

TESTIMONY **LATE**

HB848 HD1

(Relating to the General Excise Tax)

Hearing Date: Tuesday, March 1, 2011

Time: 11:00 a.m., Room 308

To: House Committee on Finance

From: Imperial Associates

For: Rep. Marcus Oshiro and Members of
the Committee on Finance

Testifier: James W. Y. Wong
President, James Wong & Associates

Aloha Chair Oshiro, Vice Chair Lee and Members of the Committee on Finance:

My advisors and consultants have been working with me to enact legislation that would allow for a more inclusive interpretation of the General Excise Tax Law as it pertains to a Common Paymaster for related entities. The original version of HB848 and current version HB848 HD1 has received comments of concern from some interested parties, in particular, the Department of Taxation. The proposed measure, as it stands, is seen as too broad and open to unintended consequences.

As a result of the comments made at a hearing before the House Committee on Economic Revitalization & Business on Tuesday, February 8, 2011, I met with Mr. Lowell Kalapa of the Tax Foundation of Hawaii to further understand his concerns and our office has been communicating with him on this issue. At his recommendation, we now ask that you amend the proposed measure before you to remove the provisions of SECTION 2 as it was drafted. This Section of the measure asks for an amendment to Section 237-23.5 of the Hawaii Revised Statutes.

Instead, and as a result of our discussions with Mr. Kalapa, we would like to concentrate our efforts on moving forward with legislation which would specify that only salaries and payroll related expenses and benefits would be covered. We ask that you insert new language to the bill that would amend the General Excise Tax Law by

adding a new paragraph to HRS Section 237-24.7. We suggest a new Item 10 that would read:

"Amounts received by a related or indirectly related management entity, as defined under Section 237-23.5, Hawaii Revised Statutes, taking into account the attribution rules under Section 267, Internal Revenue Code, managing the business of the affiliates including salareies, wages and related taxes, vacation pay, sick pay, 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."

In addition, we ask that you correct the effective date of the legislation from July 1, 2112 to July 1, 2011.

I have provided you with copies of the General Excise Tax Law, Section 237-24.7, which lists additional amounts that would not be taxable, for your information.

I respectfully ask for your favorable consideration of House Bill 848 HD1 and that you recommend its passage as amended.

Mahalo.

James W. Y. Wong

Darryl Wong

To: Darryl Wong
Subject: General Excise Tax

Aloha Chairman Marcus Oshirio and Vice Chair Marilyn Lee

My name is Darryl Wong and I appeared before you last month asking for a change in the common paymaster law that related to eliminating the general excise tax between related parties. The original version of HB848 and current version HB848 HD1 has received comments of concern from the Department of Taxation whereby the proposed measure is seen as too broad and open to unintended consequences.

As a result of the comments made at a hearing before Committee on Economic Revitalization and Business on Tuesday, Feb. 8, 2011, I discussed with Mr. Lowell Kalapa of the Tax Foundation of Hawaii to further understand the concerns. At his recommendation we now ask that you amend the proposed measure before you to remove the provision of SECTION 2 as it was drafted. This Section of the measure asks for an amendment ~~of~~ ^{to} Section 237-23.5 of the Hawaii Revised Statutes.

Instead, and as a result of our discussions with Mr. Kalapa, we would like to concentrate our efforts on moving forward with legislation which would specify that only salaries and payroll related expenses and benefits would be covered. We ask that you insert new language to the bill that would amend the General Excise Tax Law by adding a new paragraph to HRS Section 237-24.7. We suggest a new item 10 that would read:

“Amounts received by a related or indirectly related management entity, as defined under Section 237-23.5, Hawaii Revised Statutes, taking into account the attribution rules under section 267, Internal Revenue Code, managing the business of the affiliates including salaries, wages and related taxes, vacation pay, sick pay, 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 expense.”

In addition we ask that you correct the effective date of the legislation from July 1, 2112 to July 1, 2011.

I can provide you with copies of the General Excise Tax Law, Section 237-24.7 which lists additional amounts that would not be taxable for your information.

I respectfully ask for your favorable consideration.

To the extent not covered by subsection (a), the exemption allowed by this subsection shall not apply to the cost of services, or reimbursements of such cost by one corporation to another corporation, of an employee disbursing the amounts exempted under this subsection. Each related corporation using a common paymaster or multiple common paymaster shall keep separate payroll records and other documentation required to prove the existence of concurrent employment. Such records and documents shall be available for inspection by the director of taxation during normal business hours. [L 1988, c 175, §1; am L 1997, c 178, §4; am L 1999, c 165, §1; am L 2001, c 221, §12]

Note

The 1999 amendment applies to gross income or gross proceeds received after June 30, 1999. L 1999, c 165, §5.

The 2001 amendment applies to gross income or gross proceeds received after June 30, 2001. L 2001, c 221, §15(3).

§237-24 Amounts not taxable. This chapter shall not apply to the following amounts:

- (1) Amounts received under life insurance policies and contracts paid by reason of the death of the insured;
- (2) Amounts received (other than amounts paid by reason of death of the insured) under life insurance, endowment, or annuity contracts, either during the term or at maturity or upon surrender of the contract;
- (3) Amounts received under any accident insurance or health insurance policy or contract or under workers' compensation acts or employers' liability acts, as compensation for personal injuries, death, or sickness, including also the amount of any damages or other compensation received, whether as a result of action or by private agreement between the parties on account of the personal injuries, death, or sickness;
- (4) The value of all property of every kind and sort acquired by gift, bequest, or devise, and the value of all property acquired by descent or inheritance;
- (5) Amounts received by any person as compensatory damages for any tort injury to the person, or to the person's character reputation, or received as compensatory damages for any tort injury to or destruction of property, whether as the result of action or by private agreement between the parties (provided that amounts received as punitive damages for tort injury or breach of contract injury shall be included in gross income);
- (6) Amounts received as salaries or wages for services rendered by an employee to an employer;
- (7) Amounts received as alimony and other similar payments and settlements;
- (8) Amounts collected by distributors as fuel taxes on "liquid fuel" imposed by chapter 243, and the amounts collected by such distributors as a fuel tax imposed by any Act of the Congress of the United States;
- (9) Taxes on liquor imposed by chapter 244D on dealers holding permits under that chapter;
- (10) The amounts of taxes on cigarettes and tobacco products imposed by chapter 245 on wholesalers or dealers holding licenses under that chapter and selling the products at wholesale;
- (11) Federal excise taxes imposed on articles sold at retail and collected from the purchasers thereof and paid to the federal government by the retailer;
- (12) The amounts of federal taxes under chapter 37 of the Internal Revenue Code, or similar federal taxes, imposed on sugar manufactured in the State, paid by the manufacturer to the federal government;
- (13) An amount up to, but not in excess of, \$2,000 a year of gross income received by any blind, deaf, or totally disabled person engaging, or continuing, in any business, trade, activity, occupation, or calling within the State; a corporation all of whose outstanding shares are owned by an individual or individuals who are blind, deaf, or totally disabled; a general, limited, or limited liability partnership, all of whose partners are blind, deaf, or totally disabled; or a limited liability company, all of whose members are blind, deaf, or totally disabled;
- (14) Amounts received by a producer of sugarcane from the manufacturer to whom the producer sells the sugarcane, where:
 - (A) The producer is an independent cane farmer, so classed by the Secretary of Agriculture under the Sugar Act of 1948 (61 Stat. 922, Chapter 519) as the Act may be amended or supplemented;
 - (B) The value or gross proceeds of sale of the sugar, and other products manufactured from the sugarcane, is included in the measure of the tax levied on the manufacturer under section 237-13(1) or (2);
 - (C) The producer's gross proceeds of sales are dependent upon the actual value of the products manufactured therefrom or the average value of all similar products manufactured by the manufacturer, and;
 - (D) The producer's gross proceeds of sales are reduced by reason of the tax on the value or sale of the manufactured products;
- (15) Money paid by the State or eleemosynary child-placing organizations to foster parents for their care of children in foster homes; and
- (16) Amounts received by a cooperative housing corporation from its shareholders in reimbursement of funds paid by such corporation for lease rental, real property taxes, and other expenses of operating and maintaining the cooperative land and improvements; provided that such a cooperative corporation is a corporation:
 - (A) Having one and only one class of stock outstanding;

- (B) Each of the stockholders of which is entitled solely by reason of the stockholder's ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building owned or leased by the corporation; and
- (C) No stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except in a complete or partial liquidation of the corporation. [L 1935, c 141, §4(2); am L 1939, c 47, §1; am L 1943, c 81, §2; RL 1945, §5460; am L 1945, c 253, §4; am L 1947, c 213, §1; am L 1949, c 343, §11; am L 1953, c 229, §1; am L 1955, c 246, §5; RL 1955, §117-21; am L 1957, c 34, §11(k); am L 1959, c 277, §4(a); am L Sp 1959 2d, c 1, §16; am L 1964, c 5, §2; am L 1965, c 201, §§3, 25; am L 1966, c 28, §4; am L 1967, c 297, §§3, 4; HRS §237-24; am L 1968, c 26, §2; am L 1971, c 204, §7; am L 1973, c 91, §3; am L 1975, c 41, §1; am L 1979, c 74, §1 and c 105, §24; am L 1985, c 16, §7 and c 88, §1; gen ch 1985; am L 1986, c 86, §1, c 306, §2 and c 340, §9; am L 1987, c 7, §1, c 15, §1, c 39, §5, and c 292, §1; am L 1988, c 65, §2; am L 1989, c 8, §1; am L 1992, c 107, §1; am L 1993, c 43, §1 and c 220, pt of §2; am L 1994, c 141, §2; am L 2002, c 110, §3]

Note

Former paragraphs (17) to (25) are not part of §237-24.3.
 The 2002 amendment applies to gross income and gross proceeds received after June 30, 2002. L 2002, c 110, §5.

Cross Reference

- Tax Information Release No. 23-69, "Sales of Liquor and Tobacco Products from Bonded Warehouses to Foreign Fishing Vessels and to Common Carriers"
- Tax Information Release No. 65-79, "State Taxation of Homeowners Associations for Income, General Excise and Use Taxes"
- Tax Information Release No. 86-3, "Exemption From the General Excise Tax for Amounts Received on Purchases Made With U.S. Department of Agriculture Food Coupons"
- Tax Information Release No. 86-4, "Exemption From the General Excise Tax for Amounts Received for the Sale of Prescription Drugs and Prosthetic Devices"
- Tax Information Release No. 87-3, "Exemption From the General Excise Tax for Amounts Received on Purchases Made With U.S. Department of Agriculture WIC Food Vouchers"
- Tax Information Release No. 89-3, "State Tax Benefits Available to Persons With Impaired Sight, Impaired Hearing, or Who Are Totally Disabled"
- Tax Information Release No. 91-1, "General Excise Tax Treatment of Federal Luxury Taxes Collected"
- Tax Information Release No. 94-2, "State Tax Benefits Available to Persons Totally Disabled"
- Tax Information Release No. 94-5, "Licensing Requirements for Certain Trusts Under Hawaii's General Excise Tax Law"

Attorney General Opinions

Subsection (p) exempts certain reimbursement funds of cooperative housing corporations from the general excise tax. Att. Gen. Op. 68-2.
 Pars. (18), (21): Effect of resolution of House relating to enforcement of provisions. Att. Gen. Op. 68-6.

Case Notes

Paragraph (6). Fees paid to director of corporation are not exempt as salary or wages paid to employee. 53 H. 435, 496 P.2d 1.

Decisions under prior law.

Remedy available to taxpayer that paid general excise tax on out-of-state products where director of taxation admitted that §237-24(18)(C) (1992) was unconstitutional on its face, discussed. 76 H. 1, 868 P.2d 419.

§237-24.3 Additional amounts not taxable. In addition to the amounts not taxable under section 237-24, this chapter shall not apply to:

- (1) Amounts received from the loading, transportation, and unloading of agricultural commodities shipped for a producer or produce dealer on one island of this State to a person, firm, or organization on another island of this State. The terms "agricultural commodity", "producer", and "produce dealer" shall be defined in the same manner as they are defined in section 147-1; provided that agricultural commodities need not have been produced in the State;
- (2) Amounts received from sales of:
 - (A) Intoxicating liquor as the term "liquor" is defined in chapter 244D;
 - (B) Cigarettes and tobacco products as defined in chapter 245; and
 - (C) Agricultural, meat, or fish products;
 - to any person or common carrier in interstate or foreign commerce, or both, whether ocean-going or air, for consumption out-of-state on the shipper's vessels or airplanes;
- (3) Amounts received by the manager or board of directors of:
 - (A) An association of apartment owners of a condominium property regime established in accordance with chapter 514A; or
 - (B) A nonprofit homeowners or community association incorporated in accordance with chapter 414D or any predecessor thereto and existing pursuant to covenants running with the land,

in reimbursement of sums paid for common expenses;

- (4) Amounts received or accrued from:
- (A) The loading or unloading of cargo from ships, barges, vessels, or aircraft, whether or not the ships, barges, vessels, or aircraft travel between the State and other states or countries or between the islands of the State;
 - (B) Tugboat services including pilotage fees performed within the State, and the towage of ships, barges, or vessels in and out of state harbors, or from one pier to another; and
 - (C) The transportation of pilots or governmental officials to ships, barges, or vessels offshore; rigging gear; checking freight and similar services; standby charges; and use of moorings and running mooring lines;
- (5) Amounts received by an employee benefit plan by way of contributions, dividends, interest, and other income; and amounts received by a nonprofit organization or office, as payments for costs and expenses incurred for the administration of an employee benefit plan; provided that this exemption shall not apply to any gross rental income or gross rental proceeds received after June 30, 1994, as income from investments in real property in this State; and provided further that gross rental income or gross rental proceeds from investments in real property received by an employee benefit plan after June 30, 1994, under written contracts executed prior to July 1, 1994, shall not be taxed until the contracts are renegotiated, renewed, or extended, or until after December 31, 1998, whichever is earlier. For the purposes of this paragraph, "employee benefit plan" means any plan as defined in section 1002(3) of title 29 of the United States Code, as amended;
- (6) Amounts received for purchases made with United States Department of Agriculture food coupons under the federal food stamp program, and amounts received for purchases made with United States Department of Agriculture food vouchers under the Special Supplemental Foods Program for Women, Infants and Children;
- (7) Amounts received by a hospital, infirmary, medical clinic, health care facility, pharmacy, or a practitioner licensed to administer the drug to an individual for selling prescription drugs or prosthetic devices to an individual; provided that this paragraph shall not apply to any amounts received for services provided in selling prescription drugs or prosthetic devices. As used in this paragraph:
- (A) "Prescription drugs" are those drugs defined under section 328-1 and dispensed by filling or refilling a written or oral prescription by a practitioner licensed under law to administer the drug and sold by a licensed pharmacist under section 328-16 or practitioners licensed to administer drugs; and
 - (B) "Prosthetic device" means any artificial device or appliance, instrument, apparatus, or contrivance, including their components, parts, accessories, and replacements thereof, used to replace a missing or surgically removed part of the human body, which is prescribed by a licensed practitioner of medicine, osteopathy, or podiatry and which is sold by the practitioner or which is dispensed and sold by a dealer of prosthetic devices; provided that "prosthetic device" shall not mean any auditory, ophthalmic, dental, or ocular device or appliance, instrument, apparatus, or contrivance;
- (8) Taxes on transient accommodations imposed by chapter 237D and passed on and collected by operators holding certificates of registration under that chapter;
- (9) Amounts received as dues by an unincorporated merchants association from its membership for advertising media, promotional, and advertising costs for the promotion of the association for the benefit of its members as a whole and not for the benefit of an individual member or group of members less than the entire membership;
- (10) Amounts received by a labor organization for real property leased to:
- (A) A labor organization; or
 - (B) A trust fund established by a labor organization for the benefit of its members, families, and dependents for medical or hospital care, pensions on retirement or death of employees, apprenticeship and training, and other membership service programs.
- As used in this paragraph, "labor organization" means a labor organization exempt from federal income tax under section 501(c)(5) of the Internal Revenue Code, as amended;
- (11) Amounts received from foreign diplomats and consular officials who are holding cards issued or authorized by the United States Department of State granting them an exemption from state taxes; and
- (12) Amounts received as rent for the rental or leasing of aircraft or aircraft engines used by the lessees or renters for interstate air transportation of passengers and goods. For purposes of this paragraph, payments made pursuant to a lease shall be considered rent regardless of whether the lease is an operating lease or a financing lease. The definition of "interstate air transportation" is the same as in 49 U.S.C. 40102. [L 1993, c 220, pt of §2 and am c 43, §1; am L 1994, c 116, §1; am L 2000, c 38, §1; am L 2001, c 210, §2; am L 2002, c 40, §7; am L 2003, c 135, §5]

Revision Note

Paragraph (10) redesignated.

Note

Effective July 1, 2002, chapter 415B referred to in paragraph (3)(B) is repealed. For provisions effective July 1, 2002, see chapter 414D.

Cross Reference

Tax Information Release No. 93-4, "Application of Section 237-24.3(1)(C), Hawaii Revised Statutes (HRS) (Formerly Section 237-24(18)(C), HRS) (Note: the reference to section 237-24.3(1)(C) should be to section 237-24.3(2)(C))"

Tax Information Release No. 98-5, "General Excise Tax Exemption for Tangible Personal Property, Including Souvenirs and Gift Items, Shipped Out of the State"

Case Notes

Decisions under prior law.

Options available to director of taxation to remedy constitutional defect in §237-24(18)(C) (1992) and appellant's entitlement to refund if director chose refund as a remedy, discussed, 76 H. 1, 868 P.2d 419.

§237-24.5 Additional exemptions. (a) In addition to the amounts exempt under section 237-24, this chapter shall not apply to amounts received by:

- (1) An exchange from:
 - (A) Transaction fees charged exchange members by the exchange for:
 - (i) The sale or purchase of securities or products, or both, bought or sold on an exchange by exchange members for their own account or an account for which they have responsibility as an agent, broker, or fiduciary;
 - (ii) Order book executions made for purposes of effecting transactions; and
 - (iii) Trade processing performed by an exchange in matching trades, keypunching, record keeping, post cashing, and notarization;
 - (B) Membership dues, fees, charges, assessments, and fines from individuals or firms, including charges for firm symbols (member identification), application processing, registration, initiation, membership transfers, floor or post privileges, transaction time extensions, expediting transactions, crossover trades (trading out of assigned functions) and rule infractions;
 - (C) Service fees charged to members including fees for communications, badges, forms, documents, and reports;
 - (D) Listing fees and listing maintenance fees charged to companies that wish to be listed and have their securities or products traded on the exchange; and
 - (E) Participation in the communication network consortium operated collectively by United States exchanges or other markets recognized by the Securities and Exchange Commission, the Commodities Futures Trading Commission, or similar regulatory authorities outside the United States that provides last sale and quote securities information to subscribers or that connects such markets or exchanges for purposes of data transmission;
- (2) Exchange members by reason of executing a securities or product transaction on an exchange; provided that this exemption shall apply only to amounts received by exchange members from brokers or dealers registered with the Securities and Exchange Commission, from futures commission merchants, brokers, or associates registered with the Commodities Futures Trading Commission, or from similar individuals or firms registered with similar regulatory authorities outside the United States; and
- (3) Exchange members as proceeds from the sale of their exchange memberships.

(b) As used in this section:

"Exchange" means an exchange or board of trade as defined in 15 United States Code section 78c(a)(1) or in 7 United States Code section 7, respectively, which is subject to regulation by the Securities and Exchange Commission or the Commodities Futures Trading Commission or an organization subject to similar regulation under the laws of a jurisdiction outside the United States.

"Exchange member" means an individual or firm that is qualified by an exchange as a member and pays membership dues to an exchange in order to trade securities or products on an exchange.

"Securities" means securities as defined in 15 United States Code section 78c and "products" means contracts of sale of commodities for future delivery, futures contracts, options, calls, puts, and similar rights as defined in 7 United States Code section 2, which securities or products are permitted to be traded on an exchange. [L 1988, c 295, §1; am L 1989, c 118, §§2, 3; am L 1990, c 108, §1; am L 1997, c 107, §5]

§237-24.7 Additional amounts not taxable. In addition to the amounts not taxable under section 237-24, this chapter shall not apply to:

- (1) Amounts received by the operator of a hotel from the owner of the hotel in amounts equal to and which are disbursed by the operator for employee wages, salaries, payroll taxes, insurance premiums, and benefits, including retirement, vacation, sick pay, and health benefits. As used in this paragraph:
- “Employee” means employees directly engaged in the day-to-day operation of the hotel and employed by the operator.
- “Hotel” means an operation as defined in section 445-90.
- “Operator” means any person who, pursuant to a written contract with the owner of a hotel, operates or manages the hotel for the owner.
- “Owner” means the fee owner or lessee under a recorded lease of a hotel;
- (2) Amounts received by the operator of a county transportation system operated under an operating contract with a political subdivision, where the political subdivision is the owner of the county transportation system. As used in this paragraph:
- “County transportation system” means a mass transit system of motorized buses providing regularly scheduled transportation within a county.
- “Operating contract” or “contract” means a contract to operate and manage a political subdivision’s county transportation system, which provides that:
- (A) The political subdivision shall exercise substantial control over all aspects of the operator’s operation;
- (B) The political subdivision controls the development of transit policy, service planning, routes, and fares; and
- (C) The operator develops in advance a draft budget in the same format as prescribed for agencies of the political subdivision. The budget must be subject to the same constraints and controls regarding the lawful expenditure of public funds as any public sector agency, and deviations from the budget must be subject to approval by the appropriate political subdivision officials involved in the budgetary process.
- “Operator” means any person who, pursuant to an operating contract with a political subdivision, operates or manages a county transportation system.
- “Owner” means a political subdivision that owns or is the lessee of all the properties and facilities of the county transportation system (including buses, real estate, parking garages, fuel pumps, maintenance equipment, office supplies, etc.), and that owns all revenues derived therefrom;
- (3) Surcharge taxes on rental motor vehicles imposed by chapter 251 and passed on and collected by persons holding certificates of registration under that chapter;
- (4) Amounts received by the operator of orchard properties from the owner of the orchard property in amounts equal to and which are disbursed by the operator for employee wages, salaries, payroll taxes, insurance premiums, and benefits, including retirement, vacation, sick pay, and health benefits. As used in this paragraph:
- “Employee” means an employee directly engaged in the day-to-day operations of the orchard properties and employed by the operator.
- “Operator” means a producer who, pursuant to a written contract with the owner of the orchard property, operates or manages the orchard property for the owner where the property contains an area sufficient to make the undertaking economically feasible.
- “Orchard property” means any real property that is used to raise trees with a production life cycle of fifteen years or more producing fruits or nuts having a normal period of development from the initial planting to the first commercially saleable harvest of not less than three years.
- “Owner” means a fee owner or lessee under a recorded lease of orchard property;
- (5) Taxes on nursing facility income imposed by chapter 346E and passed on and collected by operators of nursing facilities;
- (6) Amounts received under property and casualty insurance policies for damage or loss of inventory used in the conduct of a trade or business located within the State or a portion thereof that is declared a natural disaster area by the governor pursuant to section 209-2;
- (7) Amounts received as compensation by community organizations, school booster clubs, and nonprofit organizations under a contract with the chief election officer for the provision and compensation of precinct officials and other election-related personnel, services, and activities, pursuant to section 11-5;
- (8) Interest received by a person domiciled outside the State from a trust company (as defined in section 412:8-101) acting as payment agent or trustee on behalf of the issuer or payees of an interest bearing instrument or obligation, if the interest would not have been subject to tax under this chapter if paid directly to the person domiciled outside the State without the use of a paying agent or trustee; provided that if the interest would otherwise be taxable under this chapter if paid directly to the person domiciled outside the State, it shall not be exempt solely because of the use of a Hawaii trust company as a paying agent or trustee.
- (9) Amounts received by a management company from related entities engaged in the business of selling interstate or foreign common carrier telecommunications services in amounts equal to and which are