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

Date: Thursday, March 27, 2014  
Time: 2:00 p.m.  
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: S.B. 2893, S.D. 1, Relating to Trust Fund Liability for Amounts Passed on as Tax

The Department of Taxation (Department) strongly **supports** S.B. 2893, S.D. 1, an Administration measure, and provides the following information and comments for your consideration.

S.B. 2893, S.D. 1, provides that amounts passed on to consumers as tax are held in trust for the State prior to remittance, as well as creating a presumption that a taxpayer is liable to the State for all amounts passed on as tax. Liability is reduced by any amount that the taxpayer can prove has been returned to the source from which it was collected. This means that the amount remitted to the State will not be less than the amount passed on as tax to consumers.

Currently, businesses are administratively allowed to pass on certain taxes to the consumers; however, businesses do not always remit those amounts in the entirety to the State, either in an attempt to avoid paying taxes or because they dispute their liability for the taxes owed. The Department foresees that the enactment of this measure will expedite the resolution tax disputes in cases where the taxes are visibly passed on.

S.B. 2893, S.D. 1, will also have the effect of ensuring fair treatment of consumers in the State, as well as assisting the Department and other State agencies in enforcement of the State's tax laws. In addition, S.D. 1 adds an exception for amounts that are returned to the consumer by the taxpayer. This ensures that any amounts paid as taxes to businesses will be remitted to the State or returned to the consumers as applicable.

Thank you for the opportunity to provide comments.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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**SUBJECT:** ADMINISTRATION, Trust fund liability for amounts passed on as tax

**BILL NUMBER:** SB 2893, SD-1

**INTRODUCED BY:** Senate Committee on Ways and Means

**EXECUTIVE SUMMARY:** The department of taxation has consistently, since 1957, taken a hands-off position regarding amounts passed on to consumers as tax, saying it is a consumer protection issue rather than a tax issue. Now the department proposes to “solve” this problem by saying that it just keeps the money. There is potential to create far more problems because the “trust fund” concept that it espouses may change the rules on whether passed-on tax is itself taxable, and thereby erode the revenue base.

**BRIEF SUMMARY:** Adds a new section to HRS chapter 231 to provide that if an amount is separately stated as tax in a receipt, contract, invoice, billing, or other evidence of the business activity, that amount shall be held in trust for the state and must be remitted to the state. Creates a conclusive presumption that the taxpayer is liable to the state for any such amounts collected by the taxpayer, and states that the taxpayer is also so liable for any amounts added as penalties and interest under HRS section 231-39. The taxpayer’s liability shall be reduced by any amount collected as a recovery of the taxpayer’s liability.

**EFFECTIVE DATE:** Upon approval

**STAFF COMMENTS:** This is an administration measure submitted by the department of taxation TAX-08 (14). It appears that the department is bothered by some taxpayers who visibly pass on a tax, such as the general excise tax or transient accommodations tax, and then fail to remit those monies to the department. As justification for the measure, the department states: “The public will benefit from this new provision because there will be certainty that any amount paid as tax will be remitted to the State and not retained by the taxpayer,” and “The Department will have an easier time with assessment and collection in cases where any title 14 tax is passed on.”

This measure, as proposed, has the potential to cause many more problems than it is intended to solve, and cannot be justified.

Consistently, since 1957, the department has always maintained in General Excise Tax Memorandum No. 4, that the “pass on” of tax is purely a matter of contract between the buyer and seller. The tax laws really don’t care what is represented to the buyer by the seller, it just cares that any amount paid between them becomes income to the seller and is then subject to tax as provided by law. This bill appears to make the taxing law irrelevant: if the seller states that a certain amount is tax and the buyer pays it, then the department is entitled to assess and collect that amount regardless of any other law. What if the seller made a mistake and applied either an incorrect rate or forgot to take advantage of an exemption that is allowed by law? Under current law, the seller is entitled to pay the department no more than the correct amount of tax, and then the seller must make peace with the buyer or suffer consequences under the consumer protection law. (See the discussion in Tax Facts 96-1.) Under this bill, the correct amount

of tax is irrelevant. Assuming that the taxpayer can't prove that the difference has been refunded to the proper customer, the department just keeps the money. It's a "heads I win, tails you lose" situation.

Next, the department really should be very careful when brandishing this "trust fund" concept because it could lead to unintended erosion of the tax base. As mentioned above, under General Excise Tax Memorandum No. 4, the tax law doesn't care about whether an amount paid from buyer to seller is represented as tax or anything else; anything paid to the buyer is income to the buyer and therefore taxable. That's why any amount passed on as tax on the invoice is subject to the tax in Hawaii where it isn't in sales tax states. That's why Hawaii retailers pass on 4.712% or 4.166% while the statutory tax rate is 4.5% or 4%, and why retailers in sales tax states always charge sales tax at exactly the statutory tax rate. In sales tax states, the tax is not included in the tax base because the sales tax isn't the seller's money, but is held by the seller in trust to pay the sales tax imposed upon the buyer. The classic definition of income, as stated by the U.S. Supreme Court in *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), is "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." To the extent that money is held in trust for the state, taxpayers don't have complete dominion over it; therefore, how can it be taxable income? If this measure is enacted, the department will lose its justification for taxing the passed-on amount and the revenue base will drop.

Digested 3/24/14



# Chamber of Commerce HAWAII

*The Voice of Business*

**Testimony to the House Committee on Finance  
Thursday, March 27, 2014 at 2:00 P.M.  
Conference Room 308, State Capitol**

**RE: SENATE BILL 2893 SD1 RELATING TO TRUST FUND LIABILITY FOR  
AMOUNTS PASSED ON AS TAX**

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") would like to **express concerns** regarding SB 2893 SD1, which creates trust fund liability for any title 14, Hawaii Revised Statutes, tax that is passed on, and creates a conclusive presumption of, liability for any title 14 tax amounts passed on.

The Chamber is the largest business organization in Hawaii, representing over 1,000 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 members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

Currently, the GET on Oahu is 4.5%. GET taxpayers who pass on the GET - such as retailers - charge 4.72% because the amount they collect as tax is itself taxable. This tax-on-the-tax is charged because when a retailer collects tax, it is viewed as part of the gross receipts of the retailer.

This bill, in our view, changes this. To the extent that the GET becomes a "trust fund" tax, amounts collected by the retailer are no longer gross receipts of the retailer and instead are held "in trust" for the State. Under both Department of Taxation guidance and potentially some Hawaii court decisions, when a party receives amounts "in trust" for another party, the receiving party does not count those amounts as its own gross receipts. Rather, the party for whom the amounts are held in trust is deemed to be the recipient. Accordingly, to the extent that a retailer receives amounts "in trust" for the Department of Tax, we believe that the retailer should not be taxed on these amounts. With this measure, retailers would have a strong argument that they should go back to charging 4.5% rather than 4.7% because they should no longer be taxed-on-the-tax - because the amounts received in trust for the Department of Tax are no longer gross receipts of the retailer, but instead amounts received on behalf of the Department.

The Department of Tax, unsurprisingly, disagrees with this position and would likely assert that the trust fund amounts remain gross receipts of the retailer. Accordingly, at the very least, we believe that the legislation introduces unnecessary uncertainty regarding the proper treatment of amounts received as tax-on-the-tax. While we understand the Department's concerns on some businesses not paying their taxes in a timely manner, we do not believe that



Chamber *of* Commerce HAWAII  
*The Voice of Business*

this bill creates the certainty they claim this will create. Rather, as we have stated above, this bill will create more uncertainty.

Thank you for the opportunity to testify.

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HOUSE OF REPRESENTATIVES  
THE TWENTY-SEVENTH LEGISLATURE  
REGULAR SESSION OF 2014

COMMITTEE ON FINANCE  
Testimony on S.B. 2893 S.D. 1  
Hearing: March 27, 2014

(RELATING TO TRUST FUND LIABILITY FOR AMOUNTS PASSED ON AS TAX)

Chair Luke, Vice Chairs Nishimoto and Johansen, and members of the Committee. My name is Peter Fritz. I am an attorney in private practice and a former Rules Specialist with the Department of Taxation (“DOTAX”). I am testifying **in opposition** to this bill because as currently drafted, it could impose liability for an amount greater than the amount of tax owed under the applicable Chapter of Title 14, and that it is possible that the only people liable for the payment of taxes would be small business owners.

This bill this bill creates trust fund liability for any Title 14, Hawaii Revised Statutes, taxes that are passed on and creates a presumption of, liability for any Title 14 tax amounts passed on.

#### **Creation Of Trust Fund Liability In Excess Of The Amount Of Tax Owed**

- The amount passed on an approximation of the amount of the tax on a purchase. It is not the exact amount of the tax and often has to be rounded up to nearest penny. The General Excise Tax (“GET”) is a percentage of an entity’s total gross receipts. It is possible for the amount that has been added onto purchases to exceed the amount of tax owed by the taxpayer. I have attached an example of just such a situation as Exhibit 1 to this testimony.
- When a seller adds amount for tax to the purchase price of an item, the seller makes an approximation of the amount. For sales Oahu, the amount added on in his 4.712% of the purchase price. On the outer islands, it is 4.166% of the purchase price. Because this often results in an amount that is includes a fractional amount of a cent, the seller rounds up or rounds down to the nearest penny.
- The General Excise Tax (“GET”) is imposed on the gross receipts of the business. Any amounts added to a purchase as the seller’s tax is considered part of the total price subject to Excise Tax. (See Tax Facts 96-1). The tax is based on the gross receipts of a business and not the tax from individual a transactions.

- In the attached example,
  - A “Dollar Store” located on Oahu
  - It sells an item for \$1.00 and adds an additional 4.712%<sup>1</sup> of the purchase price to cover the general excise tax. This amounts to an additional \$.04712. The store rounds up the purchase price to \$1.05. If the store makes 100,000 sales at \$1, it would pass on an additional \$.05 per sale. The total amount passed on would be \$5000.00.
  - The GET on the \$105,000 dollars of gross receipts would be 4.5% of this amount or \$4725.00.
  - Under this bill, a taxpayer would be required to remit \$5000.00 to the state of Hawaii to avoid trust fund liability under this bill notwithstanding the fact that the taxpayer’s tax liability is only \$4725.00 because this bill requires the taxpayer to “remit to the state an amount no less than the amount of tax passed on . . .”
  - This bill should be held until such time as the DOTAX submits a draft that prevents the possibility of such situations occurring.

**This Bill Could Impose Personal Liability Upon Unincorporated Small Businesses But Not Corporations**

- Statutes that create a trust fund liability usually assess personal liability to a responsible person. This enables the government entity to proceed against the owners and other persons involved in the business. It allows the “corporate veil” to be pierced.
- However, this bill uses the term taxpayer. It would appear that the liability is solely the responsibility of the entity that owes the tax.
- The owners of a Corporation, Limited Liability Company (“LLC”) or Limited Liability Partnership (“LLP”) are shielded by law from liability for payment of taxes.
- Many small businesses are unincorporated. Therefore if a liability arose under this bill, the owner of the unincorporated small business would be personally liable for any taxes that would be owed. While the owners of a Corporation, LLC or LLP would not be personally liable for those taxes because of the shielding provided by the entity.
- This bill should be held until this unequal treatment is removed with a new draft.

Thank you for the opportunity to testify.

Respectfully submitted,



Peter L. Fritz

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<sup>1</sup> This amount represents an approximation of the pass on and to be added to the purchase price for both the General Excise Tax imposed pursuant to § 237-13 Hawaii Revised Statutes, (“HRS”) and the and the County Surcharge under Chapter 42, HRS.

	A	B
Sale amount	\$1.00	\$1.00
Rate of Pass On	4.712%	4.166%
Amount Passed On	\$0.05	\$0.04
Total Sale	\$1.05	\$1.04
100,000 Sales at \$1.00	\$100,000.00	\$100,000.00
Passed On Amount	\$5,000.00	\$4,000.00
Gross Receipts	\$105,000.00	\$104,000
Tax Rate HRS 237-13 is 4.0%	4.00%	4.00%
State Tax on Gross Receipts	\$4,200.00	\$4,160.00
Tax Rate County Surcharge	0.0050	0
Amount of Count Surcharge	\$525.00	0
Total Taxes	\$4,725.00	\$4,160.00
Diffrence Between the Amount Passed on and the Taxpayer's Liability under Title 14	\$275.00	-\$160.00