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STATE OF HAWAII
DEPARTMENT OF TAXATION
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ISAAC W. CHOY
DIRECTOR OF TAXATION

To: The Honorable Rosalyn H. Baker, Chair;
The Honorable Stanley Chang, Vice Chair;
and Members of the Senate Committee on Commerce and Consumer Protection

From: Isaac W. Choy, Director
Department of Taxation

Date: February 4, 2021
Time: 9:30 A.M.
Place: Via Video Conference, State Capitol

Re: S.B. 223, Relating to Contracting

The Department of Taxation (Department) offers the following comments regarding S.B. 223, for your consideration.

S.B. 223 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;
- 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;

- Authorizes the Department to require applications for tax clearances to be submitted through electronic means;
- 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;
- Appropriates an unspecified amount from the general funds to the counties for the enforcement of this bill; and
- Is effective on July 1, 2021.

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. The Department also 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.

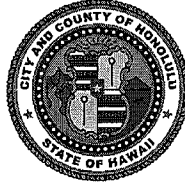
Finally, the Department appreciates the inclusion of the authority to mandate the electronic filing of the tax clearance application. Electronic filing of tax documents significantly reduces the administrative burden of processing paper documents.

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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EUGENE H. TAKAHASHI
DEPUTY DIRECTOR

February 4, 2021

The Honorable Rosalyn H. Baker, Chair
and Members of the Committee on
Commerce and Consumer Protection
Hawaii State Senate
Hawaii State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Baker and Committee Members:

**Subject: Senate Bill No. 223
Relating to Contracting**

The Department of Planning and Permitting (DPP) **opposes** Senate Bill No. 223, which would require contractors and subcontractors to submit tax clearances as a condition of obtaining building permits for private developments exceeding a certain value. This Bill also would require the "issuing officer," which in this case would be the DPP, to verify that tax clearances are valid, and that contractors and subcontractors are clear of taxes owed the State and Internal Revenue Service.

The DPP is often criticized for the time it takes to review and issue a building permit. The additional burden of verifying tax information will only add to our review time because we do not have the staff, equipment or expertise to perform such duties. A look at our records shows that from January 1, 2010 to December 31, 2020, the DPP received 20,632 building permit applications, or 171 a month, valued at \$195,000 or more. We are working hard to streamline our permit issuing process, but adding to our regulatory responsibilities will only work against us.

This Bill may unintentionally add to the cost and length of construction. 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 and verified?

Paragraph (a) of this Bill states that a building permit cannot be granted before the proposed tax documentation is submitted. However, Paragraph (c) says final inspections must be withheld until tax clearances are received, and no earlier than 45

The Honorable Rosalyn H. Baker, Chair
and Members of the Committee on
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days prior to the inspection. Because 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?

This Bill also would make it a criminal offense for “any officer or employee of any governmental agency who intentionally violates any provisions” in the Bill. A violator faces up to a year in prison, a \$1,000 fine, or both. We believe this punishment is extreme. The Bill does not state which employee will be responsible for verifying tax clearances. Does this mean every employee who reviewed an application would be liable?

We appreciate the intent of this Bill, which is to ensure that only licensed contractors who are in compliance with the tax laws are allowed to work in Hawaii. But the consequences of enforcing this Bill would lead to higher costs and longer delays in permit issuance than this Bill intended. For these reasons, we ask that this Bill be held in Committee.

Thank you for the opportunity to testify.

Very truly yours,



Dean Uchida
Director Designate

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Tax Clearance Requirements for Contractors

BILL NUMBER: SB 223

INTRODUCED BY: DELA CRUZ, KIDANI, Moriwaki, Shimabukuro, Wakai

EXECUTIVE SUMMARY: Requires contractors and subcontractors to submit tax clearances as a condition of: (1) obtaining building permits for private developments exceeding a certain value; (2) assigning a contract for private developments exceeding a certain value; and (3) obtaining final inspection of private developments exceeding a certain value. Authorizes the department of taxation to require that tax clearance applications be submitted electronically. Establishes penalties. Appropriates funds for grants-in-aid to the counties.

SYNOPSIS: Adds a new section to chapter 46, HRS, providing that no building license shall be granted for a private development valued at \$195,000 or greater, unless the applicant has presented to the issuing officer tax clearances from the director of taxation and the Internal Revenue Service on behalf of the building contractor and any subcontractors. The issuing officer shall verify that all contractors and subcontractors have filed all tax returns due, and that all taxes, interest, and penalties levied against the contractor and subcontractors or accrued under title 14 that are administered by the department of taxation and under the Internal Revenue Code have been paid. The director of taxation may waive the Internal Revenue Service tax clearance requirement if the director determines that it is in the best interest of the State.

Provides that any assignment of a contract for a private development valued at \$195,000 or greater shall require the assignee, as a condition precedent to the assignment, to first obtain a bulk sales certificate if required under section 237-43, and present the certificate, or tax clearance as provided under subsection (a) if a bulk sales certificate is not required, to the state or county contracting officer or agent.

Further provides that all state and county contracting officers or agents shall 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; provided that 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.

Provides exceptions if the contractor or subcontractor is in good standing under a payment plan, or is in the process of contesting, the underlying taxes.

Permits the department to require an electronic application for a tax clearance.

Provides for a misdemeanor penalty for a government employee who intentionally or knowingly violates any provision proposed under the bill.

Appropriates moneys to the various counties for enforcement.

EFFECTIVE DATE: July 1, 2021.

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. That does not necessarily mean that the returns are correct, but if the Department chooses to audit one or more of the returns and has issued a final assessment of tax, the assessment would need to be paid before the tax clearance is issued.

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 attempts to be consistent with those exceptions but the language used is different. We would recommend that the language be changed to conform to the existing standards in section 103D-328.

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.

We are also concerned about the requirement that a permitting agency verify that all subcontractors have tax clearances. It is easy to imagine a scenario where subcontractor A, while working on a project, becomes bankrupt (including some tax debts) and cannot finish the job, and is replaced with subcontractor B. In this fact pattern, final inspection of the project can never be allowed because it is not possible to obtain a tax clearance for subcontractor A. In that case the law would unfairly penalize the general contractor and/or the project owner.

Digested 1/30/2021

SAH - Subcontractors Association of Hawaii

1188 Bishop St., Ste. 1003**Honolulu, Hawaii 96813-2938

Phone: (808) 537-5619 ✦ Fax: (808) 533-2739

February 4, 2021

Testimony To: Senate Committee on Commerce and Consumer Protection
Senator Rosalyn H. Baker, Chair

Presented By: Tim Lyons, President

Subject: S.B. 223 – RELATING TO CONTRACTING.

Chair Baker and Members of the Committee:

I am Tim Lyons, President of the Subcontractors Association of Hawaii. The SAH represents the following nine separate and distinct contracting trade organizations.

HAWAII FLOORING ASSOCIATION

ROOFING CONTRACTORS ASSOCIATION OF HAWAII

HAWAII WALL AND CEILING INDUSTRIES ASSOCIATION

ELECTRICAL CONTRACTORS ASSOCIATION OF HAWAII

TILE CONTRACTORS PROMOTIONAL PROGRAM

PLUMBING AND MECHANICAL CONTRACTORS ASSOCIATION OF HAWAII

SHEETMETAL AND AIR CONDITIONING NATIONAL CONTRACTORS ASSOCIATION OF HAWAII

PAINTING AND DECORATING CONTRACTORS ASSOCIATION

PACIFIC INSULATION CONTRACTORS ASSOCIATION

Although we find that this bill has the positive aspect of being sure that contractors are in compliance with laws and regulations, particularly as it relates to their financial obligations, we also find that it is impractical because it has the requirement of obtaining a tax clearance from the federal government which is being placed in state law.

Recently we started getting complaints from a large number of subcontractors that they could not get paid on their jobs because they could not obtain their Hawaii Compliance Express Certificate of Compliance even though they were fully up to date and had satisfied all of their obligations.

This is because, apparently, the individuals in charge of that part of the operation for the Internal Revenue Service, reportedly due to "COVID", had been put on indefinite leave. As a result, people were not getting paid.

We think this could be equally harmful if private building developments were not able to obtain a building license because of the same reason.

As a suggestion however, the Committee may want to look at action taken similarly for liquor license clearances where the certificate from the Internal Revenue Service was deleted entirely.

We think if the Committee would entertain that change it would make for a much better bill.

Thank you.



LATE

**SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION
State Capitol
415 South Beretania Street
Via Videoconference
9:30 am**

February 4, 2021

RE: SB 223, RELATED TO CONTRACTING

Chair Baker, Vice-Chair Chang, and members of the committee:

My name is Beau Nobmann, 2021 President of the Building Industry Association of Hawaii (BIA-Hawaii). Chartered in 1955, the Building Industry Association of Hawaii is a professional trade organization affiliated with the National Association of Home Builders, representing the building industry and its associates. BIA-Hawaii takes a leadership role in unifying and promoting the interests of the industry to enhance the quality of life for the people of Hawaii. Our members build the communities we all call home.

BIA-Hawaii is in **strong opposition to SB 223**, which proposes to require contractors and subcontractors to submit tax clearances as a condition of obtaining building permits for private developments exceeding a certain amount. The bill also requires contractors and subcontractors to submit additional tax clearances before assignment of a contract for private developments exceeding a certain amount, and establishes penalties.

The bill provides no rationale on what specific problem it is attempting to address. The county building permit process, especially on Oahu, is already a time-consuming and inefficient process (See City Auditors Report No. 20-01, January 2020). Adding more requirements to this already dysfunctional process will add more time and uncertainty to the issuance of building permits on Oahu.

Additionally, without a clear understanding of the goal of this bill, it seems rather extreme to include language stating that officers and employees of government agencies can be fined or even imprisoned for violating this process. For simply overlooking the filing of a tax clearance, a government employee could be fined and/or go to jail. This seems extreme.

We are in strong opposition to SB 223, and appreciate the opportunity to express our views on this matter.