



Hawaii Tax News

Administering the tax laws for the State of Hawaii in a consistent, uniform, and fair manner

Volume 7, Number 2

State of Hawaii • Department of Taxation

SUMMER 2003

New Deputy Director

Marie Laderta was born in Hong Kong, but came to the U.S. at age 14 and graduated from Maryknoll High School. She returned to her roots in Hawaii where her grandfather was born. She went on to get her BA from Marquette and her law degree from the John Marshall Law School in Chicago.

Since then, Marie practiced law with firms in Chicago and Hawaii, ran her own import/export business, and most recently was the Supervising Deputy Attorney General of the Tort Litigation Division of the Department of the Attorney General.

We are very excited to have Marie help manage the Tax Department, as she is a proven manager (she won the Manager of the Year award at the Attorney General's Office last year). Because Marie also managed her own business, she will help in creating a more business-friendly and customer-friendly Tax Department.

Marie brings to the Department a wealth of legal and managerial experience as all of us, both in and outside of government, deal with the many challenges we face in the tax arena.

Tax Season E-filing

In just its third year, the number of Hawaii income tax returns electronically filed (e-filed) through the Joint Federal/State E-filing (JELF) program has increased dramatically over the previous year.

The total number of e-filed Hawaii returns for all of last year was just over 81,000. As of June 18, 2003, the Department had already received 111,775 e-filed returns!

This comes as welcome news to the Department which annually hires temporary workers and contracts with temporary service agencies to help process the 390,000 income tax returns and 160,000 general excise and other business tax returns filed between January and April.

Paper returns need to be picked up from the post office, removed from their envelopes, sorted, batched, numbered, data entered, and filed away. E-filed returns bypass all of that front-end manual processing and speed

on through.

It is a real win-win situation when people e-file their returns. We save on the cost of manually processing paper returns. E-filers save on the cost and hassle of mailing their returns AND generally get their refunds faster!

Another benefit for e-filers is that fewer errors are made on e-filed returns. Correcting even a small computation error will result in processing delays, but the software used to prepare e-filed returns asks a number of appropriate questions and automatically performs most computations.

Only Hawaii residents filing Form N-11 can e-file their returns through the JELF program, and only selected attachments are allowed. Next year, the Department hopes to make direct deposits and electronic payments available.

Summer Workshops

We hope that you will join us at the Department's Summer Workshop 2003. The tentative dates are:

Kauai – Tuesday, August 5, 2003

Maui – Tuesday, August 12, 2003

Hilo – Wednesday, August 20, 2003

Kona – Tuesday, August 26, 2003

Oahu – Monday, September 8, 2003

Besides meeting Director Kurt Kawafuchi and Deputy Director Marie Laderta, you will hear presentations on the 2003 legislation, Act 221 audit

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The Direct Line ☎

By Director Kurt Kawafuchi

My first legislative session as a fully involved participant has come to an end, and it definitely was quite an experience given all the economic uncertainty. The 300 or so tax-related bills introduced at the beginning of the 2003 legislative session were winnowed down to just a few at the end.

Included in this issue of the Hawaii Tax News is a summary of the tax-related bills passed by the 2003 Legislature.

We will be writing a number of announcements on new tax legislation as the various measures become law. You can stay abreast of all the latest announcements and other developments via our website at www.state.hi.us/tax. Posting information on our website is the most efficient method we have for making tax information available and keeping you informed. Checking our "What's New @ TAX" page from time-to-time is a really good idea.

Besides the "What's New @ TAX" page, we have tax forms, publications, monthly collection reports, contact phone numbers and e-mail addresses, and a wealth of other information.

So go ahead and bookmark www.state.hi.us/tax, and discover all that's available!

Summer Workshops

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program targeting high technology tax credits, and more!

The workshops will be held from 8:30 A.M. to 12:30 P.M., and four hours of continuing professional education (CPE) credits will be offered. Attendees also will get a CD with the tax statutes and administrative rules, updated through December 31, 2002, in their workshop packets.

For the latest information and registration form, visit our website at www.state.hi.us/tax, or call our External Training and Outreach program at 808-587-1786.

Review of Research Tax Credit Claims

The Department of Taxation has a new enforcement program aimed at taxpayers who have been overly aggressive in claiming tax credits for

research activities.

The potential abuses involve a law that was enacted in 1999, and expanded greatly in subsequent years.

As originally enacted, taxpayers could claim a credit of 2.5% on research expenditures in excess of what they had spent the year before, and the credit could only be used to offset a tax that would otherwise have to be paid.

Currently, taxpayers may claim a credit of 20% on the entire amount spent in the current year. Even if those taxpayers owe no Hawaii income tax, they can still obtain a refund equal to the credit. If, for example, a new technology company spent \$1 million on qualified research but has not yet turned a profit, it will not owe any income tax to Hawaii, but will nonetheless get a \$200,000 (20% of \$1 million) refund check from the State of Hawaii as a result of this law.

This law was intended to be generous, but certain taxpayers apparently are taking positions that go well beyond what was intended by the legislature. "Qualified research," for purposes of this credit, conforms to the federal definition in §41(d) of the Internal Revenue Code.

For example, qualified research must be for the purpose of discovering, through a process of experimentation, information that is technological in nature and that is intended to be useful in the development of a new or improved business component. Some taxpayers, however, have based their credit on amounts spent for routine items such as programming or debugging computer software that do not qualify.

Qualified research also must be conducted in the course of a taxpayer's trade or business, but there are reports of the credit being claimed by tax-exempt organizations that by their very nature generally do not engage in a trade or business activity.

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Research Tax Credit

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The research credit is an income tax credit, yet there are reports of the credit being claimed by a financial institution against its franchise tax.

Others have found ways to artificially inflate the numbers, and still others have engaged in related party transactions and claimed both this credit and the 100% investment credit that was the subject of Tax Information Release No. 2003-1, which provides information on the proper application of the law regarding the high technology business investment tax credit.

The Department will audit certain returns on which potentially abusive research credits have been claimed, and will disallow any claims that do not comply with both the spirit and letter of the law. Penalties will be assessed in appropriate cases.

The Department continues to support the development of high-technology businesses in Hawaii, but also must administer the tax laws to prevent abuses, which harm all of Hawaii's taxpayers.

Legislative Highlights

The following is a digest of bills passed by the 2003 Legislature. It includes only those measures which affect Hawaii's tax laws and is provided for your information. It is issued solely as a guide and is not intended to be either authoritative or complete.

Copies of the Senate and House bills passed by the Legislature may be obtained from the Senate and House printshops, or from the Legislature's website at www.capitol.hawaii.gov.

Administrative Tax Measures

ACT 77 (S.B. No. 1267, H.D. 2, C.D. 1)

Relating to Tobacco

Amends various provisions to enhance the Attorney General's ability to enforce the Master Settlement Agreement and cigarette tax stamp program.

Under one provision, the Department of the Attorney General will develop, maintain, and make available to the public a directory of certified tobacco product manufacturers and their certified brand families.

One related provision makes it a class C felony to knowingly affix a tax stamp to cigarette packages not listed in the directory, or to import, sell, offer, keep, store, acquire, transport, distribute, receive, or possess for sale or distribution cigarettes not listed in the directory.

Act 77 also allows the Attorney General to obtain a temporary or permanent injunction to prevent the sale, use, distribution, etc., of cigarettes manufactured by a manufacturer that knowingly fails to comply with various reporting requirements.

Effective May 20, 2003.

ACT 177 (S.B. No. 1279, S.D. 2, H.D. 2, C.D. 1)

Relating to Tobacco

Consolidates the tax stamp fees collected for the enforcement of the cigarette tax and tobacco tax law with the moneys received for enforcement of the tobacco Master Settlement Agreement. Also, further refines the laws relating to the Master Settlement Agreement.

Effective June 30, 2003.

ACT 179 (S.B. No. 1311, S.D. 1, H.D. 1)

Relating to Special Funds

As it relates to tax administration, repeals the exemption from administrative fees charged by the budget and finance director to administer the cigarette tax stamp enforcement special fund, the cigarette tax stamp administrative special fund, and the tobacco enforcement special fund. Makes an appropriation to the Department of Taxation for fees relating to the cigarette tax stamp administrative special fund.

Effective July 1, 2003.

ACT 173 (S.B. No. 1397, S.D. 1, H.D. 2)

Relating to Simplified Tax Administration

Establishes the Hawaii Simplified Sales and Use Tax Administration Act. Authorizes Hawaii to participate in multistate discussions relating to the Streamlined Sales Tax Project. Authorizes the Department of Taxation to enter into the streamlined sales and use tax agreement with one or more states to simplify and modernize sales and use tax administration.

Effective July 1, 2003, except that the provision relating to seller and third party liability shall take effect when the State becomes a member of the streamlined sales and use tax agreement.

ACT 136 (S.B. No. 1400, S.D. 1, H.D. 1)

Relating to Tax Administration

Allows the Department of Taxation (without the approval of the Governor) to accept offers in compromise involving tax liabilities of \$50,000 or less (exclusive of penalties and interest). Provides the Department of Taxation with authority to waive penalties and interest for delinquencies more than 90 days old. Allows the Director of Taxation to hire criminal investigators who will have privileges and authorities similar to police officers and deputy sheriffs.

Effective upon approval.

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Legislative Highlights

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General Excise/Use Tax Measures

ACT 135 (S.B. No. 1395, S.D. 1, H.D. 1, C.D. 1)

Relating to the Amendment or Repeal of Obsolete Tax Laws

Amends provisions relating to general excise taxes by defining retailing to include the sale of tangible personal property for consumption or use by the purchaser and not for resale, the renting of tangible personal property, and the rendering of services by one engaged in a service business or calling to a person who is not purchasing the services for resale, and repeals the provisions relating to tax on certain retailing.

Repeals the general excise tax exemption for agricultural, meat, or fish products grown, raised, or caught in Hawaii and provides the exemption to sales of agricultural, meat, or fish products to any person or common carrier in interstate or foreign commerce.

Repeals provisions relating to the county general excise tax and use tax surcharge and the county surcharge excise tax credit.

Repeals the general excise tax exemption of producers of motion picture or television films.

Effective upon approval.

Income Tax Measures

ACT 14 (S.B. No. 1396)

Relating to the Administration of Taxes

Rectifies an unintended result of Act 190, Session Laws of Hawaii 2002, by making the required annual income tax payment for all individual taxpayers 60% of current year liability or 100% of prior year liability.

Although Act 190 was intended to reduce the required annual payment percentages, it inadvertently resulted in the same or higher thresholds for certain taxpayers.

Effective April 16, 2003, and applies to taxable years beginning after December 31, 2002.

ACT 207 (S.B. No. 855, S.D. 1, H.D. 3, C.D. 1)

Relating to Energy

Provides a renewable energy technologies income tax credit for every renewable energy technology system installed and placed in service after June 30, 2003. Defines renewable energy technology system as a system that captures and converts a renewable source of energy, such as wind, heat (solar thermal), or light (photovoltaic) from the sun into (1) a usable source of thermal or mechanical energy, (2) electricity, or (3) fuel. Effective July 1, 2003, and shall be repealed January 1, 2008.

VETOED (S.B. No. 1088, S.D. 2, H.D. 2, C.D. 1)

Relating to Long-Term Care

Establishes a long-term care income tax. Provides that the tax shall go to the long-term care benefits fund. Provides that long-term care benefits paid shall be excluded from income tax. Provides a long-term care income tax credit to a taxpayer who has paid the long-term care income tax and has made premium payments for a long-term care insurance policy. Effective July 1, 2003, and shall apply to taxable years beginning after December 31, 2004.

ACT 172 (S.B. No. 1394, S.D. 2, H.D. 1)

Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code

Amends section 235-2.3(a), HRS, to conform the Hawaii Income Tax Law to the operative Internal Revenue Code (IRC) sections of subtitle A, chapter 1, amended as of December 31, 2002. Generally, subtitle A, chapter 1, refers to IRC sections 1 through 1400. For conformity purposes, the federal effective dates for amendments to operative IRC sections are adopted.

This bill conforms Hawaii's income tax law to the following changes in the IRC:

- Expansion of the exclusion from income for qualified foster care payments.
- Provisions to close a loophole used by shareholders of bankrupt S corporations and sanctioned by the Supreme Court.
- Limitation on the use of non-accrual experience method of accounting.
- Extension of the Archer MSA program through December 31, 2003.
- Clarified that for the catch-up contributions, the limit applies to all qualified retirement plans, tax-sheltered annuity plans, SEPs and SIMPLE plans maintained by the same employer on an aggregated basis, as if all plans were a single plan.
- The above the line deduction for expenses incurred by elementary and secondary school teachers for materials used by a teacher in the classroom under IRC section 62(a)(2).

Amends section 235-2.4, HRS, relating to operative IRC sections for which the State provides specific treatment by providing that Hawaii does not conform to IRC section 168(k) which concerns the "bonus" depreciation deduction. The bonus depreciation deduction is equal to 30% of the basis of a qualified asset. The "bonus" depreciation deduction includes an increased limit (from \$3,060 to \$7,660) for the luxury car depreciation deduction. This deduction is allowed for certain property acquired after September 10, 2001, and before September 11, 2004.

Amends section 235-7, HRS, to provide that Hawaii

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Legislative Highlights

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does not conform to the expansion of the net operating loss (NOL) carryback period from two to five years for NOLs in the 2001 or 2002 tax years. A Hawaii taxpayer with a NOL in a tax year ending 2001 or 2002, therefore, may carry back the NOL only two years for Hawaii income tax purposes.

Applies to taxable years beginning after December 31, 2002.

ACT 193 (H.B. No. 638, H.D. 1, S.D. 2, C.D. 1)

Relating to the Hawaii State Public Library System

Allows an individual whose state income tax refund for any taxable year is \$2 or more to designate \$2 of the refund to be paid over to the libraries special fund.

Applies to taxable years beginning after December 31, 2003.

VETOED (H.B. No. 1400, H.D. 1, S.D. 2, C.D. 2)

Relating to Hotel Construction and Remodeling Tax Credit

Provides that for costs incurred from the effective date (upon approval) to June 30, 2006, the hotel construction and remodeling tax credit will decrease to an 8% nonrefundable credit

Also, expands the definition of "qualified hotel facility" to include commercial buildings and facilities located within a qualified resort area.

For costs incurred from July 1, 2006, to June 30, 2010, the credit will be a 4% nonrefundable credit. Costs for the construction within a qualified resort area will still qualify for the credit.

The credit will be repealed on July 1, 2010.

Effective upon approval.

Miscellaneous Tax Measures

ACT 100 (S.B. No. 377, S.D. 1, H.D. 2, C.D. 1)

Relating to Taxation

Provides a new, nonrefundable attractions and educational facilities tax credit for certain expenditures related to the development of a world-class aquarium and marine science and mammal research facility at Ko Olina Resort and Marina on the Leeward Coast of Oahu or to the use of the Makaha Resort as a training and educational facility.

The credit equals 100% of the qualified costs incurred from June 1, 2003, through May 31, 2009; and may be claimed for taxable years beginning after December 31, 2004. The maximum credit is \$7.5 million in the aggregate for all qualifying taxpayers per year, and no more than \$75 million in the aggregate for all qualifying taxpayers for all years.

The credit may be used to offset the taxpayer's liability for income, general excise, transient accommodations, use,

public service company, franchise, and insurance premium taxes. The credit must be claimed on or before the 12th month following the close of the tax year, and any excess credit may be carried forward until exhausted. Effective May 29, 2003, and applies to costs incurred after May 31, 2003.

ACT 113 (S.B. No. 1040, S.D. 1, H.D. 1, C.D. 1)

Relating to Transient Accommodations Tax

Provides that transient accommodations tax revenues for the Hawaii Statewide Trail and Access Program be deposited into the Special Land and Development Fund from which expenditures for the trails and access program can be made.

Effective upon approval.

Announcements describing the provisions of the acts will be posted on the Department of Taxation website at www.state.hi.us/tax.

Recently Issued Tax Publications

The following is a list of the publications issued by the Department of Taxation from August 2002 through June 2003. Copies of these publications may be obtained from our website at www.state.hi.us/tax, by calling our request line at 587-7572 (toll-free at 1-800-222-7572), or from any district tax office.

TIR No. 2002-4 - Provides information on Act 98, SLH 2002, Relating to the Conformity of the State Tax Laws to the United States Constitution.

TIR No. 2003-1 - Provides information on the proper application of the law regarding the high technology business investment tax credit.

TIR No. 2003-2 - Provides information on the extension of deadlines and other tax relief for members of the armed forces, reserves, and Hawaii National Guard.

Announcement No. 2002-18 - Announces the adoption of amendments to chapters 18-243 and 18-251, HAR, and the repeal of chapter 18-244D, HAR.

Announcement No. 2002-19 - Provides additional information on Act 246, SLH 2002, which increases the excise tax on cigarettes.

Announcement No. 2002-20 - Provides information on the general excise tax exclusion for certain amounts collected under Act 176, SLH 2002, which implements a "bottle bill."

Announcement No. 2003-1 - Provides information on the new and revised high technology business investment tax credit forms.

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Recent Publications

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Announcement No. 2003-2 - A listing of new and obsolete tax forms, instructions, and schedules; errors found on Hawaii tax forms.

Announcement No. 2003-3 - Provides a list of candidates for political office who voluntarily filed affidavit forms with the campaign spending commission.

Announcement No. 2003-4 - Provides information on Act 14, SLH 2003, which provides corrective legislation to Hawaii's estimated tax underpayment penalty and clarifies the law regarding extensions to file tax returns.

Announcement No. 2003-5 - Provides information on Act 100, SLH 2003, which provides a nonrefundable attractions and educational facilities tax credit equal to 100% of certain costs incurred after May 31, 2003, and before June 1, 2009, for the development of such facilities at Ko Olina Resort and Marina and the Makaha Resort.

Announcement No. 2003-6 - Provides information on Act 136, SLH 2003, which changes tax administration by (1) authorizing the Department of Taxation to waive penalties and interest on tax liabilities that have been delinquent for more than 90 days, (2) streamlining the offers in compromise process by authorizing the tax director, instead of the Governor, to accept offers in compromise for tax liabilities that are \$50,000 or less (exclusive of penalties and interest), and (3) allowing the tax director to hire tax criminal investigators.

Announcement No. 2003-7 - Provides information on the increase in the cigarette tax to 6.5 cents per cigarette for sales, use, or possession of cigarettes after June 30, 2003.

Announcement No. 2003-8 - Announces the increase in the Maui County gasoline and diesel fuel tax rate from 13 cents to 18 cents per gallon, effective July 1, 2003.

Pending Tax Publications

The following is a list of some of the Department's pending tax publications.

Administration of Taxes

- Application of penalties and interest and the waiver of penalties and interest - sections 231-3 and 231-39,

HRS.

Income Tax Law

- Clarify the application of the Hawaii tax credit for increasing research activities.
- Clarify the application of the Act 221 high technology tax incentives.
- Clarify the application of the income tax to pension amounts rolled over to an Individual Retirement Account - section 235-7, HRS.

General Excise Tax Law

- Clarify the general excise tax rules, including the application of the general excise tax for reimbursements - section 237-20, HRS.

Transient Accommodations Tax

- Clarify the application of the transient accommodations tax rules.

Conveyance Tax Law

- Clarify the application of the conveyance tax rules.

Mailing of the Hawaii Tax News

The most recent issue of the Hawaii Tax News (HTN) is available at our website (www.state.hi.us/tax) under "What's New @ TAX". This allows you to read the HTN upon issuance rather than waiting for the HTN to be mailed to you. Prior issues are available at our website under "General Information, Brochures, & Publications".

We will discontinue our mass mailing of the HTN as a cost savings measure. The HTN will continue to be available at our website and will be mailed to you only upon your request. If you wish to continue receiving the HTN by mail, please provide us with your name, company, mailing address, day-time telephone number, fax number, and e-mail address. The requested information may be (1) mailed to the Technical Section, Department of Taxation, P.O. Box 259, Honolulu, Hawaii 96809-0259, (2) faxed to (808) 587-1584, or (3) e-mailed to Technical_Section@tax.state.hi.us.

Third Quarter State Tax Collections

January 2003 - March 2003

(In Millions of Dollars)

	<u>FY 2003</u>	<u>FY 2002</u>	<u>Difference</u>	
			<u>Amount</u>	<u>Percent</u>
Individual Income Tax	\$ 254.1	\$ 266.4	\$ -12.3	-4.6%
Corporate Income Tax	-25.4	18.7	-44.1	nm*
General Excise Tax	455.0	395.8	59.2	15.0%
Transient Accommodations Tax	44.0	35.9	8.1	22.6%
All Others	169.0	153.5	15.5	10.1%
Total Tax Collections	\$ 896.7	\$ 870.3	\$ 26.4	3.0%
General Fund Revenues	\$ 772.0	\$ 761.9	\$ 10.1	1.3%

(Note: Totals may not add up due to rounding.)

*nm = not meaningful

Total tax collections for the third quarter of fiscal year 2003 amounted to \$896.7 million, or 3.0% (\$26.4 million) more than the same period of last fiscal year. Although general fund revenues for the third quarter grew by 1.3%, or \$10.1 million, the economy was growing fairly strong, as indicated by several key tax components. As a general barometer of the economy, general excise tax collections showed a 15.0% growth. Transient accommodations tax collections increased by \$8.1 million. Taxes withheld from individual income taxes jumped by 6.5%, or \$17.1 million, consistent with the growth rate of 2.9% for the number of jobs.

Slower growth in tax revenues for the third quarter was caused by lower corporate and individual income tax collections as payment with returns and estimated tax payments declined \$59.5 million during the third quarter. Possible reasons explaining the decline include higher tax credits (high technology and residential construction and remodeling) claimed by individuals and corporations, lower paid-in requirements for individual income taxes, as well as a decrease in income from capital gains.

DISTRICT TAX OFFICES

Forms and Information may be obtained from any district tax office, Mondays through Fridays, except State holidays, from 7:45 A.M. to 4:30 P.M.

WEB INFORMATION AND FORMS

www.state.hi.us/tax

OAHU DISTRICT OFFICE

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Telephone:
For Tax Information:
808-587-6515 (January - April 20)
808-587-4242
1-800-222-3229 (Toll-Free)
808-587-1418 (TDD - For the hearing impaired)
1-800-887-8974 (TDD Toll-Free - For the hearing impaired)
Forms By Fax/Mail:
808-587-7572
1-800-222-7572 (Toll-Free)

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