

**TESTIMONY OF JAN K. YAMANE, ACTING STATE AUDITOR,
ON HOUSE BILL NO. 506, RELATING TO GENERAL EXCISE TAX**

**House Committee on Finance
February 14, 2013**

Chair Luke and Members of the Committee:

I am Jan Yamane, Acting State Auditor. Thank you for this opportunity to testify in support of this bill that would amend Chapter 237, Hawai'i Revised Statutes (HRS), the *General Excise Tax Law*, by adding a section prohibiting the State from paying or reimbursing contractors for any amount due to the State under that chapter.

The impetus for this bill is our recommendation in Report No. 12-07, *Management Audit of the Department of Education's School Bus Transportation Services*, in which we found, among other things, that the department was paying contractors for their general excise taxes due to the State. We recommended, among other things, that Chapter 237, HRS, be amended to explicitly prohibit the State from paying or reimbursing contractors for general excise taxes.

We are pleased that 17 legislators found our recommendation worthy of introduction as a bill, and we support passage of HB 506. I am available to answer any questions you may have.

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SUBJECT: GENERAL EXCISE, Payment of contractors by the state

BILL NUMBER: HB 506

INTRODUCED BY: Jordan, Cabanilla, Coffman, Hanohano, Ichiyama, Ito, Kawakami, Kobayashi, C. Lee, Lowen, Oshiro, Say and 5 Democrats

BRIEF SUMMARY: Adds a new section to HRS chapter 237 to provide that the state shall not pay or reimburse contractors for any amount due to the state under the general excise tax by contractors.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: In a management audit of the department of education's (DOE) school bus transportation services, the auditor found that in the DOE's contracts with bus service providers contain a provision requiring the DOE to pay the general excise taxes of these contractors. The DOE could not explain why the clause was contained in the contracts and subsequently the auditor, in the audit, recommended that the general excise tax laws be amended to prohibit the state from paying or reimbursing contractors for general excise taxes.

It should be noted that there is no legal requirement that the amount of the general excise tax that would be due on gross income received be shown out separately on an invoice. In fact, all the department of taxation is interested in is that 4% be paid on the amount invoiced. Thus, if the above bus service contractor had bid an amount inclusive of the general excise tax, the issue may not have caught the eye of the auditor. The misconception embodied by this proposal is that the general excise tax is the same as a retail sales tax where the incidence or responsibility for the payment of the tax is on the purchaser. It must be remembered that the general excise tax is the liability of the business, or in this case the bus service provider, for the "privilege of doing business" in the state. That is why customers see 4.16% or 4.712% tacked on to their receipt as the business must pay the 4/4.5% on any amounts they have "passed-on" as the general excise tax.

So while this measure attempts to prohibit the pass-on of the tax to the DOE, the tax on the amount received from the DOE will still be subject to the general excise tax and the bus service provider will still owe the state the 4% general excise tax - and whether or not shown out separately, the cost of the tax is included in the gross income received from the DOE. It is obvious that neither the auditors nor the drafters of the contract understand the structure of the tax.

While it appears that this bill is proposed to address a specific incident involving the escalating costs of providing student bus transportation in the state, as currently drafted, the language is vague and nonspecific and could be interpreted to restrict any payment of general excise taxes by the state to any contractor.

Digested 2/13/13

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February 14, 2013

Testimony To: House Committee on Finance
Representative Sylvia Luke, Chair

Presented By: Tim Lyons
President

Subject: H.B. 506 – RELATING TO THE GENERAL EXCISE TAX

Chair Luke and Members of the Committee:

I am Tim Lyons, President of the Subcontractors Association of Hawaii. The Subcontractors Association of Hawaii is composed of the following nine separate and distinct subcontracting organizations which include:

HAWAII FLOORING ASSOCIATION
ROOFING CONTRACTORS ASSOCIATION OF HAWAII
HAWAII WALL AND CEILING INDUSTRIES ASSOCIATION
TILE CONTRACTORS PROMOTIONAL PROGRAM
PLUMBING AND MECHANICAL CONTRACTORS ASSOCIATION OF HAWAII
SHEETMETAL CONTRACTORS ASSOCIATION OF HAWAII
PAINTING AND DECORATING CONTRACTORS ASSOCIATION
PACIFIC INSULATION CONTRACTORS ASSOCIATION
ELECTRICAL CONTRACTORS ASSOCIATION OF HAWAII

We are opposed to this bill.

This bill reflects the sad state of financial affairs and tax policy that has surfaced in recent years at this legislature.

For the State, on the one hand, to require that contractors pay 4% on their gross proceeds and on the other hand to prohibit them from charging or getting reimbursed for any amount due for the tax is nothing short of ludicrous.

We fail to understand how it is that anyone thinks that the tax, as a cost of doing business, is not included in the price somewhere whether it is identified or not. In fact, we can remember bills in sessions past where contractors were proposed to be exempt from the payment of the excise tax on proceeds from the State. After all, you appropriate money for projects, contractors bid and pay the tax as a cost. We have now come full circle and what is now proposed is the contractors have to pay it but cannot get the money back for that expense. Whether it is a box of nails, gas or the tax, if the business cannot recoup it, then it may be unprofitable for them to provide that service at all. We can easily see this law passing and then someone pressing a fraud case against the contractor who discloses that his tax cost was in his cost for the contract so therefore he was being reimbursed.

Based on the above, we find this bill ludicrous and cannot agree to its passage.

Thank you.