayers have been pondering compliance with this act since it requires the issuance of receipts for all transactions. However, telephone inquiries to the department of taxation have resulted in various answers from providing receipts **only upon request** to providing receipts on each transaction. Merchant/taxpayers were also informed that they had to have a particular general excise tax license displayed - merchants with various locations were not allowed to have a copy on display. In addition, Act 134 also contains a provision relating to failure to record transactions by register. Again, without any rules issues by the department, merchant/taxpayers at farmers' markets, etc., are unsure of when a cash register is required or how they are going to comply with the provision when no electric power is available to run the registers. While the intent of Act 134 is commendable, that is to ensure compliance with the general excise tax, it is questionable about the methodology of enforcement and compliance. Again, education of the merchant/taxpayers and the issuance of administrative rules would greatly assist in the compliance of Act 134.

Digested 2/4/11

NFIB
The Voice of Small Business®

Before the House Committee on Economic Revitalization and Business and the House Committee on Labor and Public Employment

DATE: February 7, 2011

TIME: 1:15 p.m.

PLACE: Conference Room 016

Re: Senate Bill 778
Relating to Taxation

Testimony of Melissa Pavlicek for NFIB Hawaii

Thank you for the opportunity to testify in support of SB 778. NFIB strongly supports this measure. This bill would repeal Act 155 which unnecessarily penalizes taxpayers for commonplace errors. Act 155 has the unintended consequence of deterring businesses to come to Hawaii. We recognize and appreciate the efforts of legislators to address small business concerns.

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 more than 1,000 members. NFIB's purpose is to impact public policy at the state and federal level and be a key business resource for small and independent business in America. NFIB also provides timely information designed to help small businesses succeed.

Thank you for the opportunity to submit this testimony.

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ALOHA SOCIETY OF ASSOCIATION EXECUTIVES
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February 7, 2011

Testimony To: Senate Committee on Economic Development and Technology
Senator Carol Fukunaga, Chair

Presented By: Tim Lyons
Legislative Chairman

Subject: S.B. 778 – RELATING TO TAXATION

Chair Fukunaga and Members of the Committee:

I am Tim Lyons, Legislative Chairman for the Aloha Society of Association Executives, a trade association comprised of most of the Executive Directors of non-profit associations from throughout the state. We support this bill.

We support this bill based on the very purpose as stated in Section 1 of the bill. The law as it was passed is too harsh. Non-profit organizations have a particularly hard time, not only being managed on a day-to-day basis but also compliance with a myriad of legal requirements. For those organizations that are professionally staffed, it is perhaps easier because it is the job of their executive director to stay up to date with the laws and regulations however, no one made them geniuses and their knowledge about tax laws may not be as up to speed as their knowledge about running an association.

Actually, we do not have an objection to non-profit organizations registering to do business in Hawaii and filing their tax returns in a timely manner. The problem is with the personal trust liability that exists. It is difficult enough to find dedicated individuals who are willing to serve non-profit organizations who typically receive zero compensation and yet also add to this a liability they did not ask for. We think that if this act was repealed and in its place was a requirement to register and file returns in a timely manner with some reasonable penalty for those organizations which missed the deadline, it would be acceptable.

Based on the above, we support this bill but can also suggest that it be modified to address the position that we have stated above.

Thank you for this opportunity to testify.

Aloha Society of Association Executives – Hawaii Chapter Membership List

AlohaCare
Building Industry Association of Hawaii
Expert Event Planners of Hawaii
General Contractors Association of Hawaii
Hawaii Association of Independent Schools
Hawaii Association of Realtors
Hawaii Bankers Association
Hawaii Convention Center
Hawaii Credit Union League
Hawaii Food Industry Association
Hawaii Insurers Council
Hawaii Museums Association
Hawaii Optometric Association, Inc.
Hawaii Orthopedic Association
Hawaii Pacific Tennis Foundation
Hawaii Society of Certified Public Accountants
Hawaii Transportation Association
Hawaii Visitors & Convention Bureau
Hawaii Wall & Ceiling Industry Association
Honolulu Board of Realtors
Kaua'i Visitors Bureau
Legislative Information Services of Hawaii
LH Hospitality Group, LLC
Mid-Pacific Country Club
National Association of Insurance & Financial Advisors Hawaii
Organizations Management, LLC
Pacific Telecommunications Council
Painting & Decorating Contractors Association
Plumbing & Mechanical Contractors Association
Presentation Resources
PROcom Hawaii
Retail Merchants of Hawaii
Sand Island Business Association
Sheet Metal Contractors Association
SMEI Honolulu
Hawaii Association of Broadcasters
The Legislative Center, Inc.
Waikiki Improvement Association
Waikoloa Beach Marriott

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THE SENATE
THE TWENTY-SIXTH LEGISLATURE
Regular Session of 2011

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
Chair Fukunaga, Vice Chair Wakai, Members of the Committee:

Hearing date: Monday, February 7, 2011
Testimony on SB 778
(Relating to Taxation)
Act 155 Repeal

Chair Fukunaga, Vice Chair Wakai, Members of the Committee:

Thank you for scheduling this bill for hearing. We urge passage of this bill which would repeal Act 155 (SLH 2010). Act 155 was introduced by the administration in 2010, passed by the Legislature, and signed into law by Governor Lingle. The Act is too heavy handed in its approach to foster tax compliance, and was passed without much notice to the public.

Act 155 applies to gross income received on or after July 1, 2010. Act 155 upsets decades of settled expectations on how the GET is administered by: (1) providing for the forfeiture of GET exemptions, deductions, income splitting, wholesale rates, and any other such GET benefit just because the annual Form G-49 reconciliation is not filed within 12 months of its due date; and (2) imposing personal liability on responsible persons who willfully fail pay over unpaid GET, whether or not the GET was passed on and collected.

Forfeiture of GET benefits

As to the forfeiture of GET benefits, this sanction is out of line with the stated purpose of Act 155, i.e., to obtain information about taxpayers' claims of GET benefits. This forfeiture can occur even if all monthly or other periodic Form G-45 returns are filed, and taxes paid and benefits reported thereon. There are enough penalties on the books to penalize taxpayers for not filing the annual Form G-49, e.g., statute of limitations does not begin to run until the Form G-49 is filed even if all periodic Forms G-45 are filed, and monetary penalties for failure to file the Form G-49 on time.

The forfeiture of GET benefits can even prevent a taxpayer from raising exemptions or deductions in an audit, to counter assessments by the department. A taxpayer already has the burden to prove the department wrong when being assessed additional tax, and should be permitted to raise any defenses available.

Many taxpayers will be caught unawares when their GET benefits are forfeited due to Act 155. For example, a wholesaler can lose the benefit of the .5% wholesale GET rate on its gross income and be subject to the 4% retail rate instead just because it forgets to file the annual Form G-49.

Another example is an exempt school that is required to file the IRS Form 990 but forgets to file the Form G-49. This school is now subject to the GET on all of its tuition income. Since the GET liability will be significant, the school's fiscal situation may be such that the GET cannot be paid. However, Act 155 also provides that unpaid GET will now become the personal liability of officers and directors of the school even if it dissolves.

That the department needed to issue TIR 2010-5 to take back the harshness of Act 155 speaks volumes. However, a TIR is only an administrative pronouncement, not the law, and can be withdrawn at any time.

The department has enough powers at its disposal to enforce the tax laws without Act 155. However, if the Legislature feels that the GET forfeiture provision should remain law, then I respectfully ask that you consider amending the Act as follows:

1. Delay its effective date to provide more time and resources to educate the public about Act 155.

2. In lieu of forfeiture of GET benefits, impose civil penalties of a dollar amount per month capped at a dollar amount. See, e.g, IRC § 6652(c)(per diem penalty up to $5,000 for failure to file information returns); Act 206 (SLH 2007)(per month penalty of $1,000 up to $6,000 for failure to file QHTB annual survey).

3. Give taxpayers the right to assert any GET benefit when audited to offset any assessments under the GET or income tax.

4. Provide an exemption for small businesses.

5. Provide an exemption for exempt organizations that have registered for exemption from the GET.

6. Provide that the statute of limitations on assessments is to run from the periodic Form G-45 periodic return filings, not the annual Form G-49.

Personal Liability for Unpaid GET

This will be another trap for the unwary and one that will impose significant personal liabilities due to the GET being imposed on gross income. The GET, being unlike most other states' sales taxes, applies to virtually all economic activity, it pyramids, and is complex. Repeal of this provision of

Act 155 is recommended. However, if the Legislature sees fit to retain this provision, I respectfully ask that you consider amending the Act to provide as follows:

1. Delay the effective date of Act 155 to provide for more time and resources to educate the public about Act 155.

2. Limit personal liability only to the amount of the GET visibly passed on and collected from the taxpayer's customers.

3. Permit the responsible person to challenge any assessments against the taxpayer entity within 30 days of being notified of the personal assessment.

4. Give immunity for volunteer board members of tax-exempt organizations.

5. Permit the right of contribution among responsible persons, as provided under federal law for employment tax liabilities.

6. Afford prior notice procedures for personal assessments, as provided under federal law.

7. Provide a statute of limitations on personal assessments (remarkably, none provided now!).

8. Conform to IRC § 7491(c) on the burden of production being on the government.

9. Permit taxpayers to direct that payments be applied first to satisfy GET taxes, then to penalties and interest.

10. On liquidation, limit personal liability to the value of assets distributed to the responsible person being assessed.

Very truly yours,

CHUN, KERR, DODD, BEAMAN & WONG,
a Limited Liability Law Partnership

Ray Kamikawa

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THE SENATE
THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2011

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY
Hearing February 7, 2011
Testimony on S.B. 778
(Relating to Taxation)

Chair Fukunaga, Vice-Chair Wakai and Members of the Committee:

Thank you for the opportunity to testify. My name is Peter Fritz. I am an attorney specializing in tax matters. Last year, I opposed H.B. 2595 which became Act 155. I am now supporting S.B. 778, which would repeal Act 155 Session Laws of Hawaii 2010.

Act 155, Session Laws of Hawaii 2010 added two new sections to Chapter 237, Hawaii Revised Statutes §237-9.3 and §237-41.5.

Under §237-9.3, a taxpayer that fails to file the annual general excise tax forfeits the right to claim any excise tax exemption or benefit under the General Excise Tax (GET) law. These benefits are forfeited even though the taxpayer filed every periodic return required under the GET law. This is a draconian penalty. A taxpayer that did not file the annual reconciliation tax return cannot cure this failure once 12 months have elapsed from the due date for the return even if the taxpayer correctly filed and paid the proper amount of GET on all periodic returns required by law. There is no basis for this harsh penalty. The harshness is not ameliorated by the Department of Taxation's Tax Information Release 2010-5 as it does not have the force of law and is subject to change at any time.

Section 237-41.5 states that any amount of GET, whether or not separately stated, is considered to be held in trust and imposes personal liability for these amounts. If an amount is not added to the transaction, a taxpayer has personal liability for the amount "imputed" to the transaction (by the Department of Taxation). Unfortunately, the Department has not issued the necessary guidance to allow the taxpayer to always add the correct amount of tax to a transaction. For example, a taxpayer, after examining all of the available guidance determined that the tax was .05% on a transaction. However, if the Department of Taxation disagreed and imputed a rate of 4%, the taxpayer would be personally liable for 4%. Considering that the Department has been working on some GET rules projects for more than 10 years, it is unfair to impose personal liability without providing guidance to taxpayers. It is a trap for the unwary.

Act 155 creates the potential for excessive punishments. A representation that the Department

will not enforce the law against certain taxpayers is not the solution since it can be withdrawn at any time. Repealing Act 155 is appropriate.

Respectfully Submitted,

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TESTIMONY BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TECHNOLOGY

In Support of Senate Bill 778

Monday, February 7, 2011 at 1:15 pm
State Capitol, Conference Room 016

Chair Fukunaga, Vice-Chair Wakai, 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. Last year, I opposed House Bill 2595, which became Act 155. I am now supporting Senate Bill 778, which would repeal Act 155.

Last year, I said:

> 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.

We are now seeing that Act 155 has indeed caused a great deal of confusion and concern. Some of that has been alleviated by the Department of Taxation announcing that it will NOT take away tax benefits in certain situations (see Tax Information Release 2010-5) but that is a mere announcement, without the force of law and subject to change at any time.

As actually written, Act 155 creates consequences for taxpayers that are totally out of proportion to any error by the taxpayer. For example, suppose you own an apartment that you rent out, and you pay $30 or $40 per month in General Excise Tax. You file all of the monthly GET returns on time, and pay your taxes in full and on time. During the tax year, you sell the apartment for $300,000. That sale is not subject to GET, because the sale of land and

improvements to land is exempt. However, you forget to file your annual reconciliation return. (You filed all of the monthly returns – you just forgot about the annual return form.) Under Act 155, you lose the "tax benefit" of the exemption on the sale, and you owe 4% tax (or 4.5% on Oahu) on the entire $300,000 – a $12,000 tax (or $13,500 if you're on Oahu). **The bottom line is effectively a penalty of $12,000 (or $13,500) even though you filed all of your monthly returns on time and paid all of your tax on time, just for forgetting to submit the annual form.** This is grossly unreasonable – the punishment is completely out of proportion to the "offense."

This is just one example – many others are possible. The point is that Act 155, as actually adopted by the Legislature, creates the potential for punishments that are absurd and excessive. Relying on the Department of Taxation to NOT enforce the law is a poor solution. Repealing it makes more sense.

Respectfully submitted,

Ronald I. Heller

HANO
Hawai`i Alliance of Nonprofit Organizations

February 6, 2011

LATE

Senator Carol Fukunaga
Chair, Committee on Economic Development and Technology
Hawaii State Senate
State Capitol, Room 016
Honolulu, HI 96813

RE: SB 778, Relating to General Excise Tax

Dear Chair Fukunaga and members of the Senate Committee on Economic Development and Technology:

The Hawai`i Alliance of Nonprofit Organizations (HANO) supports SB 778, which repeals Act 155. HANO is a statewide, sector-wide professional association for nonprofits. HANO member nonprofits provide essential services to every community in the state. Our mission is to unite and strengthen the nonprofit sector as a collective force to improve the quality of life in Hawai‘i.

Act 155 stipulates possible tax-exemption revocation for a nonprofit that willfully neglects to file the annual G-49 form within 12 months of the due date. This policy does not provide sufficient due process as it is a significant departure from the existing tax law and will most likely cause confusion among nonprofits in terms of their tax reporting requirements and tax obligations. What was previously a formality is now an enormous unknown burden.

The proposed sec. 237(c) of Act 155 gives the Director the power to "waive the denial of the GET benefit....if the failure to comply is due to reasonable cause and not willful neglect." It is not clear how "reasonable cause" is defined.

Section 237(b) holds "any officer, member, manager, or other person.." personally liable who does not fulfill the organization’s general excise tax obligation.. It is not clear whom this broad application extends to. Personal liability will hinder board volunteerism in our sector.

Personal liability and possible tax-exemption revocation are disproportionate and severe ramifications for an unclear tax policy and will distract from our ability to deliver on our missions to improve the quality of life in our community.

Thank you for the opportunity to testify on SB 778.

Mahalo,
Lisa Maruyama
President and CEO

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