



Hawaii Tax News

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

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State of Hawaii • Department of Taxation

WINTER 2003

Direct Deposit is Coming!

When you file your 2003 resident individual income tax return, Form N-11, you can have your State tax refund deposited directly into your bank account instead of waiting for a paper check! Direct deposit will be available for other forms in the future, but

DIRECT DEPOSIT

Simple. Safe. Secure.

for now will be another incentive to e-file the Form N-11. If you e-file your Form N-11

through the joint federal-state e-filing program, your refund will be even faster! E-filed returns bypass manual processing and speed on through. E-filing also results in fewer errors and is more convenient than filing a paper return.

Conformity to Federal Tax Changes

Just a reminder that federal tax changes are not applicable to Hawaii until such time as they are enacted by Hawaii. Federal provisions that were enacted in 2003 by the Jobs and Growth Tax Relief Reconciliation Act and the Military Family Tax Relief Act cannot be claimed on 2003 state tax returns until and unless such legislation is enacted.

If you use tax preparation software, by the way, check that it actually prepares state tax returns correctly, and that you are familiar with the particular quirks of that software.

For example, Hawaii did not adopt the 30% bonus depreciation and (at least not yet) the 50% bonus depreciation. Neither has Hawaii yet adopted the expanded \$100,000 IRC §179 expense. Does your software compute the correct amount of Hawaii depreciation? Is the correct basis being used in subsequent years? Does it correctly compute the Hawaii capital goods excise tax credit?

Notify vendors of any errors you find, and visit their websites periodically for any updates and fixes.

As the above example illustrates, it is particularly important to be aware of the federal provisions that were

NOT adopted by Hawaii.

A list of 2002 federal tax changes that are operative and not operative for Hawaii income tax purposes is included in our annual "Digest of Tax Measures" that is posted on our website at www.state.hi.us/tax under "Recent Legislation." The Department is currently working on the Digest of the 2003 Federal Tax Laws.

2004 Legislative Session

The 2003 legislative session is over and the 2004 session has not yet begun. That doesn't mean, however, that legislative activities are not continuing.

Work at all levels is ongoing. In addition to our annual Internal Revenue Code conformity bill, you can expect to see in 2004 a number of bills that did not pass in 2003, because the 2004 legislative session is the second year of the two-year legislative cycle.

For example, House Bill 851, H.D. 1, S.D. 1, which would repeal the requirement that assessed taxes be paid prior to a first appeal to either the district board of review or the tax appeal court, is such a carryover bill.

Also, the Senate Tourism Committee held an

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The Direct Line

By Director Kurt Kawafuchi

As we conclude another year, I wish to thank all of you for the assistance and support you've given me. I'm also looking forward to 2004 and a brand new filing season. Here are a few things that are new for 2004.

- *Direct deposit will be available to you if you file Form N-11 - no more waiting for a paper check! See the article on page 1.*
- *Our recently implemented One-Stop Taxpayer Services will go a long way towards making it easier for you to get information and assistance. Our beefed-up Taxpayer Services Branch on Oahu can now handle most calls; even routine billing and tax return adjustment questions and problems. More information on our One-Stop Service can be found on page 4.*
- *Tax-reducing rate changes that will be effective January 1, 2004, are discussed on page 4. Our staff has received a number of calls recently about the phased-in general excise tax deduction for certain business-to-business transactions. When the rate reduction began, I understand that some businesses didn't want to bother with it. Now that the effective rate will be 1.5%, more people are interested. To see what transactions qualify, go to our website at www.state.hi.us/tax. Select "Recent Legislation," scroll to the section on the 2000 Legislative Session, and then select "Outline: Act 71 . . ." and also "Chart of Examples: Act 71 . . ."*

Finally, I'd like to wish you and your families a safe and happy holiday season!

2004 Session

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informational hearing in October on House Bill 1554, H.D. 1, S.D. 2, which would allow the counties to impose a 1% retail sales tax on tangible personal property in exchange for their share of the transient accommodations tax.

The sales tax proposed in House Bill 1554, H.D. 1, S.D. 2, is a new tax and is different than the State's general excise tax. For information on the differences, see our publication, Tax Facts No. 96-1, General Excise vs. Sales Taxes.

Another carryover bill is Senate Bill 1621, H.D. 1, which would increase Hawaii's standard deduction for individuals who do not itemize their deductions.

The standard deduction is currently \$1,500 for single

individuals, \$1,650 for heads of households, \$1,900 for married couples filing joint returns, and \$950 for a married individual filing a separate return.

In recommending an increase to the standard deduction, the 2001-2003 Tax Review Commission noted that the deduction had not changed in 20 years and "is the major reason why the State unnecessarily continues to tax persons with income levels that qualify for public assistance."

Tax Facts No. 96-1 is available on 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. The Tax Review Commission report is available on our website at www.state.hi.us/tax/trc_rpt.html.

Keep up to date on the 2004 legislative session at www.capitol.hawaii.gov.

Changes to 2003 Tax Forms

Hawaii tax forms have been revised for 2003 to reflect recent tax law changes. The following list summarizes some of the changes to the tax forms, new forms for 2003, and forms which are now obsolete.

Extension Forms

- **Form N-100A**, Application for Additional Extension of Time to File Hawaii Return for a Partnership, Trust, or REMIC - Redesigned back to an 8-1/2 inch by 11 inch form and will no longer be processed as a payment voucher. The signature line is on the front of the form once again.

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Tax Form Changes

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- **Form N-101B**, Application for Additional Extension of Time to File Hawaii Individual Income Tax Return - Redesigned back to an 8-1/2 inch by 11 inch form and will no longer be processed as a payment voucher. The signature line is on the front of the form once again.
- **Form N-301**, Application for Automatic Extension of Time to File Hawaii Corporation Income Tax Return - The signature line was moved to the front of the form. The list of reasons for rejection of the extension is still printed on the back of the form.

Individual Income Tax Returns

- **Form N-11**, Individual Income Tax Return (Resident Filing Federal Return) - Direct deposit of the taxpayer's refund is available.
- **Form N-12**, Individual Income Tax Return (Resident Not Filing Federal Return) - (1) The line to report the Archer MSA deduction was deleted to conform to the federal form. Any Archer MSA deduction will be claimed in the Total Adjustments line to conform to the federal instructions. (2) A line was added for the above the line deduction for educator expenses. For Form N-11, the deduction for educator expenses will already be included in the line for the taxpayer's federal adjusted gross income.
- **Form N-13**, Individual Income Tax Return (Resident Short Form) - (1) The threshold amount for reporting interest income and ordinary dividends on Parts I and II of Form N-13 is increased from \$400 to \$1,500 to conform to the federal threshold amount. (2) A line was added on Form N-13 (and Schedule CR for other filers) for the renewable energy technologies income tax credit.
- **Form N-15**, Nonresident and Part-Year Resident Tax Return - Same changes as Form N-12.
- **All Individual Income Tax Returns** - Any amount for the underpayment of estimated tax penalty should not be included in the amount overpaid or balance due lines. If any taxes are due, include the amount of the penalty on Form N-200V. If there is an overpayment, the overpayment will be reduced automatically by the amount of the penalty.

Business Income Tax Returns

- **Form N-30**, Corporation Income Tax Return - In the signature area, a line was added for the officer who signs the tax return to print the officer's name.
- **Form N-35**, S Corporation Income Tax Return - Same changes as Form N-30.

- **Form N-40**, Fiduciary Income Tax Return - (1) A line was added for the renewable energy technologies income tax credit. (2) A line was added to report the tax withheld on Form N-4.

Tax Credit Forms

- **Form N-157A**, Information Statement Concerning Credit for Energy Conservation, was made obsolete. The tax credit information for members of pass-through entities must be provided on the appropriate Schedule K-1.
- **Form N-306**, Credit for Energy Conservation - Corporate, was made obsolete. The information from Form N-306 was incorporated into Form N-157 which will now be used by all taxpayers.
- **Form N-163A**, Information Statement Concerning Fuel Tax Credit for Commercial Fishers, was made obsolete. The tax credit information for members of pass-through entities must be provided on the appropriate Schedule K-1.
- **Form N-308**, Fuel Tax Credit for Commercial Fishers - Corporate, was made obsolete. The information from Form N-308 was incorporated into Form N-163 which will now be used by all taxpayers.
- **Form N-312A**, Information Statement Concerning the Capital Goods Excise Tax Credit, was made obsolete. The tax credit information for members of pass-through entities must be provided on the appropriate Schedule K-1. If the pass-through entity has to recapture the credit, the entity must report the credit recapture information on Form N-312, Part II.
- **Form N-316A**, Information Statement Concerning the Motion Picture and Film Production Income Tax Credit, was made obsolete. The tax credit information for members of pass-through entities must be provided on the appropriate Schedule K-1.
- **Form N-334**, Renewable Energy Technologies Income Tax Credit, and **Form N-334A**, Information Statement Concerning Renewable Energy Technologies Income Tax Credit - New forms used to claim the renewable energy technologies income tax credit.

Transient Accommodations Tax, Withholding, and Rental Motor Vehicle and Tour Vehicle Surcharge Tax Booklets

- All maintenance forms, such as the cancellation, change of address, and change to application forms, have been removed from the booklets. The maintenance forms in the general excise tax booklet are still available.

Order the 2003 Tax Information CD

The 2003 Tax Information CD will be available for a nominal price of \$10.00. The 2003 CD will include Tax Information Releases, Announcements, Tax Facts, brochures, 2003 tax forms, business registration forms, and employer's reporting forms. All forms will have writable fields.

Order forms are available on 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. Persons who attended our year-end workshop may purchase the 2003 CD at a discounted price of \$5.00.

One-Stop Service is Here!

Do you know which office to call when you have a tax question or problem that needs to be resolved? Recent changes at the Department make that an easy question to answer!

Just call our Taxpayer Services Branch on Oahu, toll-free from the neighbor islands and continental U.S., for one-stop customer service.

If you need basic information about a notice, bill, procedure, or tax, just call Taxpayer Services! In most cases, they can help. Taxpayer Services has been restructured, beefed-up with positions transferred to it from other areas, and given the authority to resolve many problems without referring you to another section.

With Taxpayer Services handling the more routine calls, specialists in other areas, such as audit and collections, are able to focus on the more serious or difficult needs of our customers.

For our neighbor island customers, your district tax offices will continue to provide the excellent one-stop service they have always provided to their walk-in clientele. However, most notices, bills, and other communications will have the Oahu Taxpayer Services telephone numbers on them.

When calling Taxpayer Services, you will have the option to hear recorded information about commonly requested questions, even after hours! Just press the message number and the pound (#) sign when prompted. During business hours, press zero (0) at any time to be connected to a live assistor. If something comes up that we think will generate a lot of calls, a new message can be added immediately!

To make it easier to get refund information, the

Department plans to implement an Interactive Voice Response system in early 2004 so that callers can get automated refund information 24 hours a day, 7 days a week.

One-stop customer service should be fully up to speed sometime next year. In the meantime, there are a number of new positions to fill and employees to train; your patience during this transitional period is greatly appreciated.

The telephone numbers for Taxpayer Services are listed on the last page of the newsletter.

Lower Tax Rates Effective January 1, 2004

A number of phased-in tax rate reductions will once again change on January 1, 2004.

- The phased-in general excise tax deduction factor for qualifying sublease transactions will increase from 0.75 to 0.875, for an effective rate of 0.5%. This is the last increase to the sublease deduction factor, which began in October 1998.
- The phased-in general excise tax deduction factor for business-to-business transactions that qualify for pyramiding relief under Act 71, SLH 1999, and Act 198, SLH 2000, will increase from 0.5 to 0.625, for an effective rate of 1.5%.
- The public service company tax rate on sales of telecommunications services by a public utility to an interstate telecommunications provider for resale is reduced from 4% to 3.5% for calendar year 2004.

Federal Legislation on Internet Taxes

The U.S. Congress is considering amendments to the Internet Tax Freedom Act (ITFA) that could have a significant impact on Hawaii.

The ITFA imposed a temporary moratorium (which expired on November 1, 2003) on: (1) the taxation of Internet access, unless the taxes were imposed and enforced prior to October 1, 1998, and (2) on the imposition of multiple or discriminatory taxes on e-commerce.

The grandfather clause regarding the taxation of Internet access was important for Hawaii, because

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Internet Taxes

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Internet access is subject to our general excise tax (GET) just like any other service.

The House-passed version, H.R. 49 (the Senate is considering a similar measure, S. 150), makes the moratorium permanent, removes the grandfather clause, and more significantly broadens the definition of "Internet access service," with the potential effect of allowing a broad spectrum of telecommunications services utilizing the Internet to escape taxation.

Under the ITFA, telecommunications services are not Internet access services and can be taxed. Under H.R. 49 and S. 150, telecommunications services are not Internet access services UNLESS "used to provide Internet access."

If telecommunications companies continue to convert their traditional telephone systems to Internet-based systems, and if services to provide access to the Internet for the purpose of voice transmission are considered services to provide Internet access, then Hawaii's public service company and GET tax base would erode considerably, resulting in an estimated \$40 million to \$70 million reduction in tax collections.

The Department is keeping a close eye on this federal legislation, and we will inform the business community, particularly those firms involved in telecommunications, of the progress of this bill as it moves through Congress.

Proposed Administrative Rules

The Director of Taxation will hold a public hearing on December 29, 2003, 9:30 a.m., at the Princess Ruth Keelikolani Building, Room 314, to allow the public to comment on the proposed adoption of the following administrative rules:

Proposed amendments to sections 18-247-1 through -12, Hawaii Administrative Rules, relating to the conveyance tax. The proposed amendments clarify and update provisions in accordance with statutory changes and Department positions relating to: (1) The imposition of the tax (that a conveyance or transfer of realty is subject to the conveyance tax unless exempt by statute; that the tax is payable on the actual and full consideration paid or ultimately required to be paid; it is immaterial that a conveyance or transfer will result in a capital gain or loss; and that the conveyance tax is not applicable to an option contract or a right of first refusal agreement when they are a prelude to a conveyance of realty). (2) Definitions ("actual and full consideration," "authorized representative,"

"purchaser," and "seller"). (3) Basis and rate of tax (reflecting current statutory tax rates; clarifying the conveyances and transfers that are subject to the tax; describing application of the tax to sales of time share units; and updating appendices with respect to rate tables, extensions or amendments to leases, and Inwood factor). (4) The scope of certain statutory exemptions to the tax.

Proposed amendments to section 18-237D-1-01 to -15-01, Hawaii Administrative Rules, relating to the transient accommodations tax. The proposed amendments clarify and update provisions in accordance with statutory changes and Department positions relating to: (1) The application of the tax to transient accommodation rentals and long-term rental agreements; (2) Update the tax rate to 7.25%; (3) The definition of "occupant"; (4) The application of the tax with respect to rentals due to natural disasters; (5) The scope of exemptions with respect to military personnel, students, diplomats, and non-military officers and federal and state government employees; and (6) The application of the tax as well as other requirements to time share plan managers.

Proposed amendments to section 18-235-98, Hawaii Administrative Rules, relating to extensions of time for filing tax returns. The main purpose of the amendment is to provide that the 4-month automatic extension of time for filing an income tax return for individuals and the 3-month automatic extension for partnerships (or entities treated as partnerships for tax purposes), estates, trusts, or real estate mortgage investment conduits will not require any form (or application) to be filed with the Department. Extensions for corporations are not affected by these amendments. In particular the amendment: (1) Provides that automatic extensions will be granted if the taxpayer files the tax return within the extension period accompanied by payment of the balance due; (2) Repeals the 0.5% penalty for failure to pay after timely filing an income tax return for a taxpayer who obtains an automatic extension; (3) Clarifies that if a taxpayer obtains an automatic extension, but then fails to pay in full when the return is filed within the extension period, the extension will be invalidated and penalties and interest will be calculated from the original due date; and (4) Provides that taxpayers who seek a second extension of time to file must provide the Department with "reasonable cause" for additional time to file the return and also make payment of 90% (rather than 100% required under the current rules) of the estimated tax liability at the time of application.

A copy of the proposed rules may be obtained from any district tax office. For more information, or to request a copy of the proposed rules, call the Department of Taxation, Director's Office, at 587-1540.

Abusive Tax Avoidance Transactions

Director Kurt Kawafuchi has signed a Memorandum of Understanding (MOU) with the Internal Revenue Service (IRS) in which the IRS will share information on abusive tax avoidance transactions and taxpayers who participate in them with Hawaii and other states that have signed the MOU.

These schemes hurt all of us in Hawaii, and this new partnership will help ensure that the participants pay their fair share of taxes.

Of course, it is our hope that this program, and the resulting publicity, will make some participants think twice before they enter into an abusive tax avoidance transaction.

New E-mail Addresses

Beginning January 2004, the entire Department will be switching from the GroupWise e-mail system to LotusNotes, and our addresses will be changing. For example, the general e-mail address for the Director's Office will change to Tax.Directors.Office@hawaii.gov, and the Taxpayer Services information e-mail address will change to Taxpayer.Services@hawaii.gov.

E-mail sent to the old e-mail addresses will be automatically forwarded to the new addresses for several months at least. A more complete listing will be provided in our publication, "Hawaii Tax Information at a Glance," when it is revised in 2004.

Recently Issued Tax Publications

The following is a list of the publications issued by the Department of Taxation from January 2003 through December 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. 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. 2003-1 - Provides information on the new and revised high technology business investment tax credit forms.

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.

Announcement No. 2003-9 - Provides information on Act 135, SLH 2003, which amends or repeals obsolete tax laws.

Announcement No. 2003-10 - Provides information on Act 172, SLH 2003, which brings Hawaii Income Tax Law into conformity with many but not all of the changes made to the Internal Revenue Code as of December 31, 2002.

Announcement No. 2003-11 - Provides information on Act 173, SLH 2003, which authorizes Hawaii's

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Recent Publications

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participation in multistate discussions relating to the Streamlined Sales Tax Project which is a nationwide effort being undertaken among the various states.

Announcement No. 2003-12 - Announces the adoption of the IRS optional standard mileage rates for 2004.

Digest of Tax Measures - Enacted by the State of Hawaii, Twenty-Second Legislature, Regular Session of 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.
- Clarify the offers in compromise process.

Income Tax Law

- Clarify the application of the Hawaii tax credit for increasing research activities.

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.

Conveyance Tax Law

- Clarify the application of the conveyance tax.
-

First Quarter State Tax Collections

July 2003 - September 2003

(In Millions of Dollars)

	FY 2004	FY 2003	Difference	
			Amount	Percent
Individual Income Tax	\$ 274.4	\$ 266.3	\$ 8.0	3.0%
Corporate Income Tax	8.2	4.3	3.9	91.1%
General Excise Tax	473.3	473.2	0.0	0.0%
Transient Accommodations Tax	46.8	48.2	-1.4	-2.9%
All Others	178.8	174.2	4.6	2.7%
Total Tax Collections	\$ 981.4	\$ 966.2	\$ 15.2	1.6%
General Fund Revenues	\$ 819.2	\$ 820.3	\$ -1.1	-0.1%

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

Total tax collections for the first quarter of fiscal year 2004 amounted to \$981.4 million, or \$15.2 million (1.6%) more than the same period of last fiscal year. Tax collections for the first quarter grew for corporate and individual income taxes to \$8.2 million and \$274.4 million, respectively. First quarter general excise tax collections remained almost unchanged at \$473.3 million, while transient accommodations taxes dropped slightly by \$1.4 million to \$46.8 million. General fund revenues of \$819.2 million for the first quarter represent a \$1.1 million decrease over last year's total of \$820.3 million.

Even though the economy was improving, the month of July 2003 saw a \$56.9 million drop in collections because of technical factors including the weekend effect where taxes due on June 30, 2002 (Sunday) were payable on July 1, 2002 (Monday), boosting the July 2002 collections. As the economic growth accelerated, increased collections for August and September 2003 raised the cumulative total for the first quarter of the current fiscal year to offset this big drop in July 2003.

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Fax: 808-587-1488

Telephone:

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)