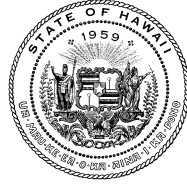


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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Thursday, January 30, 2014
Time: 9:00 A.M.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

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

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

S.B. 2893 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. 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 the entirety of those amounts 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.

In addition, S.B. 2893 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. Consumers will have certainty that any amounts paid as taxes to businesses will be remitted to the State.

Thank you for the opportunity to provide comments.

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

BILL NUMBER: SB 2893; HB 2343 (Identical)

INTRODUCED BY: SB by Kim by request; HB by Souki by request

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.

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 consumer protection law. (See the discussion in Tax Facts 96-1.) Under this bill, the correct amount of tax is irrelevant. 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. In either event, 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?

Digested 1/27/14