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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, March 14, 2013
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 1190 S.D. 1, Relating to the Imposition of Use Tax on Imported Contracting

The Department of Taxation (Department) **strongly supports** S.B. 1190 S.D. 1 and provides the following information and comments for your consideration.

S.B. 1190 S.D. 1 clarifies taxation of imported contracting under the use tax laws. Specifically, it removes reference to imported contracting from items excluded from the definition of "use" in Section 238-1, Hawaii Revised Statutes and amends section 238-2.3, Hawaii Revised Statutes, which imposes the use tax on imported contracting. Existing language in Section 238-2.3, Hawaii Revised Statutes, indicates that imported contracting is subject to use tax at rates of either one-half of one percent or four percent. This measure has an effective date of July 1, 2013.

The Department notes that there is confusion among taxpayers regarding the application of existing use tax law to imported contracting. The use tax is designed as a complement to the general excise tax, and generally items should be taxed similarly under the two taxes. Contracting is subject to general excise tax at the rate of four percent, or is not taxed where the subcontractor deduction is allowed.

Amendment of sections 238-1 and 238-2.3 as described in this bill will make treatment of contracting consistent between the general excise tax and the use tax. This will help to alleviate some of the confusion presently experienced by taxpayers in regards to use tax imposition on imported contracting. If approved, the taxes imposed under chapter 237 and 238, Hawaii Revised Statutes, will be evenly applied to contracting.

Thank you for the opportunity to provide comments.

L E G I S L A T I V E

# TAXBILLSERVICE

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SUBJECT: USE, Tax on imported contracting

BILL NUMBER: SB 1190, SD-1

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends HRS section 238-1 to amend the definition of "use" to delete paragraph (10) which provides that the use of contracting imported or purchased by a contractor as defined in section 237-6 who is: (1) licensed under HRS chapter 237; (2) engaged in business as a contractor; and (3) subject to the tax imposed under HRS section 238-2.3; shall not be subject to the use tax.

Amends HRS section 238-2.3 to provide that no use tax shall be imposed if a contractor importing or purchasing contracting that become identifiable elements, excluding overhead, of the finished work or project required under the contract, and where the gross proceeds derived by the contractor are subject to HRS section 237-13(3) and the contractor could have deducted amounts paid to the subcontractor under HRS section 237-13(3)(B) if the subcontractor was subject to the general excise tax.

EFFECTIVE DATE: July 1, 2013

STAFF COMMENTS: This is an administration measure submitted by the department of taxation TAX-08 (13). This measure attempts to clarify the use tax exemption for the value of imported contracting services if such services are subject to taxation under the general excise tax. As the exemption stands currently under the use tax law, imported contracting services are exempt from the term "Use" and are subsequently subject to the use tax law if subject to the use tax at either the 0.5% or 4% rate.

This measure attempts to apply the same treatment that is accorded in the general excise tax law where amounts received are exempt when received by a contractor and subsequently paid out to a subcontractor who is then responsible for the general excise tax at the 4% rate on the amount received from the general contractor. Since the purchase of imported contract services is being made from an unlicensed contractor outside the state, there is no one to pay the 4% general excise tax on the amount paid for the imported services except the importing contractor. Thus, the exemption from the use tax is extended to the imported contracting services as long as the importing contractor pays the 4% general excise tax when that imported contracted service is sold to the customer of the contractor. Thus, this amendment provides parallel treatment to what is known as the contractor/subcontractor deduction.

This confusing dilemma could have been avoided had contracting and subcontracting been subject to what is known as the de-pyramiding treatment accorded services purchased for resale. Consideration might be given to subjecting contracting services to the pyramiding treatment accorded other services purchased for resale.

Digested 3/12/13