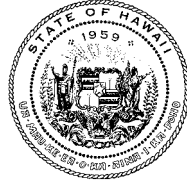


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TAX INFORMATION RELEASE NO. 2010-05

Re: Act 155, Session Laws of Hawaii 2010, Relating to General Excise Tax; The General Excise Tax Protection Act

On June 1, 2010, Governor Linda Lingle signed into law House Bill 2595 HD 1 SD 2 CD 1, which became law as Act 155, Session Laws of Hawaii 2010 (also referred to as the "GET Protection Act").

Act 155 amends Chapter 237, Hawaii Revised Statutes (HRS), by adding two new sections. The first new section statutorily denies certain general excise tax benefits to taxpayers that fail to comply with administrative procedures. The second new section creates trust fund liability, or personal liability, for certain amounts where a responsible person willfully fails to pay over those amounts to the government.

The purpose of this Tax Information Release is to provide guidance on the Department's interpretation of Act 155, in addition to providing examples and safe harbors for certain of its provisions.

DENIAL OF GENERAL EXCISE TAX BENEFITS

Section 2 of Act 155 creates a new obligation for all persons doing business in Hawaii with gross income or gross receipts as defined by HRS § 237-3, to comply with two administrative requirements. Failure to comply with the administrative requirements will result in the taxpayer's loss of any benefit available under the general excise tax law, including exemption from the law.

A. Administrative Requirements

In order to maintain entitlement to any general excise tax benefit, the person claiming the benefit must:

- 1) File for and obtain a general excise tax license, available on Form BB-1, *State of Hawaii Basic Business Application*; and
- 2) File an annual general excise tax reconciliation tax return on Form G-49, *Annual Return & Reconciliation of General Excise/Use Tax Return*, within 12 months from the due date for the return.

Taxpayers with gross income or gross receipts who are engaging in business within the meaning of Chapter 237, HRS, were always required to comply with both of these requirements. *See* HRS §§ 237-9, 237-33.

The GET Protection Act simply requires taxpayers to obtain a general excise tax license and file the annual reconciliation return. Failure to claim the general excise tax benefit on the annual return will not automatically preclude the taxpayer from claiming the general excise tax benefit on an amended return filed within the statute of limitations for assessment or refund, or from receiving the general excise tax benefit by adjustment upon audit.

B. General Excise Tax Benefits

A general excise tax benefit that could be jeopardized for failure to comply with the statutory administrative requirements of the GET Protection Act includes any of the following:

- 1) Exemption amount, including exemption from application of Chapter 237;
- 2) Exempt taxpayer or entity, including exemption from application of Chapter 237;
- 3) Any exclusion, including the exclusion for exporting tangible personal property, contracting, or services;
- 4) Reduction from the measure of general excise tax;
- 5) Deduction, including the subcontractor's deduction;
- 6) Tax credit, including an offsetting credit for taxes paid to another state;
- 7) Lower rate of tax, including the 0.15% rate for insurance producers or the 0.5% rate for certain manufacturing or wholesaling; or
- 8) Segregation or splitting of a gross income or gross receipts, including commission splitting or segregation involving agency relationships, reimbursements, or tourism activities.

Please note that the foregoing list is not exhaustive.

C. Reasonable Cause; Safe Harbor Protection

The GET Protection Act authorizes the Director of Taxation to waive the denial of general excise tax benefits in certain situations where the failure to obtain a general excise tax license or file an annual reconciliation return is due to reasonable cause and not willful neglect.

The following circumstances are deemed to have reasonable cause within the meaning of Act 155 and the Department will not utilize Act 155 to deny a general excise tax benefit in the following situations:

- 1) The provisions of the United States Constitution or laws of the United States prohibit the Department from imposing the tax;

- 2) The person is not “engaging” in “business” within the meaning of HRS § 237-2;
- 3) The amounts involved are not “gross income” or “gross proceeds of sale” as defined in HRS § 237-3(b);
- 4) The person is a Public Service Company and the gross income or gross proceeds are included in the measure of the tax imposed by Chapter 239, HRS;
- 5) Amounts received by persons exempt under HRS § 237-23(a)(3) through (6); provided that such person is exempt from filing federal Form 990, *Return of Organization Exempt from Income Tax*, or Form 990-EZ, *Short Form—Return of Organization Exempt from Income Tax*;
- 6) Amounts received that are exempt under HRS §§ 237-24(1) through (7) (with respect to certain insurance proceeds, gifts, bequests, compensatory tort damages, salaries or wages, and alimony);
- 7) Amounts received that are exempt under HRS § 237-24.8(a) (with respect to certain amounts not taxable for financial institutions);
- 8) Amounts received that are exempt under HRS § 237-29.7 (with respect to certain amounts not taxable for insurance companies);
- 9) Credit unions chartered under Chapter 412, HRS, and exempt from tax as provided in HRS § 412:10-122;
- 10) Any other amounts, persons, or transactions as determined by the Director to be made by subsequent Announcement or Tax Information Release.

The safe harbors set forth above are illustrated by the following examples:

EXAMPLE 1—ABC Corp. is headquartered and conducts primarily all of its business outside Hawaii. ABC Corp.’s business activity is the wholesaling of tangible personal property for resale at retail. ABC Corp. sells a small amount of tangible personal property in Hawaii and takes the position that it has no nexus with Hawaii. ABC Corp. therefore has not obtained a general excise tax license nor filed any general excise tax annual returns. The Department opens an audit of ABC Corp.’s nexus to determine whether ABC Corp. should have been filing Hawaii general excise tax returns. The Department determines that, because ABC Corp. was found to have a sales agent in Hawaii, ABC Corp. is responsible for the Hawaii general excise tax and should have obtained a general excise tax license and further should have filed general excise tax returns. ABC Corp. appeals the Department’s assessment, exhausting its appeals. Ultimately, it is determined that ABC Corp. has nexus with Hawaii for general excise tax purposes. Under Act 155, ABC Corp. will lose its general excise tax benefit of the lower 0.5% wholesale rate because it failed to obtain a general excise tax license and file a general excise tax annual return. ABC Corp. is not entitled to the safe harbor protection because Hawaii was not without the authority to assert the general excise tax against ABC Corp. based upon the United States Constitution’s Commerce Clause. *See Safe Harbor 1, above. [ABC Corp. would have maintained its general excise tax benefit (i.e., the lower 0.5% general excise tax rate for wholesaling, assuming ABC Corp. does in fact qualify for the lower 0.5% rate) if, prior to being audited, ABC Corp. would have obtained a general excise tax license and filed an annual general*

excise tax return claiming it had no nexus with Hawaii, even if the position was ultimately found to be in error.]

EXAMPLE 2—Assume the same facts as in Example 1, except that ABC Corp. is successful upon final appeal and is found not to have nexus with Hawaii and that Hawaii is without the power to tax ABC Corp. under the Commerce Clause. ABC Corp. falls within the safe harbor protection because Hawaii is without the power under the US Constitution to tax ABC Corp. *See Safe Harbor 1, above.*

EXAMPLE 3—Larry Landowner sold land that he owned in fee simple. Amounts received from the sale of land in fee simple are not considered “gross income” under the general excise tax. Larry Landowner will not lose his exemption from the sale of land in fee simple if he does not obtain a general excise tax license or file an annual general excise tax return because amounts received from the sale of land in fee simple is within the safe harbor protection for amounts not considered “gross income” under HRS § 237-3(b). *See Safe Harbor 3, above.*

EXAMPLE 4—John Doe is a salaried employee for Bonanza Corp. Salary and wages are exempt from general excise tax. John Doe will not lose his exemption for his salary if he does not obtain a general excise tax license or file an annual general excise tax return because employees who receive salary or wages are within the safe harbor protection for amounts received under HRS § 237-24(6). *See Safe Harbor 6, above.*

EXAMPLE 5—XYZ Organization, a nonprofit organization that provides social services to the low-income, holds a general excise tax exemption certificate from the Department. XYZ Organization’s gross receipts are less than \$15,000 per year, which are comprised of both donations and small fees charged for services that would be exempt under HRS § 237-23(a)(4). XYZ Organization is exempt from filing federal Forms 990 and 990-EZ because its gross receipts are less than the federal threshold amount (*i.e.*, normally \$25,000 or less in gross receipts per year). The Department will not utilize Act 155 to deny XYZ Organization its general excise tax exemption because XYZ Organization is within the safe harbor protection for certain organizations exempt from filing federal Forms 990 and 990-EZ. *See Safe Harbor 5, above.*

EXAMPLE 6—Assume the same facts as in Example 5, except that XYZ Organization’s \$15,000 in gross receipts per year is comprised of fees charged in furtherance of its exempt purpose that are exempt from general excise tax under HRS § 237-23(a)(4) and fundraising activities taxable under the general excise tax. Under this scenario, the Department will not utilize Act 155 to deny XYZ Organization its general excise tax exemption because XYZ Organization falls within the safe harbor protection for certain organizations exempt from filing federal Forms 990 and 990-EZ; however, upon audit, XYZ Organization will be required to obtain a general excise tax license and file general excise tax returns for the taxable receipts from fundraising activity. XYZ Organization’s tax exemption for the fees under HRS § 237-23(a)(4) will be preserved under the safe harbor protection. *See Safe Harbor 5, above. The safe harbor protection from Act 155 in this TIR does not relieve a taxpayer from general excise tax responsibility for taxable activities.*

EXAMPLE 7—Assume the same facts as in Example 5, except that XYZ Organization has gross receipts of \$100,000 per year and is required by federal law to file a federal 990 series form. Assume further that \$50,000 of XYZ Organization’s receipts constitute gifts and donations, \$30,000 of the receipts constitute fees charged in furtherance of its exempt purpose that are exempt from general excise tax under HRS § 237-23(a)(4), and \$20,000 is from taxable fundraising. Assume further that XYZ Organization has obtained a general excise tax license; however has failed to file an annual general excise tax return within the time required by Act 155. When audited, XYZ Organization will have the following adjustments due to the application of Act 155: (1) All of the \$50,000 constituting gifts or donations will continue to be exempt from general excise tax and will not have Act 155 utilized to deny the exemption for these amounts because gifts and donations are protected under a separate safe harbor. *See Safe Harbor 6 for amounts received as gifts.* (2) XYZ Organization is not entitled to the safe harbor protection for certain tax-exempt organizations under HRS § 237-23(a)(4) because its gross receipts require filing a federal 990 series form. XYZ Organization will lose the general excise tax exemption for the fees charged in furtherance of its tax exempt purpose that were otherwise tax exempt under HRS § 237-23(a)(4) by operation of Act 155. (3) XYZ Organization will owe any unpaid general excise tax for the fundraising because there is no general excise tax benefit for this amount. The conclusions in this example assume that XYZ Organization had no reasonable cause outside the safe harbors in this TIR.

EXAMPLE 8—Assume the same facts as in Example 7; however XYZ Organization demonstrated to the Director of Taxation that it had reasonable cause for failing to file its annual general excise tax return. Under these facts, XYZ Organization will be entitled to maintain the exempt character of its fees charged in furtherance of its tax exempt purpose that are exempt under HRS § 237-23(a)(4). The gifts always remained protected. XYZ Organization will owe any unpaid general excise tax for the fundraising.

TRUST FUND LIABILITY

Section 2 of Act 155 also creates liability for certain key individuals involved in the financial management of taxpayers.

A. Amounts Held in Trust

Under the new amendment, certain key individuals will be personally liable for unpaid general excise tax involving the following amounts:

- 1) Any amount separately stated as a tax. This amount includes any separately stated amount on a receipt, invoice, contract or other evidence of the business activity where the amount is designated as a tax; or
- 2) An imputed tax liability equal to the general excise tax owed on a transaction where the amount of tax is not separately stated. The imputed liability amount is the gross income multiplied by the proper tax rate. For example, assume ABC Corp. sold an automobile for \$20,000 cash with no tax separately stated. Under Act 155, the

amount of imputed tax subject to trust fund liability is \$800 of the \$20,000 received (*i.e.*, \$20,000 x 4% GET (assuming no county surcharge)).

The foregoing amounts are statutorily held in trust for the benefit of the State and for payment to the State as general excise tax liability. A key individual will be held personally liable for these amounts. Liability under Act 155 remains notwithstanding dissolution of the taxpayer's business.

B. Key Individuals

Persons subject to personal liability under Act 155 are the following persons typically involved in the financial management of taxpayers: any officer, member, manager, or other person having control or supervision over amounts of gross proceeds or gross income to be held in trust; as well as any person who is charged with the responsibility of filing or paying general excise taxes.

The liability of these key individuals is limited to the extent the person was in control or in a capacity of supervision, responsibility, or duty to act for the taxpayer.

C. Willful Failure

A person is personally liable under the GET Protection Act only where the Department proves that the person acted willfully. To prove that a person acted willfully, the Department must show that the person voluntarily and intentionally violated a known legal duty.

Act 155 authorizes the interpretation of trust fund liability to be construed in accordance with case law and regulations interpreting similar provisions of the Internal Revenue Code. The Department will utilize case law and regulations interpreting Sections 6672 and 7202 of the Internal Revenue Code (with respect to civil and criminal penalties for willful failure to pay over taxes held in trust) in construing the willful standard contained in Act 155.

D. Good Cause

The Director is authorized to relieve key individuals from liability for good cause. The burden of proof and persuasion to demonstrate good cause is upon the person seeking relief from liability.

E. Personal Liability is Prospective Only

Act 155 is effective on July 1, 2010. Personal liability under Act 155 for certain key individuals only applies to gross income or gross proceeds received by a taxpayer on or after that date. Personal liability is prospective only and does not extend to gross income or gross proceeds received prior to July 1, 2010.

EFFECTIVE DATE

Act 155 is effective on July 1, 2010, and applies to gross income or gross proceeds received on or after its effective date.

For more information, contact the Technical Section at 587-1577.

A handwritten signature in black ink, appearing to read "Stanley Shiraki". The signature is written in a cursive, flowing style.

STANLEY SHIRAKI
Acting Director of Taxation