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DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2017-07 (AMENDED)

Re: Public Service Company and Franchise Tax Requirements

This Tax Announcement amends and supersedes Announcement 2017-07, previously issued on July 31, 2017, describing the obligations of public service companies subject to the public service company (PSC) tax under chapter 239, Hawaii Revised Statutes (HRS) and banks or other financial corporations subject to the franchise tax under chapter 241, HRS. Taxpayers subject to the PSC and franchise tax should review the requirements outlined in this Tax Announcement and ensure their processes are satisfactory.

I. Chapters 239 and 241, HRS, in general.

Every public utility, as defined in section 239-2, HRS, is liable for the PSC tax imposed by chapter 239, HRS. The PSC tax is levied on the gross income of a public utility that is derived from its business. The PSC tax is in lieu of the general excise tax imposed by chapter 237, HRS.

Every bank or other financial corporation is liable for the tax under chapter 241, HRS, commonly referred to as the franchise tax. The franchise tax is in lieu of the income and general excise taxes imposed by chapters 235 and 237, HRS, respectively. The franchise tax is imposed on a taxpayer’s net income, as calculated under section 241-4, HRS.

II. Filing and payment requirements under chapters 239 and 241, HRS.

General rule

Returns and payments of PSC and franchise tax are due by the 20th day of the 4th month after the close of each taxable year. However, there are many special rules applicable to PSC and franchise tax that taxpayers must be aware of.

First and second years of business

Any taxpayer subject to PSC or franchise tax that is in its first or second year of doing business must file estimated returns and make estimated payments.

In its first year of business, the taxpayer must file an initial return by the 20th day of the 3rd month following the first month of business. The tax due with the initial return shall be based on an estimate of the gross income for the first year. The taxpayer must then file an amended return, based on the actual gross income for the first year, by the 20th day of the 4th month following the close of the first taxable year of business.

In the second year of business, another estimated return and estimated payment are due. The estimated return and payment are due by the 20th day of the 4th month following the close of the first taxable year of business and shall be based on an estimate of the gross income for the second year. The taxpayer must then file an amended return, based on the actual gross income for the second year, by the 20th day of the 4th month following the close of the second taxable year of business.

Taxpayers making estimated returns and payments in either their first or second years of business are required to pay at the time the return is due, in quarterly installments, or in monthly installments. The rules regarding payment due dates and frequencies for taxpayers' first and second years will be the same as those for taxpayers' third and subsequent years.

Third and subsequent years of business

Beginning in the third year of business, PSC and franchise tax returns and payments are not based on estimates, but rather, are based on the gross income for the previous year. Returns are due by the 20th day of the 4th month following the close of the previous taxable year. An amended return is generally not required. Payments are due by the 20th day of the 4th month following the close of the previous taxable year or based on the payment schedules described below. [1]

Taxpayers whose tax liability is $100,000 or less may elect to pay at the time the return is due or in four equal installments, each due on the 20th day of the 4th, 6th, 9th, and 12th months following the close of the previous taxable year. For calendar year taxpayers, these dates are April 20, June 20, September 20, and December 20.

If a taxpayer's tax liability exceeds $100,000 for the taxable year, the taxpayer must pay in 12 equal installments. These monthly installments are due on the 10th day of each successive month following the close of the previous taxable year. Taxpayers should note that first four monthly payments, each equal to one-twelfth (1/12) of the tax liability for the current year, will be due before the deadline to file the return. Taxpayers should therefore determine their tax

[1] Note, however, that different rules apply for taxpayers subject to the franchise tax in their final year of business. See HRS § 241-1(h).

liability for the current year (which is based on gross income for the previous year) as soon as possible after the close of the previous tax year to avoid interest and penalties for underpayment.

Notwithstanding the allowance of installment payments, if any quarterly or monthly installment is not paid by its due date, the Department has the authority to require immediate payment of the entire balance of the tax on ten days' notice. The authority to accelerate installment payments for noncompliance applies to the first, second, and all subsequent years of business.

III. Applicable penalties and interest

All applicable penalties and interest for PSC and franchise tax will be assessed by the Department, including:

- Late file penalty (HRS § 231-39(b)(1));
- Penalty for failure to pay due to negligence or fraud (HRS § 231-39(b)(2)(A),(B));
- Timely file late pay penalty (HRS § 231-39(b)(3));
- Electronic funds transfer (EFT) penalty (HRS § 231-9.9); and
- Interest (HRS § 231-39(b)(4)).

Penalties and interest on PSC and franchise tax are programmed into the Department's computer system and will be automatically assessed if triggered. Taxpayers should note that the amended returns due after the close of the first and second years of doing business, discussed above, are required returns with due dates. As such, these returns can generate late file and timely file late pay penalties of their own. For instance, if a taxpayer fails to file its amended return by the 20th day of the 4th month following the close of its initial year of business, a late file penalty will be automatically assessed.

Example 1:

A calendar year taxpayer subject to EFT who is not in its first two years of business files a return on April 21 and reports a $120,000 tax liability. The taxpayer failed to make any monthly installment payments. The taxpayer will be assessed a late file penalty of $2,000 (5% of the outstanding tax balance of $40,000), an EFT penalty of $800 (2% of the outstanding tax balance of $40,000), and interest on the $40,000.

Example 2:

A calendar year taxpayer subject to EFT who is not in its first two years of business makes payments of $9,000 each on January 10, February 10, March 10, and April 10. The taxpayer files a return on April 20 and reports a $120,000 tax liability. The taxpayer will be assessed an EFT penalty of $80 (2% of the outstanding tax balance of $4,000) and interest on the $4,000. If the taxpayer fails to pay the outstanding tax balance within 60 days from April 20, the taxpayer will also be subject to the timely file late pay penalty.

PSC and Franchise tax forms and instructions are available on the Department's website at tax.hawaii.gov. For additional information, please contact the Rules Office by phone at (808) 587-1530 or by email at tax.rules.office@hawaii.gov.

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