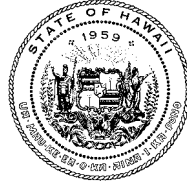


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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Thursday, April 5, 2012
Time: 9:30 A.M.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. No. 798 HD 1 SD 1 Proposed SD2, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of Proposed SD2 to H.B. 798 HD1 SD1, and offers the following information and comments for your consideration.

Proposed SD2 amends Act 105, Session Laws of Hawaii 2011, which temporarily suspends several General Excise and Use Tax exemptions for a period of two years. One of the general excise tax exemptions that had been suspended involves the gross proceeds from sales of computer hardware, computer software, and telecommunications equipment to the federal government or state-chartered credit unions; under the Proposed SD2, these gross proceeds will be excluded from the suspension, or exempt from the GET once again.

The Department notes Section 1 of the proposed bill states that because of Act 105, Hawaii businesses which engage in sales of hardware, software or telecommunication equipment must pay general excise tax and cannot pass the tax along to the federal government. This is a somewhat inaccurate statement of how the general excise tax operates.

GET law does allow businesses to visibly pass along the GET in a line item on the bill. The passed-along GET is still considered part of the purchase price negotiated as a matter of contract between the two parties, and the business owes 4% on the full amount it receives. However, the pass-along does not transfer the incidence of tax from the business to the customer.

The Department notes that it does not have any specific data related to the sales of computer hardware, computer software, and telecommunications equipment to the federal government or state-chartered credit unions. Businesses report their gross income based on their activities (ie, wholesaling, distributing), rather than by types of sales transactions or exempted activities. As a result, the Department is unsure what the actual revenue impact of these amendments to Act 105 would be on the State's revenues.

The Department also recommends the following housekeeping amendment:

- Delete paragraph (3) of Act 105, which suspends the exemption for "gross receipts of home service providers acting as service carriers providing mobile telecommunications services to other home services providers." These gross receipts are exempt from GET under federal law.

Thank you for the opportunity to provide comments.

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SUBJECT: GENERAL EXCISE, Exempt sales of computers to the federal government and credit unions

BILL NUMBER: HB 798, Proposed SD-2

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends Act 105, SLH 2011, to provide that the general excise tax exemptions suspended by Act 105 shall not be applicable to the sale of computer hardware, computer software, or telecommunications equipment to the United States and any state-chartered credit union.

EFFECTIVE DATE: Gross income or gross proceeds received after June 30, 2012

STAFF COMMENTS: Due to the state's financial crisis, the legislature by Act 105, SLH 2011, suspended selected general excise and use tax exemptions between July 1, 2011 and June 30, 2013. The proposed measure would provide that the sale of computer hardware, computer software, or telecommunications equipment to the United States and any state-chartered credit union shall be excluded from the suspension of the general excise tax exemption under Act 105.

It should be remembered that many of the exemptions that were suspended exist because if the general excise or use tax were imposed on these entities or transactions it would impose an undue burden or cause businesses to structure transactions in an inefficient manner. There are those exemptions that exist because to tax the transaction would be a violation of superior law or may be deemed unconstitutional. Other deductions, exclusions and exemptions exist because they help to reduce the pyramiding effect of the general excise tax. It should be remembered that any imposition of tax will not only result in the increase in the cost of doing business in Hawaii, but may create inequitable taxing situations that were addressed by the specific general excise tax exemption.

While this measure would grant an exclusion for a selected business sector from the suspension of the general excise tax exemptions, it should be noted that this would create an unfair advantage to these selected businesses while other businesses that were exempt from the general excise tax would be subject to the general excise tax until June 30, 2013. In addition, it should be noted that unless elected officials rein in the size and cost of running government in Hawaii, any adjustments to Act 105, SLH 2011, should not be made. While lawmakers may believe that their only alternative is to raise more revenues, doing so behind the curtain of businesses by suspending these exemptions is being less than honest with the taxpaying public as the cost of these revenue enhancements will be hidden from the public at large who instead will blame the businesses who must recover the cost of the additional tax in the shelf price of their goods and services.

It is interesting why this exclusion is being proposed when other exemptions with much broader implications will continue to be suspended. In particular, the exemption for stevedoring activities which affects all goods shipped into or out of the state and the contractor/subcontractor deduction at a time

when the construction industry is largely on the bench. Lawmakers should question why this particular business is granted preferential treatment at the expense of all other businesses. Given the overestimate of the amount of revenues that the suspension of these general excise tax exemptions would raise as opined by the Council on Revenues, it would be far more efficient, especially in these difficult economic times, to repeal the suspension of all such exemptions.

Again, many, if not all, of the exemptions that were suspended by the 2011 legislature were enacted because the imposition of the general excise on those transactions would have a devastating impact on the cost of living and doing business in Hawaii. So while the legislature fiddles with various strategies to “stimulate” the economy, continuing the suspension of these exemptions just to raise the revenues lawmakers believe they need to have to keep the doors of government open is a very disingenuous reaction of government.

Digested 4/3/12