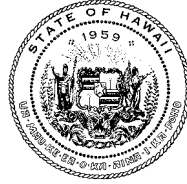


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TAX INFORMATION RELEASE NO. 2006-03

RE: Taxation of Income from Merchant Discount

This Tax Information Release ("TIR") modifies TIR 2005-2 with respect to merchant discount received by taxpayers taxable under chapter 241, Hawaii Revised Statutes ("HRS"), which imposes tax on banks and other financial institutions. In general, the merchant discount income received in connection with credit or charge card transactions is income from a core-banking function, taxable under chapter 241, HRS, and exempt from the general excise tax under section 237-24.8, HRS.

"Merchant discount" is defined in Hawaii Administrative Rules § 18-241-4-02 as "the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder".

HRS § 237-24.8(a)(1)(A) specifically exempts from general excise tax amounts received by a financial institution as "interest, discount, points, commitment fees, loan fees, loan origination charges and finance charges which are part of the computed annual percentage rate of interest and which are contracted and received for the use of money". Further HRS § 237-24.8(a)(1)(C) exempts amounts received by a financial institution from "fees or charges relating to the administration of deposits".

It is clear that the Hawaii Legislature intended to exempt core-banking activities from the general excise tax. Prior to 1992, banks were completely exempt from the general excise tax, no matter what activities they engaged in. This drew criticism from the second tax review commission in its 1989 report. Following that report, the Legislature considered the issue, and ultimately Act 106 (H.B. 3163) was passed in 1992. Act 106 repealed the blanket exemption from the general excise tax previously given to banks, and limited the exemption to banking activities. The legislative history indicates that the Legislature intended that the basic and central functions of a bank operating as such (i.e., core-banking functions) would continue to be exempt from the general excise tax. Within the banking industry, processing credit card transactions is considered to be a core-banking function.

The merchant discount business is a core-banking function and is thus the type of activity that the Legislature intended to exempt from the general excise tax for taxpayers taxable under chapter 241, HRS. Therefore, merchant discount received by a taxpayer taxable under chapter 241, HRS, is exempt from general excise tax under HRS § 237-24.8 as a discount described in HRS § 237-24.8(a)(1)(A) or a fee or charge relating to the administration of deposits described in HRS § 237-24.8(a)(1)(C).

The scope of this TIR is limited solely to the issue of the general excise tax treatment of merchant discount received by a taxpayer taxable under chapter 241, HRS. This TIR applies only to taxpayers taxable under chapter 241, HRS. This TIR applies to merchant discount income received on or after January 1, 2005.

TIR 2005-2 and TIR 2001-3 are hereby modified to the extent that they may be inconsistent with the above.

Forms and other tax information are available at the Department's website at www.state.hi.us/tax. On Oahu, forms may be ordered by calling the Department's Forms Request Line at: 808-587-7572. Persons who are not calling from Oahu may call: 1-800-222-7572 (toll-free) to receive forms by mail or by fax.



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