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RONA M. SUZUKI  
DIRECTOR OF TAXATION

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DEPUTY DIRECTOR

December 17, 2019

The Honorable Ronald D. Kouchi,  
President and Members of the Senate  
Thirtieth Legislature  
State of Hawaii  
State Capitol, Room 409  
Honolulu, Hawaii 96813

The Honorable Scott Saiki,  
Speaker and Members of the House  
of Representatives  
Thirtieth Legislature  
State of Hawaii  
State Capitol, Room 431  
Honolulu, Hawaii 96813

Dear President Kouchi, Speaker Saiki, and Members of the Legislature:

For your information and consideration, I am transmitting an electronic copy of the Fiscal Year 2019 Cash Economy Enforcement Act Report, as required by Act 134, Session Laws of Hawaii 2009. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the reports may be viewed electronically at [http://tax.hawaii.gov/stats/a5\\_1annual/](http://tax.hawaii.gov/stats/a5_1annual/).

Sincerely,

A handwritten signature in blue ink, appearing to read "Rona M. Suzuki".

RONA M. SUZUKI  
Director of Taxation

Enclosure

**DEPARTMENT OF TAXATION**  
**ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9**  
**For the period from July 1, 2018 through June 30, 2019**

Act 134, Session Laws of Hawaii 2009, also known as the "Cash Economy Enforcement Act" (hereinafter sometimes referred to as the "Act"), requires at Section 9 of the Act, that the Department of Taxation (Department) report the following information to the Legislature:

- I) The state resources committed to implementing the Cash Economy Enforcement Act; and
- II) The additional tax revenues raised as a result of the Act.

The Special Enforcement Section (SES) was established to enforce the Act. Its goal is to ensure that all sectors of Hawaii's economy, especially those that conduct a significant portion of business transactions in cash ("cash economy"), pay their fair share of taxes. In FY 2016, SES was given additional responsibilities for ensuring that short-term vacation rental operators comply with the state's transient accommodations tax laws.

**BACKGROUND**

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the "cash economy" by educating taxpayers about their tax obligations and by conducting civil tax investigations. The Act executes its mandate through the Special Enforcement Section, which is a specialized unit within the Department's Compliance Division comprised primarily of civil investigators.

The Department was authorized at Section 2 of the Act, codified as Section 231-83(b), Hawaii Revised Statutes (HRS), to utilize new hires, as well as existing labor resources to staff the SES operations. Furthermore, Section 2 of the Act authorized the Department to identify the proceeds of SES operations to substantially fund the unit. The SES is allowed to identify taxes collected from any taxpayer, assessment, investigation, or collection as a matter of the SES, which may then be deposited into the Tax Administration Special Fund, codified as HRS §231-85. Within the Tax Administration Special Fund's expenditure authority, the Department was initially allowed to retain the first \$500,000 to fund the Section's operations, with the remaining fiscal year collections being deposited into the General Fund.

Section 8 of the Act authorized establishing 6 new full-time equivalent (FTE) positions that may be filled by investigators, investigator assistants, licensed attorneys, or other support staff, in addition to using current personnel. In subsequent years, the legislature incrementally authorized the Department to retain additional funds and establish additional positions, currently up to \$2,000,000 and 13 FTE positions, to support SES's operations and help with enforcement of Transient Accommodations Tax laws, codified as HRS §235-20.5.

**ACTIVITIES AND ACCOMPLISHMENTS**

Since passage of the Cash Economy Enforcement Act, the Department has worked diligently

in expanding SES's operations and effectiveness and has been increasingly successful in identifying non-compliance, securing voluntarily filed tax returns, and collecting general excise (GET) and transient accommodation taxes (TAT).

SES's FY 2019 accomplishments include:

- Conducted 147 site visits and compliance survey campaigns at retail districts, shopping malls, industrial parks, farmers' markets, craft fairs, and single and multi-dwelling residential neighborhoods involving 1,561 retail, wholesale, and restaurant businesses and short-term rental establishments throughout the state. Educated business operators of Hawaii's GET and/or TAT laws. Issued written warnings for various compliance violations, and requests for inspection of books and records of non-compliant businesses. SES has found increased voluntary compliance following these campaigns.
- Reviewed 328 complaints and referrals provided by the public and other departments and utilized investigative and analytical methods to identify business operators showing indications of noncompliance with GET and/or TAT laws and evaluate for possible investigation.
- Using various investigative techniques, conducted tax investigations of varying complexities to identify income sources and determine the amount of income subject to taxation.
- Requested and secured voluntarily filed GET and/or TAT returns and tax payments. When a return could not be secured from the taxpayer, referred the matter and evidence of income subject to tax to Office Audit for assessment.
- Sent informational letters to over 200 transient accommodation operators advising them of registration and advertising requirements under Act 204, Session Laws of Hawaii 2015.
- Furthered projects on vacation rental/transient accommodation businesses utilizing publicly available and confidential database sources to develop leads on taxpayers who appear to be out of compliance with GET and TAT laws. These projects utilized new resources made available by the Tax System Modernization Program (TSM) to evaluate large amounts of data. As a result, significant numbers of leads have been and continue to be generated indicative of unreported and under-reported income subject to GET and TAT.

**I. STATE RESOURCES COMMITTED TO IMPLEMENTING THE CASH ECONOMY ENFORCEMENT ACT AND OTHER ACTIVITES**

In FY 2019, SES incurred the following expenditures to support its compliance activities:

<b><u>Category</u></b>	<b><u>FY 2019</u></b>
Personnel Costs	\$833,890
Other Expenses	<u>196,275</u>
Total Expenditures	\$1,030,165
No. of Staff	11

**II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT**

In FY 2019, SES continued to bring positive change by educating and bringing taxpayers into compliance and in collecting tax revenues. Each year since its establishment, SES has realized significant increases in tax collected from delinquent returns it secures. This was accomplished through increased levels of compliance campaigns and surveys, education, and compliance investigations.

SES measures its tax revenue accomplishments by determining the actual tax collections that were remitted by taxpayers on delinquent returns secured. In addition, as taxpayers brought into tax compliance by SES were largely non-filers, an estimate of SES's potential impact on tax revenues was asserted. This is because had SES not brought taxpayers into tax compliance, there is a strong likelihood that their non-compliance would have continued indefinitely. The potential impact tax revenues were based on tax collections remitted by taxpayers for a post compliance period of 18 months after they were brought into tax compliance. Delinquent return period tax collections and post compliance period collections aggregate to Impact Revenue. Accordingly, SES Total Impact Revenue grew to \$8,549,112 in FY 2019, as compared with \$7,973,436 in FY 2018, \$5,268,362 in FY 2017, and \$3,505,618 in FY 2016. The continued gains provided a return of more than \$8 in Impact Revenue for every dollar of SES's operational cost. The following is a summary of SES's FY 2019, performance measures:

	<u>FY 2019</u>	<u>FY 2018</u>
Number of Compliance Campaigns Conducted	147	46
Businesses Educated on Compliance of Tax Laws	1,561	2,359
Complaints Received and Reviewed	328	419
Number of Extensive Investigations Completed	481	229
General Tax <sup>1</sup> Revenue Collected from Delinquent Returns	\$3,213,657	\$2,791,847
TAT Revenue Collected from Delinquent Returns	<u>1,042,091</u>	<u>1,075,269</u>
Total Tax Collected from Delinquent Returns	\$4,255,748	\$3,867,116
General Tax Impact Revenue Collected	\$6,183,255	\$5,754,966
No. of Taxpayers Remitting General Tax Payments	1,165	1,004
Average General Tax Impact Revenue Collected per T/P	\$5,308	\$5,732
TAT Impact Revenue Collected	\$2,365,857	\$2,218,470
No. of Taxpayers Remitting TAT Payments	282	242
Average TAT Impact Revenue Collected per T/P	\$8,390	\$9,167
Total Impact Revenue Collected from Taxpayers	\$8,549,112	\$7,973,436

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<sup>1</sup> Includes all tax types (general excise, individual, estate, and corporate income taxes) except for transient accommodations tax. Also, includes general excise taxes associated with transient accommodation activities.