



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

SUMMER 2005

E-file Update

Many thanks to all of you who helped us increase the number of Hawaii income tax returns e-filed this filing season. Almost 153,000 N-11 income tax returns had been e-filed as of the end of April through the Joint Federal/State e-filing program (as compared to 131,336 returns e-filed last year). In addition, 3,135 resident short forms, N-13, had been e-filed via the Internet through the State's Internal portal at www.ehawaii.gov.org/efile (as compared to 1,912 returns e-filed last year). Great job!

Summer Workshops

The Department's summer workshops are scheduled for the following dates:

- Kauai – Friday, August 5, 2005
- Oahu – Monday, August 8, 2005
- Kona – Wednesday, August 10, 2005
- Hilo – Thursday, August 11, 2005
- Maui – Wednesday, August 17, 2005

All workshops will begin at 8:30 A.M. and end at 12:30 P.M. The \$60 registration fee includes a continental breakfast and workshop materials. As always, four hours of continuing professional education (CPE) credits will be provided to those who stay for the entire workshop.

Register early, as space is limited and an additional \$5 will be charged for persons registering less than 2 weeks prior to the workshop registered for.

An information and registration flyer should be available on our website at www.state.hi.us/tax in July, but also can be requested by calling our 24-hour forms request line at 587-7572, or toll-free at 1-800-222-7572.

Legislative Highlights

The following is a digest of bills passed by the 2005 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 167 (S.B. No. 460, H.D. 1)

Relating to Tax Refunds

Allows taxpayers to appeal a denial of a tax refund claim by filing a written notice of appeal to the board of review or to the tax appeal court within 30 days after notice of the denial of the claim. Further allows taxpayers to file an appeal of a refund claim when the Department of Taxation fails to act on the claim within 180 days after the claim was filed.

Applies to tax refund claims filed after June 30, 2005.

ACT 27 (S.B. No. 840, S.D. 1)

Relating to Income Tax Withholding

Clarifies the State withholding tax provisions for employers with State withholding tax liabilities exceeding \$40,000 annually. Also conforms State law to federal withholding provisions by defining a "semi-weekly schedule" similar to the federal provisions and to incorporate the federal three-day banking rule.

Effective April 25, 2005.

S.B. No. 1685, S.D. 2, H.D. 1, C.D. 1

Relating to Tax

Allows the State to share taxpayer information with the counties.

Effective upon approval.

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The Direct Line

By Director Kurt Kawafuchi

The 2005 Legislative session has come to an end. This year, we focused on increasing the standard deduction; offering a food, medical services, and non-prescription drugs tax credit for the low and modest income taxpayers; and providing tax incentives to employers and employees to purchase long-term care insurance. Unfortunately, these proposals were not passed by the Legislature. We will continue our lobbying effort to assist the lower end of the wage earners in the future.

A summary of the tax-related bills passed by the 2005 Legislature is included in this issue of the Hawaii Tax News.

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.

Legislative Highlights

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General Excise/Use Tax Measures

H.B. No. 1224, S.D. 1, C.D. 1

Relating to Taxation

Establishes requirements, procedures, standards, and guidelines for compliance with the Streamlined Sales and Use Tax Agreement project. Allows contractors contracted by the Legislative Auditor to support the project to inspect tax returns and other information for the purposes of conforming the State's general excise and use taxes to the Model Agreement and Act. Appropriates \$50,000 to be expended by the Legislative Auditor.

Effective upon approval, provided that the appropriation section takes effect on July 1, 2005.

H.B. No. 1309, H.D. 2, S.D. 2, C.D. 1

Relating to Taxation

Allows counties the option of adding a surcharge of up to 0.5 percent to the State's 4 percent general excise tax to be levied not earlier than January 1, 2007 to fund public transportation systems in their respective counties. The Department of Taxation shall levy, assess, collect, and administer the county surcharge on state tax.

Effective upon approval, provided that the counties adopt an ordinance to levy the county surcharge by December 31, 2005.

S.B. No. 179, S.D. 3, H.D. 2, C.D. 1

Relating to Housing

First, establishes a general excise tax exemption for developers of certified housing projects when: (1) at least 50 percent of the available units are for households with incomes at or below 80 percent of the area median family income; and (2) at least 20 percent of the available units are for households with incomes at or below 60 percent of the area median family income.

Second, increases the low-income housing tax credit from 30 to 50 percent of the applicable percentage of the qualified basis of each building located in Hawaii.

Third, provides a conveyance tax exemption for the conveyance of real property to any nonprofit or for-profit organization that has been certified by the Housing and Community Development Corporation of Hawaii for low-income housing development.

Effective July 1, 2005.

Income Tax Measures

H.B. No. 1554, H.D. 2, S.D. 2, C.D. 1

Relating to Leasehold Conversion

Allows a fee owner of residential leasehold property to exclude, from the fee owner's taxable income, 50 percent of the proceeds the fee owner receives from the sale, provided that the exclusion does not exceed \$75,000 in the aggregate for all taxpayers in the State in any tax year.

Applies to taxable years beginning after December 31, 2005, and ending prior to January 1, 2007.

ACT 116 (S.B. No. 116, S.D. 2, H.D. 2, C.D. 1)

Relating to Nurses

Establishes a nursing scholars program and exempts

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scholarship grants received by a student under the program from taxable income.

Effective July 1, 2005.

ACT 60 (S.B. No. 834, 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, 2004. 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:

- Uniform definition of a qualifying child.
- New state and local general sales tax deduction.
- Extension of the deduction for certain expenses of educators.
- New deduction for costs involving discrimination suits.

- Contributions for relief of tsunami victims.

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:

- Extension of the bonus depreciation provisions of IRC section 168(k) for certain property acquired after September 10, 2001, and before January 1, 2005 (including the extension of the qualifying aircraft placed in service before January 1, 2006).
- Extension of the increased IRC section 179 limits relating to the maximum deduction amount and qualifying investment amount for taxable years beginning after 2002 and before 2008.

Applies to taxable years beginning after December 31, 2004, except as otherwise provided.

ACT 23 (S.B. No. 842, S.D. 1)

Relating to Withholding of Tax on the Disposition of Real Property by Nonresident Persons

Clarifies that where a limited liability company (LLC) formed or registered to do business in Hawaii consists of a single member and the LLC has not elected to be taxed as a corporation, the LLC shall be disregarded for purposes of section 235-68, HRS, and section 235-68, HRS, shall be applied as if the sole member is the transferor.

Applies to taxable years beginning after December 31, 2004.

Miscellaneous Tax Measures

ACT 67 (H.B. No. 390, H.D. 1, S.D. 2, C.D. 1)

Relating to Rental Motor Vehicle Surcharge Tax

Permanently exempts lessors who lease vehicles to lessees whose own vehicles are under repair from the rental motor vehicle surcharge tax.

Effective May 23, 2005.

ACT 58 (H.B. No. 631, H.D. 1, S.D. 2, C.D. 1)

Relating to the Employees' Retirement System

Clarifies and corrects the Employees' Retirement System (ERS) statutes and conforms ERS statutes to current practices. Among other things, requires the ERS to comply with federal income tax limits on compensation in determining ordinary death benefits.

Effective July 1, 2005, provided that the federal limits on annual compensation for ordinary death benefits takes effect retroactively to July 1, 1996.

ACT 156 (H.B. No. 1308, H.D. 1, S.D. 2, C.D. 1)

Relating to Land Conservation

Increases conveyance tax rates based on a sliding scale for (1) all categories of property sold for \$600,000 or more, and (2) the sale of a condominium or single family residence for which the purchaser is ineligible for a county homeowner's exemption on property tax. Requires that revenues collected from the conveyance tax be allocated as follows: 10 percent to the Land Conservation Fund, 30 percent to the Rental Housing Trust Fund, 25 percent to the Natural Area Reserve Fund, and 35 percent to the General Fund.

Effective July 1, 2005.

H.B. No. 1640, H.D. 3, S.D. 2, C.D. 1

Relating to Important Agricultural Lands

Establishes State and county policies and procedures for identifying important agricultural lands. Requires the Department of Agriculture, with the assistance of the Department of Taxation, to conduct a study and develop proposals for agricultural incentives.

Effective July 1, 2005.

ACT 131 (S.B. No. 682, S.D. 2, H.D. 3, C.D. 1)

Relating to Tobacco

Requires businesses engaged in the sale of cigarettes and other tobacco products at the retail level to obtain a retail tobacco permit from the Department of Taxation beginning December 1, 2006. Makes it a criminal offense for any retailer to sell cigarettes and other tobacco products without a valid retail tobacco permit.

Effective upon approval, provided that the Act shall be repealed on July 1, 2009, and sections 245-1 and 245-2, HRS, shall be reenacted in the form in which they read on the day before the approval of this Act.

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Legislative Highlights

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S.B. No. 1127, S.D. 1

Relating to the Public Procurement Code

Eliminates the requirement that small purchase contracts awarded (less than \$25,000) by the State must obtain tax clearances, certificates of good standing, and certificates of compliance.

Effective upon approval.

ACT 146 (S.B. No. 1453, S.D. 2, H.D. 1, C.D. 1)

Relating to Public Service Company Tax

Imposes the public service company tax on the gross income of a private sewer company or facility.

Effective July 1, 2005.

S.B. No. 1729, S.D. 2, H.D. 2, C.D. 1

Relating to Tourism

Increases the transient accommodations tax (TAT) allocation to the Tourism Special Fund to 34.2 percent to provide a dedicated source of funding for the Hawaii Tourism Authority. Requires excess TAT revenues to be deposited into the general fund. Repeals the TAT Trust Fund. Revises the allocation of the TAT revenue for the State Parks Special Fund and the Special Land and Development Fund.

Effective July 1, 2005, provided that the TAT increase to the Tourism Special Fund and the repeal of the TAT Trust Fund takes effect on July 1, 2007.

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

Practitioners' Forum

The Department of Taxation held its 2005 Practitioners' Forum on May 25 in the Princess Ruth Keelikolani Building. Unlike our workshops where we present a fixed program of topics, the Practitioners' Forum is an opportunity for tax practitioners to discuss tax issues, problems, concerns or share great ideas with our senior staff and administration.

Topics discussed included the Department's plans for expanding its electronic filing programs, an update on tax services and processing, initiatives for processing (imaging project), bills passed by the 2005 Legislature, and compliance tools.

Recently Issued Tax Publications

The following is a list of the publications issued by the Department of Taxation from July 2004 through June 2005. 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), and from any district tax office.

Tax Information Release No. 2004-01 - Provides information on Act 113, SLH 2004, which conforms the state withholding tax remittance due date for employers with an annual state withholding tax liability that exceeds \$40,000 to the semi-weekly remittance due date required under federal employment tax provisions.

Announcement No. 2004-02 - Provides information on Act 89, SLH 2004, 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, 2003.

Announcement No. 2004-03 - Provides information on Act 96, SLH 2004, which lowers the tax rate on alternative fuel sold for use in operating an internal combustion engine from 1 cent to .25 cents per gallon; and lowers the percentages that are applied to the rate for diesel oil in determining the rates on alternative fuel sold for use in operating a motor vehicle on public highways as follows: ethanol (from .29 to .145); methanol (from .22 to .11); biodiesel (from .5 to .25); and other alternative fuels, other than liquefied petroleum gas (from .5 to .25).

Announcement No. 2004-04 - Provides information on Act 97, SLH 2004, which provides clarifications to the renewable energy technologies income tax credit.

Announcement No. 2004-05 - Provides information on Act 140, SLH 2004, which encourages the construction of operational, large-capacity ethanol production facilities by changing the ethanol investment tax credit to a facility tax credit.

Announcement No. 2004-06 - Announces the decrease in the Kauai County biodiesel fuel tax rate from 6.5 cents to zero cents per gallon, effective July 1, 2004.

Announcement No. 2004-07 - Provides information on Act 197, SLH 2004, which increases the allowable exclusion from Hawaii net income tax for members of the Hawaii National Guard and reserve components of the Army, Air Force, Marine Corps, and Coast Guard over five years starting January 1, 2005.

Announcement No. 2004-08 - Provides information on Act 157, SLH 2004, which prohibits the distribution of untaxed cigarettes via the telephone, mail order, the Internet, and other on-line sources.

Announcement No. 2004-09 - Provides information on Act 159, SLH 2004, which requires wireless

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Recent Publications

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providers to charge customers a 66-cent monthly surcharge to be deposited into a special fund that will be dedicated to upgrading wireless carrier locations and 911 call centers to allow public safety agencies to better locate wireless callers.

Announcement No. 2004-10 - Provides information on Act 214, SLH 2004, which provides a fraternal benefit, religious, charitable, scientific, educational, or other nonprofit organization under section 501(c) of the Internal Revenue Code, a general excise tax exemption for gross income derived from fees for convention, conference, or trade show exhibit or display spaces.

Announcement No. 2004-11 - Provides information on Act 228, SLH 2004, which establishes a net income tax check-off to allow taxpayers to voluntarily contribute \$5 on their state income tax returns to be allocated as follows: (1) One-third to the Hawaii Children's Trust Fund, and (2) Two-thirds to be divided equally among the Domestic Violence Prevention Special Fund of the Department of Health and the Spouse and Child Abuse Special Accounts under the Department of Human Services and the Judiciary.

Announcement No. 2004-12 - Provides information on Act 115, SLH 2004, which extends the "sunset date" of the Integrated Tax Information Management Systems (ITIMS) Special Fund from July 1, 2004 to July 1, 2005.

Announcement No. 2004-13 - Provides information on Act 195, SLH 2004, which permits a tax deduction of up to \$3,000 for one tax year out of every three consecutive tax years for an individual taxpayer's qualified expenditures to maintain an exceptional tree that is on the taxpayer's private land and is designated as an exceptional tree by the local county arborist committee under chapter 58, Hawaii Revised Statutes.

Announcement No. 2004-14 - Provides information on Act 123, SLH 2004, which provides for the first tax appeal to either the district board of review or the tax appeal court to be made without payment of the assessed tax.

Announcement No. 2004-15 - Provides information on Act 215, SLH 2004, which amends various provisions of Act 221, SLH 2001, relating to high technology investment tax credits, extends the sunset date for certain tax incentives to December 31, 2010, and establishes a State Private Investment Fund.

Announcement No. 2004-16 - Provides information regarding the new Hawaii Tax Identification Numbers that will be issued to replace the eight-digit general excise license numbers.

Announcement No. 2004-17 - Provides information regarding relief for taxpayers affected by the heavy rains and flooding on October 30 and 31, 2004 in the Manoa

Valley area in the City and County of Honolulu.

Announcement No. 2004-18 - Announces the adoption of the IRS optional standard mileage rates for 2005.

Announcement No. 2005-01 - Provides instructions on filing federal Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors, for Hawaii withholding tax purposes.

Digest of Tax Measures - Enacted by the State of Hawaii, Twenty-Second Legislature, Regular Session of 2004.

The following Reports are available on our website at www.state.hi.us/tax. A limited number of the Reports also are available for a nominal fee from our Tax Research and Planning Office. Contact them by phone at 808-587-1440 or by e-mail at Tax.Research@hawaii.gov to request an order form.

- Annual Report 2002-2003
- Tax Credits Claimed by Hawaii Taxpayers - 2001
- Hawaii Income Patterns - Individuals - 2001

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.
- Clarification of the offers in compromise process.

Income Tax Law

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

General Excise Tax Law

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

Transient Accommodations Tax

- Clarification of the application of the transient accommodations tax.

Conveyance Tax Law

- Clarification of the application of the conveyance tax.

Third Quarter State Tax Collections

January 2005 - March 2005

(In Millions of Dollars)

	<u>FY 2005</u>	<u>FY 2004</u>	<u>Difference</u>	
			<u>Amount</u>	<u>Percent</u>
Individual Income Tax	\$ 338.6	\$ 261.8	\$ 76.8	29.4%
Corporate Income Tax	12.4	12.0	0.4	3.2%
General Excise Tax	579.5	506.1	73.4	14.5%
Transient Accommodations Tax	54.6	50.2	4.4	8.7%
All Others	216.5	190.9	25.6	13.4%
Total Tax Collections	\$ 1,201.6	\$ 1,021.0	\$ 180.6	17.7%
General Fund Revenues	\$ 1,054.8	\$ 874.0	\$ 180.8	20.7%

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

Total tax collections of \$1,201.6 million for the third quarter of fiscal year 2005 represent a 17.7% growth, or \$180.6 million increase over the same period of last fiscal year. General fund revenues increased 20.7% from \$874.0 million to \$1,054.8 million for the third quarter. General excise tax collections jumped \$73.4 million, while transient accommodations tax collections went up by \$4.4 million. The sizeable \$76.8 million increase in individual income tax collections was mostly due to a \$57.7 million increase in withholding taxes and \$27.3 million in estimated taxes.

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