



TAX FACTS 99-3

General Excise and Use Tax Information for Construction Contractors

Construction contractors are subject to income tax, general excise tax (GET) and use tax. A contractor with employees is also subject to withholding and unemployment tax. This Tax Facts answers basic questions about how these taxes apply to construction contractors. The GET is a privilege tax imposed on business activity in the State of Hawaii. If you are engaging in business in Hawaii you are required to have a GET license.

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General Information

1 What licenses do I need to operate in Hawaii?

You need to register your business with the Department of Commerce and Consumer Affairs (DCCA) at cca.hawaii.gov/breg/ and obtain a contractor or specialty contractor license at cca.hawaii.gov/pvl/boards/contractor/. You will also need to obtain a GET license from the Department of Taxation (Department) at tax.hawaii.gov by submitting Form BB-1. If you have or will have employees you will need to obtain a withholding license from the Department as well as register with the Department of Labor and Industrial Relations (DLIR) for unemployment insurance at labor.hawaii.gov/ui. You may also need county permits or licenses. Please ask the county (Hawaii, Kauai, Maui, and Honolulu) where you plan to do business for its requirements.

2 Who is a contractor?

Under section 237-6, Hawaii Revised Statutes (HRS), a contractor is a person who erects, constructs, repairs, or improves buildings, highways, and other structures. It also includes those engaged in architecture, engineering, land surveying, landscape architecture, and pest control or fumigation.

“Other structures” means property that is on or attached to land or other real property and does not include ships. Service providers are not considered contractors.

3 I am a Hawaii retailer that sells cabinets, windows, hot water heaters, carpet, etc., but I hire another business to perform the actual installation. How do I report my gross income?

You are a contractor under section 237-6, HRS, because you provide installation services (by hiring a subcontractor) for the cabinets, windows, hot water heater, carpet, etc. that you sell. You should report the amount you receive from your customer under the contracting classification and may take a deduction for the amount you pay to the subcontractor who installs the cabinets, windows, hot water heater, carpet, etc. See question 10 for more information.

If you are a retailer that sells cabinets, windows, hot water heater, carpet, etc. and your customer is responsible for finding a contractor to install these items, you are not a contractor. You should report the income you receive under the retailing classification.

Who Must Pay

4 I am an out-of-state contractor, am I subject to GET on a construction project located in Hawaii?

Yes. The gross income from contracting is allocated to where the project is located. Therefore, an out-of-state contractor, who has no permanent office in Hawaii, is subject to GET on contracting income from a project located in Hawaii.

If you have been awarded a contract with the federal government for any construction project in Hawaii and you do not have a valid GET license on the date that the contract is awarded, you are required to file Form G-15, Information Return for Unlicensed

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Contractors on Federal Construction Projects, with the Department within 30 days from date the contract was awarded.

5 I am a Hawaii contractor, am I subject to GET on a construction project located outside of Hawaii?

No. Gross income from contracting pertaining to real property located outside the State is exempt from the GET under section 237-29.53, HRS. For example, income from architectural work done in Hawaii for a hotel being built in Guam is exempt. Complete Form G-61, Export Exemption Certificate, and retain it for your records. For more information see section 18-237-29.53-03, Hawaii Administrative Rules (HAR).

6 I have a project located in Hawaii and perform part of the work outside of Hawaii, am I subject to GET?

Yes. Since the gross income from contracting is allocated to where the project is located, the gross income from contracting work performed both in and out of Hawaii for a project located in Hawaii is subject to GET.

7 What is the GET rate on contracting income?

Gross income from contracting is subject to the GET at the rate of 4% (4.5% if subject to the county surcharge).

8 Is my contracting income subject to the county surcharge?

Income from contracting is allocated to the taxation district where the job site is located pursuant to section 18-237-8.6-03, HAR. If the job site is located in a county that adopted a county surcharge, the contracting income will be subject to 4.5% GET, which includes the 0.5% county surcharge.

Deductions

9 Can I deduct the cost of materials?

No. The cost of materials cannot be deducted from gross income subject to the GET.

10 Can I deduct payments to subcontractors?

Yes. Payments made by a contractor to subcontractors, including specialty contractors, may be deducted from gross contracting income subject to the GET if certain conditions are met. See section 237-13(3)(B), HRS.

First, both the contractor and the subcontractor must have GET licenses.

Second, the contractor claiming the deduction must report the name, Hawaii Tax I.D. Number, and the amount paid to each subcontractor on the contractor's accompanying Schedule GE.

Third, the subcontractor must be:

1. A contractor as defined in section 237-6, HRS; or
2. A specialty contractor, duly licensed by the DCCA under section 444-9, HRS; or
3. A specialty contractor who is not licensed by the DCCA under section 444-9, HRS, but who performs contracting activities exclusively on federal military installations in the State.

This deduction is commonly called the subcontract deduction. See Department of Taxation Announcement No. 99-25, "The General Excise Tax Subcontract Deduction" for more information.

Example 1: ABC Construction Company (ABC), a contractor with a GET License, is the prime contractor for the construction of a building. ABC subcontracts with DEF Company (DEF) to install the plumbing system. DEF is not licensed as a specialty contractor under Chapter 444, HRS. Although DEF is not licensed as a specialty contractor, DEF qualifies as a contractor under section 237-6, HRS. Therefore, ABC is allowed to take the subcontract deduction for payments made to DEF, provided that ABC properly reports the payment made to DEF on Schedule GE.

11 Who can claim a subcontract deduction?

A prime contractor and a subcontractor may claim a subcontract deduction if all the requirements in question 10 are met.

12 If I pay my subcontractors more than I receive for the total contract price, can I deduct everything I paid to my subcontractors?

No. For each project, your deductions cannot exceed your gross income.

Example 2: Charlie Construction Company has a contract to construct a building for \$500,000. Charlie Construction Company subcontracts the plumbing work to Drain, Inc. for \$150,000, the electrical work to Gray & Associates for \$200,000, and the roofing work to Steeple, Ltd. for \$200,000, for a total of \$550,000. Charlie Construction Company must report \$500,000 as contracting income. The maximum subcontract deduction that Charlie Construction Company may claim is \$500,000. Charlie Construction Company may not claim the \$50,000 of subcontractor payments that exceed its

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income from this project to offset its income from other contracting jobs.

13 Can I claim a subcontract deduction if I buy building materials, supplies, and other goods from a contractor?

No. Payments made for construction materials and supplies to a contractor who is acting as a seller of goods is not eligible for the subcontract deduction.

Example 3: ABC Supply House, a contractor, sells customized cabinets to Gravel Construction Company, a contractor who installs the cabinets for its own customers. ABC Supply House is acting as a seller of tangible personal property, not a contractor, and should therefore report its income under “retailing” or “wholesaling,” whichever is applicable. Gravel Construction Company should report its income under “contracting,” but may **not** claim the subcontract deduction for payments to ABC Supply House.

Example 4: ABC Supply House also sells and installs cabinets for OK Construction Company, a general contractor. Because ABC Supply House installs the cabinets, ABC Supply House should report its income from OK Construction Company under “contracting.” Additionally, OK Construction Company may claim the subcontract deduction for the amounts paid to ABC Supply House.

Materials and Services Rate

14 Are sales of construction materials and supplies to me considered wholesale transactions or retail transactions?

Sales of materials that are incorporated by you into the finished work and remain perceptible to the senses are considered wholesale transactions taxed at the rate of 0.5%. If you are making wholesale purchases, provide your supplier with the applicable resale certificate (Form G-17 or Form G-18). All other sales, such as sales of equipment, are retail transactions taxed at the rate of 4% (4.5% if subject to the county surcharge).

15 What types of services are taxable at the 0.5% rate?

Services rendered to contractors are sales at wholesale under section 237-4(a)(10), HRS, and taxed at the rate of 0.5%, if all the following are met:

- (1) The benefit of the services passes to the customer of the licensed contractor as an identifiable element of the contracting being sold to the customer;
- (2) The cost of the services is not overhead to the licensed contractor;
- (3) The gross income of the licensed contractor is not divided (does not qualify for income splitting) between the licensed contractor and another licensed seller or contractor;
- (4) The gross income of the licensed contractor is not subject to a deduction under the GET law; and
- (5) The resale of the contracting is subject to tax imposed under the GET law at the highest rate.

If you are purchasing services at wholesale, provide your service provider with Form G-82.

16 What types of services are taxable at the 4% rate (4.5% if subject to the county surcharge)?

Services rendered to the contractor that do not meet the requirements outlined in question 15 are subject to GET at the rate of 4% (4.5% if subject to the county surcharge).

Costs that are overhead to the licensed contractor also do not qualify for the 0.5% GET rate. Overhead means continuous or general costs occurring in the normal course of a business, including but not limited to costs for labor, rent, taxes, royalties, interest, discounts paid, insurance, lighting, heating, cooling, accounting, legal fees, equipment and facilities, telephone systems, depreciation and amortization. See section 237-1, HRS.

Exemptions

17 Is contracting work performed for the county, state or federal governments subject to GET?

Yes. Contracting activity with any government entity, including activity performed on government properties such as military bases, is subject to GET.

18 Are there any other GET exemptions specifically for contractors?

Yes. There is an exemption from GET for the planning, design, financing, construction, sale, or lease for low- and moderate-income housing projects in Hawaii.

To qualify for this exemption, the general contractor must complete Form G-37, General Excise Tax Exemption For Certified or Approved Housing Projects, for each contractor or supplier connected with the project, and submit the forms to the Hawaii Housing Finance and Development Corporation (HHFDC), or, if a county project, to the appropriate county housing authority for approval. A copy of the approved Forms G-37 must be filed with the tax assessor in the taxation district of the claimant.

Also, section 237-29.53, HRS, allows an exemption for contracting work exported out of Hawaii. See question 5.

19 Is the sale of goods and services to a contractor who qualifies for the certified housing project exemption subject to GET?

Yes. The sale of goods and services to a contractor who qualifies for this exemption is subject to the GET **unless** the general contractor has submitted an approved Form G-37 to the Department on behalf of the supplier or service provider.

20 How should I report my deductions on my GET return when I qualify for the certified housing project exemption?

Once you have your approved Form G-37 from the HHFDC (see question 18), report the exemption in column b of Form G-45/G-49 up to the approved amount.

Example 5: Champion Construction is a prime contractor with an approved Form G-37 on file with the Department for \$500,000 for a specific contract. Champion also submits Form G-37 to HHFDC on behalf of Subcontractor A and Subcontractor B. Subcontractor A (a structural engineer) receives a certified Form G-37 in the amount of \$100,000 and Subcontractor B (an environmental consultant) receives a certified Form G-37 in the amount of \$10,000 for the specific contract. Champion collects income of \$200,000 and pays Subcontractor A \$45,000 and Subcontractor B \$5,000. Champion should report gross income of \$200,000 in Part II, line 10, columns a and b of Form G-45/G-49. On Schedule GE, Champion may report \$155,000 ($\$150,000 + \$5,000 = \$155,000$) in Part I P210/100 and \$45,000 in Part I P210/148. Champion should also report \$45,000 in Part III with the required subcontractor's information. Although the environmental consultant (Subcontractor B) may not be a contractor as defined in section 237-6, HRS, because it has an approved G-37 and is involved in the planning, design, financing, construction, sale or lease of an approved housing project, it is eligible for the GET deduction up to the approved amount. Subcontractor A would report income of \$45,000 in Part II, line 10, columns a and b of Form G-45/G-49 and on Schedule GE Part I P210/100. Subcontractor B

would report income of \$5,000 in Part I, line 4, under the wholesale services classification, in columns a and b of Form G-45/G-49 and on Schedule GE Part I P14/100. Subcontractor B should also obtain a completed Form G-82 from the prime contractor and keep it for its records.

21 If my contracting income is exempt from the GET, may I also claim the subcontract deduction for this same project?

No. As stated in question 12, the subcontract deduction cannot be more than the total gross income that would be taxable were it not for this deduction. Since the income from this project is already exempt from the GET, you may not also claim the subcontract deduction.

Filing Your Returns

22 What tax returns must I file with the Department of Taxation?

The business must file a Hawaii income tax return to report the income and expenses for the year. In addition, the business must file periodic GET returns (Form G-45) and the annual return and reconciliation (Form G-49). See the specific form instructions for more information.

23 Should I report my income under "contracting" or "services including professional," on my GET returns?

Contractors, including those engaged in architecture, engineering, land surveying, landscape architecture, and pest control or fumigation, should report their income under "contracting." Certain taxpayers, such as architects and engineers, may be engaged in business as both contractors and service providers, depending on the work performed. An architect or engineer is a contractor when it manages or designs a construction project. In contrast, an architect or engineer is a service provider when it creates a feasibility study or provides consulting services unrelated to a specific construction job.

24 Is it possible for me to have more deductions than income to report on a periodic GET return?

Yes. It is possible to have more deductions than income to report on a periodic return. See question 25 for more information.

Example 6: Champion Construction files a monthly GET return on which it reports \$100,000 of gross contracting income. Because all of this income is from a low-income housing project for

which a certified Form G-37 has been submitted to the Department, Champion Construction can deduct all \$100,000. Champion Construction also has a \$10,000 bad debt from another contract to be deducted on this return. As a result, Champion Construction has \$100,000 in gross income, and \$110,000 of deductions to report.

25 How should I report my deductions on my GET returns when my deductions are greater than my income?

If your deductions exceed your income, you may NOT claim a refund on your periodic GET return (Form G-45) by reporting negative taxable income and calculating a credit. You will NOT receive a refund or credit because no tax has been paid for the period. When you file your periodic GET return, if your deductions are greater than your income for the period, report your allowable deductions up to your gross income and report any excess deductions on your next periodic GET return and any future periodic GET return until claimed in full.

When you file your annual GET return (Form G-49), report the full amount of your deductions. If your deductions exceed your gross income, resulting in a negative tax amount, the amount may be refunded. (**Note:** See questions 12 and 24 for exceptions.) You may not carry deduction amounts over into another tax year.

26 Do I need to use the accrual method of accounting for GET purposes if I am using the accrual method of accounting for income tax purposes?

No. Many contractors, particularly those whose contracts extend over several months or who maintain an inventory of construction materials, use the accrual method of accounting for income tax purposes. This requires the contractors to report their GET on the accrual basis. However, contractors can report their GET on a cash basis provided the contractors notify the Department of the basis upon which the GET is to be reported.

27 How is the income from bonded jobs reported?

When a construction project is bonded, payments are made to the bonding company rather than to the prime contractor for the project. The bonding company will pay the subcontractors, retain any amounts due to it, and pay the remainder to the prime contractor.

The bonding company is only considered a custodian of the funds and will only be taxed on its share of the income. The prime contractor must report as gross income the total contract amount, although it may claim any allowable deductions such as the

subcontract deduction. However, the amount the bonding company retains is NOT a subcontractor deduction; it is overhead of the prime contractor and not allowed as a deduction.

28 If a contractor gives a subcontractor the materials needed for a job and a check for the difference between the contract amount and the cost of the materials, what is the subcontractor's gross income?

Gross income includes the value of any goods and services received. Therefore, the subcontractor will be subject to the GET on the full contracted amount, and may not exclude the cost of the materials provided by the prime contractor.

Use Tax Information

29 When does the use tax apply and what are the rates?

The use tax is imposed on tangible personal property, services, or contracting imported for use in Hawaii and acquired from a seller located outside of the State who is not subject to the GET. The use tax is based on the landed value of the property, services, or contracting when they are brought into the State. The landed value is the value of the item at the time it arrives in Hawaii and includes the sales price of the item, shipping and handling fees, insurance costs, and customs duty fees.

The use tax is 0.5% on the value of goods, such as building materials, which a contractor will incorporate into a finished work or project in such a form that they remain perceptible to the senses.

The use tax is 4% (4.5% if subject to the county surcharge) on the value of goods, such as tools and equipment, which a contractor will use but not incorporate into a finished work or project.

If the imported services become identifiable elements of the finished work under the contract, the use tax is 0.5% of the value of the imported services.

In all other cases, the value of the imported services is subject to the use tax at the rate of 4% (4.5% if subject to the county surcharge).

30 If I import heavy equipment into Hawaii for use on a project, is it subject to the use tax?

The import of heavy equipment into Hawaii for temporary use on a project is not subject to the use tax. Temporary use means the property is located in and used in Hawaii for 365 days or less.

31 If I import used equipment I bought from a mainland contractor, for use in Hawaii, is it subject to the use tax?

No. You may claim an exemption or exclude or apportion the value of imported property, services, or contracting for use tax purposes when an exemption, exclusion, or apportionment of gross receipts would be allowed under the GET law in the case of a similar local transaction.

Example 7: A mainland contractor sells a backhoe, which was previously used in the mainland contractor's business, to a Hawaii contractor who imports the backhoe into and for use in Hawaii. The use tax will not apply to this transaction. The Hawaii contractor is exempt from the use tax upon importation of the backhoe because if the backhoe had been purchased from a Hawaii contractor, the sale would have been exempt from the GET as a casual sale under section 237-2, HRS.

Other Information

32 What are federal cost-plus contracts, and how are they taxed for GET purposes?

Federal cost-plus contracts are contracts in which the federal government agrees to reimburse the contractor for the cost of material, plant, or equipment used in the performance of the contract and pay the contractor an additional amount which either may be a fixed fee or a percentage.

Federal cost-plus contractors may exclude from gross income the amount reimbursed for costs incurred for material, plant, or equipment purchased from a seller with a GET license, provided that (1) the reimbursement does not exceed the gross proceeds of sale

and (2) the seller certifies to the Department that the seller agrees and elects to report the gross proceeds of the sale as a retail sale taxed at the rate of 4% (4.5% if subject to the county surcharge).

The certification requirement may be satisfied by a statement given to the contractor by the seller where the seller agrees and elects to report the sale at the 4% (4.5% if subject to the county surcharge) retail rate. The contractor should retain the seller's statement in the event that the contractor is audited.

33 Do I need to keep records?

Yes. Keep records of your income and expenses. If you have any employees, you must also keep employment records. Your records will help you to prepare your tax returns. Your records must be able to support what you report on your tax returns. Your deductions will be disallowed if your records are not sufficient to support your deductions.

34 Where can I find more information on GET and use tax?

The Department has published two brochures:

- "An Introduction to the General Excise Tax"
 - "An Introduction to the Use Tax"
- Also available are two Tax Facts:
- Tax Facts No. 95-1, "Use Tax"
 - Tax Facts No. 37-1, "General Excise Tax"

These publications are available on our website at tax.hawaii.gov.

Where to Get Forms and Information

Website: tax.hawaii.gov

Telephone: 808-587-4242

Toll-Free: 1-800-222-3229

Telephone for the hearing impaired: 808-587-1418

Toll-Free for the hearing impaired: 1-800-887-8974

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