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DEPARTMENT OF TAXATION**

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To: The Honorable Aaron Ling Johanson, Chair
and Members of the House Committee on Labor & Public Employment

Date: Thursday, March 14, 2019
Time: 9:00 A.M.
Place: Conference Room 309, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 397, S.D. 2, Relating to Contracting

The Department of Taxation (Department) offers the following comments on S.B. 397, S.D. 2, for the Committee's consideration.

S.B. 397, S.D. 2, adds a new requirement for all contractors and subcontractors applying for a building license for private developments exceeding an unspecified amount to submit tax clearances as a condition to obtain the license. A summary of key provisions of this bill are as follows:

- Requires all contractors and subcontractors applying for a building license for private developments valued at \$195,000 or greater to submit tax clearances from the Department and the Internal Revenue Service (IRS);
- Requires the license issuing officer to verify that all contractors and subcontractors have filed all tax returns due, and that all taxes, interest, and penalties have been paid;
- Authorizes the Director of Taxation to waive the IRS tax clearance requirement if the Director determines that it is in the best interest of the State;
- Authorizes the Department to require applications for tax clearances to be submitted through electronic means;
- Requires all assignees of a contract for a private development valued at \$195,000 or greater to obtain a bulk sales certificate if required under Hawaii Revised Statute (HRS) section 237-43 or tax clearances if the bulk sales certificate is not required;
- Requires all contractors and subcontractors to submit tax clearances dated no earlier than 45 days prior to the date of the request for final inspection as a condition of final building inspection;
- Exempts the tax clearances requirement if the Department certifies that the contractor or subcontractor is in good standing under a plan in which delinquent taxes, interest, and penalties are being paid to the Department or the IRS;

- Imposes a penalty of not more than \$1,000 or imprisonment of not more than one year, or both, to any officer or employee of any governmental agency that intentionally violates the new requirement under this bill;
- Exempts the tax clearances requirement during the period that the validity of the taxes, penalties, or interest is being contested in an administrative or judicial appeal with the Department of IRS;
- Appropriates an unspecified amount from the general funds to the counties for the enforcement of this bill; and
- Has a defective effective date of July 1, 2050.

First, First, the Department notes that this bill is very similar to the requirement to obtain tax clearances for certain contracts with the state and counties set forth in HRS section 103-53. Thus, this measure may be somewhat duplicative of the existing tax clearance requirements.

Second, the Department notes that the Senate Committee on Ways and Means addressed an issue that that the Department previously raised by replacing the term “most recent tax clearances” with language specifying that the tax clearance must be dated no earlier than 45 days prior to the date that final inspection is requested.

Third, the Department notes that every two years, the State Contractors License Board requires contractors to renew their contractor’s licenses, and one of the requirements to renew the license is to submit a tax clearance certificate.

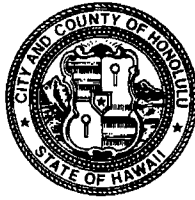
Finally, the Department respectfully requests that the effective date of the measure be no earlier than January 1, 2020 to allow the Department sufficient time to prepare for changes proposed by this measure.

Thank you for the opportunity to provide comments on this measure.

DEPARTMENT OF PLANNING AND PERMITTING
CITY AND COUNTY OF HONOLULU

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March 14, 2019

The Honorable Aaron Ling Johanson, Chair
and Members of the Committee on Labor
and Public Employment
Hawaii House of Representatives
Hawaii State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Johanson and Committee Members:

**Subject: Senate Bill No. 397, SD 2
Relating to Contracting**

The Department of Planning and Permitting (DPP) **opposes** Senate Bill No. 397, SD 2, which would tie state and federal tax compliance of contractors and subcontractors to the building permit process. This compliance check must be done for each building permit application, for each contractor and subcontractor.

Our major concern is the lack of clarity in this Bill's language:

- We assume reference to a "building license" is a reference to a county building permit.
- The first paragraph (a), first sentence states that the permit applicant must submit tax clearances. The second sentence states that the county must verify all tax returns due, and all taxes, interests and penalties paid. Checking for a tax clearance form is different from actually reviewing tax documents. We prefer a clearance form, rather than having to examine actual tax filings. We have no expertise in this area, and this would delay the issuance of building permits.
- Under paragraph (b), clarification is needed on references to "assignment of a contract." Is this a reference to the issuance of the building permit, or the contract between the general contractor and subcontractors?
- The Department of Planning and Permitting is not involved with bulk sales transaction, so it is problematic why this requirement is being placed under Chapter 46, HRS. Further, it is not clear who is the referenced "state or country contracting officer or agent."
- Under paragraph (c), there is, again, a reference to "state and county contracting offices or agents." Who are these people? Does it apply to the state Department of Health inspectors?

- Paragraph (a) clearly states that the building permit cannot be granted before the proposed tax documentation is submitted. Paragraph (c) says final inspections must be withheld until tax clearances are received, and no earlier than 45 days prior to the inspection. Larger projects take many months to complete; does this mean that tax clearances must be submitted twice? If a project is completed in less than 45 days, does the first submittal suffice?

A secondary concern is that there are unrecognized costs and questions raised by this Bill:

- Note that contractors and subcontractors often are substituted after a building permit is issued. In such cases, are new clearances required? If so, does construction have to stop while a new clearance form is submitted?
- By ordinance, certain types of building permits are required to be processed in a certain number of days. This Bill makes no provision that tax documentation by the Department of Taxation must be provided on a timely basis. If the clearance form is not received before the deadline, is the building permit expected to be denied?
- The director of taxation may waive the requirement if "it is in the best interest of the State." This appears to be a very broad criteria. How will appeals to this decision be addressed, given that this is under Chapter 46, which addresses county matters? Will it be appealable to our Building Board of Appeals?
- Paragraph (e) specifies penalties if this new requirement is violated by any "any officer or employee of any governmental agency." Who would impose the penalty? Is there no penalty for a building permit applicant and contractor who violate this section?
- Often, final inspections are scheduled weeks before the requested inspection date. This means that clearances will likely delay some final inspections. Is that the intent?
- This new requirement leaves many issues unaddressed, as suggested above, and therefore calls for the adoption of rules. Which department should be responsible for them?

We are grateful for the willingness to fund the counties to implement this Bill. However, proposed levels will not cover actual costs. In addition to the initial check at the time a building permit application is submitted, this program will affect the inspection process, and appeals, whatever the appeal process. It requires us to modify our permit tracking database. Employee overtime may have to be used to comply with this requirement added to all existing deadline requirements of the review process. The economy, and the construction industry in particular, could be significantly disrupted due to this new requirement. A rough estimate is that more than a hundred permits per month would fall above the \$195,000 threshold.

Lastly, if adopted, the effective date should recognize the need to adopt rules and develop protocols between each county and the state Department of Taxation. The effective date should be at least one year of date of adoption.

The Honorable Aaron Ling Johanson, Chair
and Members of the Committee on Labor
and Public Employment
Hawaii House of Representatives
Hawaii State Capitol
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To sum, there are too many questions and serious impacts to this Bill. Please hold
Senate Bill No. 397, SD 2.

Thank you for the opportunity to testify.

Very truly yours,

A handwritten signature in black ink, appearing to read "Kathy K. Sokugawa". The signature is fluid and cursive, with the first name "Kathy" being the most prominent.

Kathy K. Sokugawa
Acting Director

AMERICAN INSTITUTE OF ARCHITECTS

March 14, 2019

Honorable Aaron Ling Johanson, Chair
House Committee on Labor & Public Employment

Re: Senate Bill 397 SD2 Relating to Contracting

Dear Chair Johanson and Members of the Committee,

My name is Daniel Chun Government Affairs Commissioner of the American Institute of Architects Hawaii State Council (AIA) **OPPOSING** Senate Bill 397 SD2. Current language requires the applicant to submit tax clearances for general contractor and subcontractors. In many cases the architect is the applicant; thus increasing our service burden to the state's benefit. Even worse the bill will delay construction and final building use. If you want more delays, this is just the bill to pass!

The current language does not state a reason for the bill, with Hawaii contractors' license renewals already subject to tax clearances. If the intent is to capture tax revenue owed but not now being collected, AIA suggests SB 397 SD2 be amended to capture use tax on "imported contracting" services: The bill title should still be constitutional because architect services are "contracting" under Hawaii tax law.

Exported contracting services sold by Hawaii architects already can be exempted from GET. In lobbying this small business tax relief about 20 years ago, it was AIA understanding that lost GET revenue would be balanced with use tax on imported contracting services:

Quoting from Hawaii Department of Taxation An introduction to the use tax Page 5 revised March 2018

"Question: I am a Hawaii homeowner. I hired an architect located outside Hawaii who is not licensed for GET, to draw plans to build an extension on my Hawaii home. The architect did not perform any work in Hawaii. Do I need to pay use tax?

Answer: Yes, the value of contracting imported into Hawaii is subject to use tax at rate of 4% (4.5% if subject to the county surcharge)."

It may be the case that non-payment of use tax extends unto big-box retailers and high-rise luxury condominium developers who bought design service from out-of-state unlicensed architects. Our local architect businesses holding GET licenses are disadvantaged with respect to unlicensed architects. From building owners not paying use tax on imported contracting services.

While the new county surcharges give counties incentive to enforce use tax compliance. the process could be made less burdensome:

1. Require the applicant to provide the GET license number under which tax on design service was paid. Similar to providing architect DCCA license number. Just one more number on a long list of contractor license numbers already required.
2. Use self-reporting honor system without penalizing over-worked county building department staff.
3. DOTAX can audit by focusing on the largest and tallest buildings in the state as these are constructed. You may find more non-compliance in higher profile buildings.
4. If counties are unable to assist in GET/Use Tax compliance, you might require one of the state agencies already having jurisdiction over building to be the enforcing agency.

Thank you for this opportunity to **OPPOSE** the current language of SB 397 SD2.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Requires Additional Tax Clearances for Contractors

BILL NUMBER: SB 397, SD-2

INTRODUCED BY: Senate Committee on Ways & Means

EXECUTIVE SUMMARY: Requires contractors and subcontractors to submit tax clearances as a condition of obtaining building permits for private developments exceeding a certain value. Requires contractors and subcontractors to submit additional tax clearances before final inspection of private developments exceeding a certain value. Contractors already need tax clearances to obtain and renew their licenses, and to bid or receive final payment on state or county government contracts. It is questionable whether these additional clearances are justified given the massive delays in the permitting process that already exist.

SYNOPSIS: Adds a new section to chapter 46 providing that no building license is to be granted for a private development valued at \$195,000 or greater unless tax clearances for state and federal tax are presented for the contractor and any subcontractors.

Provides that the director of taxation may waive the IRS tax clearance requirement if the director determines that it is the best interest of the State.

Any assignment of a contract for a private development valued at \$195,000 or greater shall require the assignee to present a bulk sales certificate if required, or tax clearance as above if a bulk sales certificate is not required, to the state or county contracting officer or agent.

Requires all state and county contracting officers or agents to withhold final inspection of a private development valued at \$195,000 or greater until the receipt of tax clearances from the director of taxation and the Internal Revenue Service on behalf of the building contractor and any subcontractors. The tax clearances shall be dated no earlier than forty-five days prior to the date of the request for final inspection of the private development.

Does not apply if the contractor is current under a payment plan with the taxing authority, or if the taxes are being contested in an administrative or judicial appeal.

An officer or employee of any governmental agency who intentionally or knowingly violates any provision under this section shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

EFFECTIVE DATE: July 1, 2050.

STAFF COMMENTS: In general, a tax clearance is issued when a taxpayer has filed all required returns and has paid all tax assessed on those returns.

Tax clearances are now required to obtain or renew a contractor's license under Hawaii Admin. Rules section 16-77-8(b)(2) and 16-77-55(b)(2). Contractor's licenses are renewed during each even-numbered year. Section 444-15, HRS.

One of the primary uses of a tax clearance is to allow persons to bid on, and receive final payment on, a contract with state or county government. HRS section 103D-328, however, provides for two exceptions: (1) if the taxpayer is in good standing on a payment plan with the tax agency; and (2) if the taxpayer is contesting the validity of a tax debt in an administrative or judicial appeal. This bill is consistent with those exceptions.

We are concerned that this bill may be overkill given that contractors are required to obtain tax clearances every two years anyway, and it may further burden a permitting and inspection process that is already fraught with delays. The Department might be able to turn around the applications quickly given that they are to be filed in electronic form, but the county inspecting and permitting agencies are still going to have to wait for the clearances and incorporate that verification step into their own processes.

Digested 3/12/2019

SB-397-SD-2

Submitted on: 3/11/2019 5:10:01 PM

Testimony for LAB on 3/14/2019 9:00:00 AM

Submitted By	Organization	Testifier Position	Present at Hearing
Karin Nomura	Individual	Support	No

Comments:

I support this bill as I believe this will assist in stolen identities of licensed contractors (or underhanded dealings), but also hope that regardless of price listed for a project that proper insurance for casualties (internal and externally) are also looked at, as the most costly issues are the ones that deal with "accidents"/"incidents" which aren't just part of those who are part of the project.