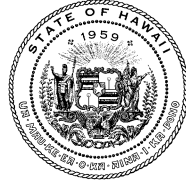


DAVID Y. IGE  
GOVERNOR

SHAN TSUTSUI  
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MARIA E. ZIELINSKI  
DIRECTOR OF TAXATION

STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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To: The Honorable Sylvia Luke, Chair  
and Members of the House Committee on Finance

Date: Wednesday, March 4, 2015  
Time: 11:00 A.M.  
Place: Conference Room 308, State Capitol

From: Maria E. Zielinski, Director  
Department of Taxation

Re: H.B. 968, H.D. 1, Relating to Liability for Amounts Passed on as Tax

The Department of Taxation (Department) strongly supports H.B. 968, H.D. 1, an Administration measure, and provides the following information and comments for your consideration.

H.B. 968 creates a conclusive presumption that a taxpayer is liable for any amounts passed on as a tax under title 14 of the Hawaii Revised Statutes (HRS), where said amount is separately stated in a receipt, contract, invoice, or bill. The amount of liability, however, is reduced by any amount the taxpayer returns to the source from which it was collected. This bill also authorizes the Department to adopt rules stating the maximum rates at which taxes may be passed on and imposes a civil penalty of up to \$500 on businesses that pass on a tax at a rate higher than the maximum rate allowed. Finally, this bill requires the Department to notify the Department of Commerce and Consumer Affairs (DCCA) of judicial appeals in which a taxpayer has passed on a tax and has failed to remit the amount to the State or has been assessed a penalty for passing on a tax at a rate higher than the maximum allowed.

The Department has found that taxpayers often visibly pass on title 14 taxes, such as the general excise tax (GET) and the transient accommodations tax (TAT), but do not remit these amounts to the State. These taxpayers often claim that they either do not owe the State any tax for the transaction or that they owe a lesser amount than what was collected.

Hawaii tax law is silent on the issue of passing on taxes such as the GET and TAT. The restriction on the amount of tax passed on is based in consumer protection law. For example, where the amount visibly passed on is represented as GET, the business cannot pass on an amount which exceeds the actual GET due on the gross income from that transaction. To do so

would be a misrepresentation of the facts and a violation of consumer protection laws which the DCCA's Office of Consumer Protection monitors.

H.B. 968, H.D. 1 will assist the Department administratively with assessments and collections and will expedite the resolution of tax disputes. Taxpayers will not be able to take the contradictory position that they do not owe tax under title 14, HRS, even though they passed on and collected the tax from a third party. In addition, the public will benefit from this bill, as they will have greater certainty that any amount paid for a purported tax will be remitted to the State and not retained by the taxpayer.

It is important to note that adoption of this measure will not provide a windfall for the State, as H.B. 968, H.D. 1 does not impose any liability above the amount the taxpayer actually passed on and collected, and expressly excludes from liability amounts the taxpayer collected but then returned to third parties.

This measure will also provide clarity for taxpayers and consumers by allowing the Department to set forth by administrative rule the maximum rate at which a Hawaii tax may be passed on. The Department regularly receives questions from taxpayers and consumers regarding the permissible rate of GET and/or TAT that may be passed on.

Much of the uncertainty arises from the fact that amounts visibly passed on as GET are also subject to GET. As a result, a business may pass on GET at a rate higher than the statutory rate to make up for the difference.

For example, suppose that a taxpayer sells an item for \$100 and is subject to GET at 4%. Further, suppose that the taxpayer passes on the GET at 4%, thereby collecting a total of \$104 from the customer. Although the taxpayer collected \$104, the taxpayer owes the State \$4.16 (4% of \$104), which is less than the \$4 collected for tax. To make up for this difference, taxpayers are allowed to pass on GET at a rate 4.166% without violating consumer protection laws.

Unlike GET, which is imposed on gross income or proceeds, including amounts that were visibly passed on as GET, TAT is not imposed on amounts that were visibly passed on as GET or TAT. Accordingly, a business may only pass on TAT at the statutory rate.

For example, suppose that a taxpayer charges \$100 for furnishing a hotel room and is subject to GET at 4% and TAT at 9.25%. The taxpayer may pass on \$4.16 for GET (4.166% of \$100), but may only pass on \$9.25 for TAT (9.25% of \$100). Of note, although amounts passed on as GET are subject to GET, amounts passed on as TAT are not subject to GET.

This bill will clear up any confusion regarding what rates may be passed on as Hawaii tax. Taxpayers who charge customers more than the maximum rates (e.g. charging a customer 5% instead of 4.166% for GET) will be subject to a civil penalty not to exceed \$500, similar to the civil penalties imposed for other violations of the tax laws, such as failure to file or failure to pay taxes.

In summary, H.B. 968, H.D. 1 would amend the law to require taxpayers to remit the amounts visibly passed on and actually collected as Hawaii taxes. Taxpayers would not be required to remit any amounts returned to customers. H.B. 968, H.D. 1 would also authorize the Department to adopt rules setting forth the maximum rates at which taxes may be passed on and impose civil penalties for violating said rates.

Thank you for the opportunity to provide testimony in support of this measure.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

**SUBJECT:** ADMINISTRATION, Liability for amounts passed on as tax

**BILL NUMBER:** HB 968, HD-1

**INTRODUCED BY:** House Committee on Judiciary

**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. This bill creates a conclusive presumption that the taxpayer is liable to the state for any such amounts collected as a recovery of the taxpayer's liability. This may create unintended problems, and we have provided some fact patterns to consider.

**BRIEF SUMMARY:** Adds a new section to HRS chapter 231 to provide that if an amount is charged as the tax owed by the taxpayer for the transaction and is separately stated in a receipt, contract, invoice, billing, or other evidence of the business activity, that taxpayer is conclusively liable for any amounts charged. States that the taxpayer is also 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 (15). 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 the seller. Current tax laws really don't care what is represented to the buyer by the seller, only 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 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.

Consider the following situations:

Contractor C is hired to do a renovation for a taxpayer, and the contract price is \$10,000. C subcontracts part of the work to S for \$4,000 including tax. C charges the owner  $\$10,000 + 4.166\% = \$10,416$ . The owner pays that amount. Under current law, C is liable for tax on 4% of the gross price less the subcontract deduction, or 4% of  $\$6,416 = \$256$ . S is liable for tax on 4% of the  $\$4,000 = \$160$ . Under the bill, C must pay \$416 tax and S must still pay the \$160.

Tour operator T offers a package tour to tourists for \$100, which includes payments to bus company B for \$20, attraction A for \$30, and hotel H for \$45. T charges the tourist \$104.16, and the tourist pays it. Under current law, T is liable for tax at 4% of what T keeps, namely 4% of \$9.16 or about 37 cents. B, A, and H are liable for tax at 4% of what they respectively keep. Under the bill, T must pay \$4.16 and B, A, and H must still pay 4% of the \$95 they get between them.

Is this really what is intended? If not, the bill needs to be fixed.

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# Chamber of Commerce HAWAII

*The Voice of Business*

**Testimony to the House Committee on Finance  
Wednesday, March 4, 2015 at 11:00 A.M.  
Conference Room 308, State Capitol**

**RE: HOUSE BILL 968 HD1 RELATING TO LIABILITY FOR AMOUNTS PASSED  
ON AS TAX**

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

The Chamber of Commerce Hawaii ("The Chamber") **opposes** HB 968 HD1, which creates conclusive presumption that taxpayer is liable for any amounts passed on to consumers as payment for any tax authorized by title 14, Hawaii Revised Statutes, unless the taxpayer returns the overpayment to the consumer. Also provides for civil penalty and reporting of violations to the office of consumer protection.

The Chamber is the largest business organization in Hawaii, representing about 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.

The Chamber is concerned that this bill may create presumptions where they might be factually inaccurate. For example, if a business charges the GET at 4.5%, then realizes that it could charge 0.5% under the wholesale rate rules. This would make the taxpayer "conclusively presumed" to be liable for the tax. We believe that the tax liability should depend on whether or not the taxpayer actually engaged in a taxable transaction.

Thank you for the opportunity to testify.

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HOUSE OF REPRESENTATIVES  
THE TWENTY-EIGHTH LEGISLATURE  
REGULAR SESSION OF 2015

COMMITTEE ON FINANCE  
Testimony on H.B. 968 HD1  
Hearing: March 4, 2015

(RELATING LIABILITY FOR AMOUNTS PASSED ON AS TAX)

Chair Luke, Vice Chair Nishimoto, 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 statute in Title 14 and denies due process to a taxpayer.

This bill creates a conclusive presumption that a taxpayer is liable for any amounts passed on to consumers as payment for any tax under title 14, Hawaii Revised Statutes and requires DOTAX to adopt administrative rules stating the maximum rates at which taxes under title 14 may be passed on. It provides for civil penalties, even if the tax liability under Title 14 is less than the amount passed on to the consumer because of rounding.

**I. It is not possible for DOTAX to adopt rules that assess the exact amount of General Excise tax (“GET”) that can be added to an individual sale because GET is calculated on the total gross receipts of a business. When GET is calculated on an individual sale, the amount added to an invoice must be rounded up or down to the nearest \$0.01.**

- The General Excise Tax (“GET”) is a tax that is imposed under Title 14. The tax is either 4% of total gross income for all retail purchases or 0.5% of total gross income for all wholesale purchases. There is also a county surcharge of .05% for gross receipts on retail sales on Oahu. Because the GET is imposed on a business’ gross receipts, it may not be possible add the exact amount of GET when the amount is calculated on an individual sale.
  - Businesses can add an amount onto invoices to cover the amount of tax on a sale. Because any amount passed on to a consumer is part of a business’ gross receipts and taxable, the tax rate is increased from 4.5% to 4.712%<sup>1</sup> to cover the tax on the amount added to an invoice. This often necessitates rounding of the amount passed to the nearest whole \$0.01.

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<sup>1</sup> This amount represents an approximation of the tax and the tax on the amount passed on of tax and 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.

- **This Bill Creates a Different Liability for GET and Liability for Amounts Added to an Invoice as Tax and Passed Onto the Consumer.** This bill creates a liability that could be greater than the tax imposed by the applicable tax statute because of the need to round to the nearest \$0.01.
  - Example: A “Dollar Store” located on Oahu sells an item for \$1.00 and adds an additional 4.712% 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 of gross receipts would be 4.5% of this amount or \$4725.00.
  - This bill creates a conclusive presumption of liability for all amounts added to an invoice as tax. A conclusive presumption is a presumption which cannot be overcome or changed by any additional evidence or argument.
  - **Under this bill, a taxpayer would be liable to pay \$5,000.00 to DOTAX notwithstanding the fact that the taxpayer’s tax liability under § 237-13, HRS and Chapter 42, HRS is only \$4725.00. Because this bill creates a conclusive presumption, this liability could not be overcome or changed by any additional evidence or argument other than showing that an amount was repaid to the consumer. However, because of rounding, the fractional cents cannot be returned to a consumer.**
  - How can a taxpayer be liable to the Department of Taxation for an amount in excess of the tax imposed under § 237-13, HRS?
- **Different Liability for GET Tax and Liability for Amounts Collected for Taxpayers that Round Down.**
  - A “Dollar Store” sells an item for \$1.00 and adds an additional 4.166% of the purchase price to cover the general excise tax. This amounts to an additional \$.04166. The store rounds the purchase price down to \$1.04. If the store makes 100,000 sales at \$1, it would pass on an additional \$.04 per sale. The total amount passed on would be \$4000.00.
  - The GET on the total gross receipts of \$104,000.00 is \$4160.00. However the taxpayer added a total of \$4000.00 for the individual sales.
  - Can the taxpayer claim that the tax liability is limited to the \$4,000.00?

## II. Denial of Due Process

- This bill could deny due process to a Taxpayer.
  - This bill creates a conclusive presumption of liability. A conclusive presumption is a presumption of law that cannot be rebutted by evidence and must be taken to be the case whatever the evidence to the contrary. Courts have held conclusive presumptions to be unconstitutional; too unfair, and thus a denial of due process.
  - Example: Change of classification of transaction from retail to wholesale. A business sells a product at \$2.00. It adds \$0.08 cents for GET for a total price of \$2.08. The business subsequently determines that the sale was at wholesale and the tax on a wholesale transaction is  $(\$2.08 * .005)$  or \$.01. The business includes the \$2.08 in its



gross receipts and calculates the tax on its total gross receipts. **If DOTAX does not change the classification from wholesale back to retail during an audit, the taxpayer paid the proper amount of tax required by Chapter 237, HRS.**

- If the taxpayer paid the legal amount of tax required by law, how can DOTAX insist that the business is liable for an additional \$0.07 (the difference between the \$0.08 added for a retail sale and the \$0.01 for a wholesale sale)?
  - DOTAX does not have the authority to collect amounts other than the amount of tax owed. Title 14 does not contain any statute authorizing collection of non-tax amounts.
- **Denial of Due Process:** If the consumer owes money to the business, the business should be able to offset any claim by the consumer for a refund of the \$0.07 against the amount owed to the company. However, the amount, which is not an amount of tax owed to the state, is required by this bill to be paid to DOTAX. If it is not paid to DOTAX the business is liable for this non-tax amount. There are no provisions in this bill that would allow a business to claim an offset for amounts owed to it by a consumer because this bill would create a conclusive presumption that the taxpayer is liable for this amount.

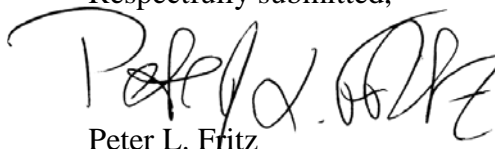
**III. Potential to Reduce State Tax Receipts.** Businesses could decide to avoid liability by ending a visible pass on of the tax. When a business visibly adds an amount to an invoice, that amount is part of the gross receipts of the business and is taxed. However, if a business decides to stop visibly passing on a tax, tax receipts would drop because there would be no GET from an amount added to the invoice.

**IV. Potential to Undermine Future Actions Against Businesses such as Online Travel Companies.**

- Judge Chang, when rendering a decision in open court in the Online Travel Companies (“OTC”) litigation, made it very clear that he was finding that the excise tax was far reaching and that the nonresident OTCs had GET liability. However, the decision might have been different if Hawaii had had a sales tax.
- Under the holding of Quill Corp. v. North Dakota, 504 U.S. 298 (1992) a state may only require a business to collect the state’s sales tax if the business has a substantial nexus with the state. Because Hawaii has an excise tax, the holding of Quill may not apply.
- Changes to tax law that make it operate like a sales tax could cause a court to rule that the substantial nexus requirements of Quill prevent Hawaii from prevailing in an action to collect a tax in future actions that are similar to the OTC litigation.

Thank you for the opportunity to testify.

Respectfully submitted,



Peter L. Fritz



# Chamber of Commerce HAWAII

*The Voice of Business*

**Testimony to the House Committee on Finance  
Wednesday, March 4, 2015 at 11:00 A.M.  
Conference Room 308, State Capitol**

**LATE**

**RE: HOUSE BILL 968 HD1 RELATING TO LIABILITY FOR AMOUNTS PASSED  
ON AS TAX**

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

The Chamber of Commerce Hawaii ("The Chamber") **express serious concerns** on HB 968 HD1, which creates conclusive presumption that taxpayer is liable for any amounts passed on to consumers as payment for any tax authorized by title 14, Hawaii Revised Statutes, unless the taxpayer returns the overpayment to the consumer. Also provides for civil penalty and reporting of violations to the office of consumer protection.

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We have serious concerns on this bill as it seems the bill creates presumptions where they might be factually inaccurate. Tax liability should turn on whether or not the taxpayer actually engaged in a taxable transaction.

We do understand a consumer protection problem if someone collects tax from a customer but doesn't remit the collected amounts to the taxing authority. Luckily, DOTAX has already stated that, to the extent you tell customers that you're collecting tax and don't actually pay it to the state, the matter will be referred to consumer protection enforcement folks.

Thank you for the opportunity to testify.

DAVID Y. IGE  
GOVERNOR

SHAN TSUTSUI  
LT. GOVERNOR



STATE OF HAWAII  
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MARIA E. ZIELINSKI  
DIRECTOR OF TAXATION

Revised / corrected  
3/4/2015 | 8:00 AM

**LATE**

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

Date: Wednesday, March 4, 2015  
Time: 11:00 A.M.  
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From: Maria E. Zielinski, Director  
Department of Taxation

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The Department has found that taxpayers often visibly pass on title 14 taxes, such as the general excise tax (GET) and the transient accommodations tax (TAT), but do not remit these amounts to the State. These taxpayers often claim that they either do not owe the State any tax for the transaction or that they owe a lesser amount than what was collected.

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would be a misrepresentation of the facts and a violation of consumer protection laws which the DCCA's Office of Consumer Protection monitors.

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It is important to note that adoption of this measure will not provide a windfall for the State, as H.B. 968, H.D. 1 does not impose any liability above the amount the taxpayer actually passed on and collected, and expressly excludes from liability amounts the taxpayer collected but then returned to third parties.

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In summary, H.B. 968, H.D. 1 would amend the law to require taxpayers to remit the amounts visibly passed on and actually collected as Hawaii taxes. Taxpayers would not be required to remit any amounts returned to customers. H.B. 968, H.D. 1 would also authorize the Department to adopt rules setting forth the maximum rates at which taxes may be passed on and impose civil penalties for violating said rates.

Thank you for the opportunity to provide testimony in support of this measure.