NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

RANDOLF L. M. BALDEMOR
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1540
FAX NO: (808) 587-1560

LATE

To: The Honorable Carol Fukunaga, Chair
and Members of the Senate Committee on Economic Development and Technology

Date: Monday, January 30, 2012
Time: 1:15 p.m.
Place: Conference Room 016, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 2238 Relating to Taxation

The Department of Taxation (Department) appreciates the intent of S.B. 2238 and provides the following information and comments for your consideration.

S.B. 2238 seeks to repeal Act 155, Session Laws of Hawaii 2010, which added two provisions to Hawaii general excise tax law. The first provision requires taxpayers to obtain a general excise tax license and file an annual tax return or potentially jeopardize general excise tax benefits. The second provision added trust fund liability for taxpayers that willfully failed to pay their general excise tax liability. These provisions were enacted to assist the Department in collecting outstanding general excise taxes owed.

I. Denial of General Excise Tax Benefits

While the Department understands the concerns raised, subsequent to the enactment of Act 155, the Department issued Tax Information Release (TIR) No. 2010-05, dated July 29, 2010, which provided substantial guidance to taxpayers on how to comply with Act 155. In TIR No. 2010-05, 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."

II. Trust Fund Liability

Under Act 155, personal trust fund liability for willfully failing to pay general excise taxes was established to assist the collection and compliance functions of the Department. In many cases, the Department has encountered egregious non-payers, who simply dissolve and create new businesses to avoid paying their general excise tax liabilities. This provision was adopted with the intention of providing the Department with an additional tool to address **willful** tax violators.

Thank you for the opportunity to provide comments.

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

Testimony to the Senate Committee on Economic Development and Technology
Monday, January 30, 2012 at 1:15 p.m.
Conference Room 016, State Capitol

RE: SENATE BILL NO. 2238 RELATING TO TAXATION

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

The Chamber of Commerce of Hawaii ("The Chamber") **supports SB 2238 relating to Taxation**. 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 2238 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 2238.

Thank you for the opportunity to provide testimony.

HANO
Hawai`i Alliance of Nonprofit Organizations

January 29, 2011

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

RE: SB 2238, 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 2238, 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.

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. At the very least, it should be clear to nonprofit organizations what constitutes reasonable cause.

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. More specificity is required. Personal liability will hinder board volunteerism in our sector when it is already very challenging for nonprofits to find good volunteers.

Personal liability and possible revocation of an organization’s tax-exempt status 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 2238.

Mahalo,
Lisa Maruyama
President and CEO

P.O. Box 240382 • Honolulu, HI 96824-0382
info@hano-hawaii.org • hano-hawaii.org
(808) 529-0466

LATE

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF SENATE BILL 2238, RELATING TO TAXATION

January 30, 2012

Via e mail

Hon. Carol Fukunaga, Chair
Committee on Economic Development and Technology
State Senate
Hawaii State Capitol, Room 016
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Fukunaga and Committee Members:

Thank you for the opportunity to testify in Support of SB 2238, relating to Taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association, who represents more than three hundred (300) legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies account for 90% of the assets and premiums of the United States Life and annuity industry. ACLI member company assets account for 91% of legal reserve company total assets. Two hundred thirty-five (235) ACLI member companies currently do business in the State of Hawaii; and they represent 93% of the life insurance premiums and 92% of the annuity considerations in this State. Four fraternal benefit society member companies operate in the State of Hawaii.

SB 2238 repeals Act 155 which requires all businesses that are exempt from Hawaii's general excise tax to register to do business in the State file their general excise tax returns and affirmatively claim their exemptions.

A fraternal benefit society is exempt from Hawaii's general excise tax under Section 237-23(a) and (b), HRS.

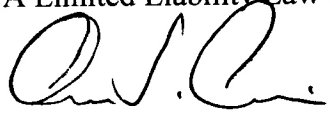
Under Act 155, if a fraternal benefit society fails to file its annual general excise tax return (form G-49) within 12 months of its due date it forfeits its excise tax exemption.

The severe penalty of the forefeiture of a fraternal's exemption solely because it fails to file the required return and to claim its exemption is unwarranted and is out of proportion to the Act's stated purpose – to capture relevant information on claims for the general excise tax benefits. The loss of a fraternal society member company's exemption would reduce its ability to provide the kinds and level of services and programs to its members and the members of their communities in which they live.

On behalf of its fraternal benefit society member companies, therefore, ACLI supports the repeal of Act 155 and supports passage of SB 2238.

Again, thank you for the opportunity to testify in support of SB 2238.

LAW OFFICES OF
OREN T. CHIKAMOTO
A Limited Liability Law Company



Oren T. Chikamoto
737 Bishop Street, Suite 2100
Honolulu, Hawaii 96813
Telephone: (808) 531-1500
Facsimile: (808) 531-1600

ANDREW V. BEAMAN
ANDREW R. BUNN
ANDREW W. CHAR
LEROY E. COLOMBE
RAY K. KAMIKAWA
DANTON S. WONG
ADRIENNE S. YOSHIHARA

BETHANY C.K. ACE
ANNE E. LOPEZ
CHASE T. TAJIMA

CHUN, KERR, DODD, BEAMAN & WONG
A LIMITED LIABILITY LAW PARTNERSHIP
FORT STREET TOWER, TOPA FINANCIAL CENTER
745 FORT STREET, 9TH FLOOR
HONOLULU, HAWAII 96813-3815
TELEPHONE (808) 528-8200
FACSIMILE (808) 536-5869
www.chunkerr.com

SENIOR COUNSEL:
EDWARD Y. C. CHUN
WILLIAM H. DODD

GEORGE L. T. KERR
1933-1998

GREGORY P. CONLAN
1945-1991

THE SENATE
THE TWENTY-SIXTH LEGISLATURE
Regular Session of 2012

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

Hearing date: Monday, January 30, 2012
Testimony on SB 2238
(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!).

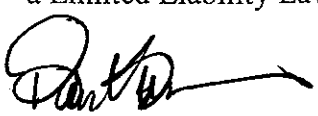
8. Conform to IRC § 7491(c) on the burden of production being on the government.

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

TESTIMONY OF WILLIAM G. MEYER, III

HEARING DATE/TIME: Monday, January 30, 2011
1:15 p.m. in Conference Room 016

TO: Senate Committee on Economic Development and Technology

RE: Testimony in Support of SB2238

Dear Chair, Vice-Chair and Committee Members:

My name is William G. Meyer, III. I have been practicing law in the State of Hawaii since 1979 and am a co-owner of a small business – my law firm. In my practice I represent many small and medium size businesses and have been concerned that Act 155 imposes draconian and unreasonable penalties upon local businesses that are struggling to survive in this difficult economic environment. Accordingly, I support SB2238 and respectfully encourage your Committee to pass SB2238 and repeal Act 155

Respectfully submitted,

/s/ William G. Meyer, III

William G. Meyer, III

PETER L. FRITZ
414 KUWILI STREET, #104
HONOLULU, HAWAII 96814
TELEPHONE: (808) 426-0000
E-MAIL: PLFLEGIS@FRITZHQ.COM

THE SENATE
THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2012

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY

Hearing January 30, 2012
Testimony on S.B. 2238
(Relating to Taxation)

Chair Fukunaga, Vice-Chair Wakai and Members of the Committee, my name is Peter Fritz. I am an attorney specializing in tax matters. I am testifying **in support** of S.B. 2238.

Act 155, Session Laws of Hawaii 2010 added two new sections to Chapter 237, Hawaii Revised Statutes §237-9.3 and §237-41.5 which impose new and disproportionate penalties for the simple failure to file a General Excise Tax ("GET") return and personal liability for unpaid GET.

Act 155 classified GET taxes as trust fund taxes. A responsible person has personal liability for unpaid trust fund taxes. Examples of responsible persons are directors, officers, an employee with check signing privileges or responsible for preparing the forms to remit the taxes. When the Internal Revenue Service asserts personal liability for trust fund taxes, personal liability is often asserted against all directors. The director will have to prove that he/she is not a responsible person.

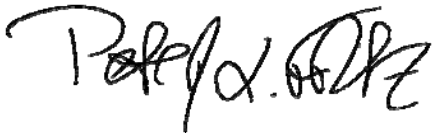
This potential for personal liability has made it difficult for nonprofit organizations to recruit qualified directors. People are reluctant to serve on the board because they can have personal liability for taxes that they did not think were owed. For example, a nonprofit organization holds a fund raising dinner at $500.00 a ticket. It calculates that contribution portion of the ticket's price is $600.00. If the Department of Taxation ("Department") audits the organization and determines that the deductible portion of the ticket should have been $400.00, the director/responsible person would have personal liability for the GET on the $200.00 for each ticket that was sold.

The lack of guidance from the Department makes the risk even greater. 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 disagrees and imputes 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.

Under §237-9.3, a nonprofit organization that fails to file the annual general excise tax return "not later than twelve months from the due date prescribed for the return" forfeits the right to claim any excise tax exemption or benefit under the General Excise Tax (GET) law. As currently written, a taxpayer who failed to file the return is estopped from filing the return and may have to file a new G-6 to qualify as a nonprofit organization

These benefits are forfeited even though the taxpayer filed every periodic return required under the GET law. This is a draconian penalty. 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.

Respectfully Submitted,



SUBJECT: GENERAL EXCISE, Repeal Act 155, SLH 2010

BILL NUMBER: SB 2238; HB 2045 (Identical)

INTRODUCED BY: SB by Fukunaga; HB by Ito and Keith-Agaran

BRIEF SUMMARY: Repeals Act 155, SLH 2010.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: The legislature by 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 entice 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 Act 155 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 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 do 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.

As such, Act 155 should be repealed and the effort to encourage and insure compliance should begin from scratch as obviously it is not being effective in helping taxpayers understand the importance of complying with the law.

Digested 1/27/12