

DEPARTMENT OF TAXATION
ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period from July 1, 2015 through June 30, 2016

Act 134, Session Laws of Hawaii 2009, also known as the "Cash Economy Enforcement Act" (hereinafter sometimes referred to as the "Act"), requires at Section 9 of the Act, that the Department of Taxation (Department) report the following information to the Legislature:

- 1) The state resources committed to implementing the Cash Economy Enforcement Act; and**

- 2) The additional revenues raised as a result of the Act.**

BACKGROUND

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the cash economy, as well as high-risk and complex civil tax investigations in general. The primary focus of the Cash Economy Enforcement Act was the creation of the Special Enforcement Section (SES), which is a specialized unit within the Department's Compliance Division comprised primarily of civil investigators.

The Department was authorized at Section 2 of the Act (codified as Section 231-83(b), Hawaii Revised Statutes (HRS), to utilize new hires, as well as existing labor resources to staff the SES operations. Furthermore, Section 2 of the Act authorized the Department to identify the proceeds of SES operations to assist in the funding of the unit. The SES is allowed to identify taxes from any taxpayer, assessment, investigation, or collection matter as a matter of the SES, which may then be deposited into the Tax Administration Special Fund (codified as HRS §231-85). Within the Tax Administration Special Fund's expenditure authority, the Department is allowed to retain the first \$700,000 (effective January 1, 2016) to fund the Section's operations, with the remaining fiscal year collections being deposited into the General Fund. See HRS §235-20.5, as amended by Act 204, Session Laws of Hawaii 2015. The Department was also provided legislative authority at Section 8 of the Act to establish six new full-time equivalent (FTE) positions that may be filled by investigators, investigator assistants, licensed attorneys, or other support staff, in addition to using current personnel.

ACTIVITIES AND ACCOMPLISHMENTS

Since passage of the Cash Economy Enforcement Act, the Department has worked diligently in implementing SES's operations within the Compliance Division. In the Department's assessment, it believes that it has been increasingly successful in identifying non-compliance, securing voluntarily filed returns, and collecting tax revenues.

In FY2016, the unit was given an additional assignment of focusing on the compliance of short-term rentals or transient accommodations operators that specifically advertise on websites. This area had experienced a high number of complaints from the public expressing concerns on whether or not these operators were making payments of Transient Accommodations Taxes on the advertised rentals. As a result, SES has dedicated significant resources toward fostering compliance regarding short-term rentals.

The Governor signed Act 204, SLH 2015, on July 2, 2015, which went into effect on January 1, 2016. Act 204 added the definition of "transient accommodations broker" to Chapter 237D and requires registration of operators who fall under the definition of transient accommodations brokers. Act 204 authorizes the Department to issue citations to individuals and website brokers for failing to display proper information on advertisements. To ensure that such brokers were informed of the new requirements under Act 204, SES sent out notification letters to entities who were potentially includable under the definition of transient accommodation brokers.

SES's FY2016 accomplishments include:

- Conducted outreach and informational briefings regarding the SES and the General Excise Tax (GET) and Transient Accommodations Tax (TAT) laws of the State of Hawaii on the islands of Oahu, Maui, Hawaii and Kauai through various business fairs and other groups that requested briefings;
- Conducted site visits at retail establishments, restaurants, shopping malls, industrial parks, farmers' markets, craft fairs, short-term rental establishments, and other places of business across the state and obtained acknowledgment forms from operators that they have been informed of Hawaii's GET and/or TAT laws. Issued written warnings with request to inspect books and records for businesses that did not comply with tax laws;
- Reviewed complaints and information provided by the public and utilized other investigative methods to identify business operators who did not appear to be compliant with GET and TAT laws. Using various investigative techniques, conducted complex tax investigations to determine if the operators had a GET and/or TAT filing obligation and the amount of income subject to taxation. (SES has found increased voluntary compliance following contact with SES Investigators);
- Requested and secured voluntarily filed GET and/or TAT returns and tax payments. When a return could not be secured from the taxpayer, referred the matter to Office Audit for assessment and collection;
- Identified and sent out letters to 67 entities who were potentially transient accommodations brokers advising them of their broker obligations;
- Assisted with the implementation of the Tax System Modernization program to improve SES processes and procedures for greater efficiencies and better identify leads with potential for non-compliance.

I. STATE RESOURCES COMMITTED TO IMPLEMENTING THE CASH ECONOMY ENFORCEMENT ACT

In Fiscal Year 2016, SES expenditures were as follows:

Category	Fiscal Year 2016
Personnel	\$345,810
Other Expenses	\$186,487
Total	\$532,297

As of October 27, 2016, FY2017 SES expenditures were \$173,668, consisting of \$120,932 in personnel costs and \$52,736 in other expenses.

SES currently employs four investigators and a newly hired supervisor. The unit is currently recruiting to fill a fifth investigator position. It was also authorized another investigator position during the last legislative session which will be established shortly. SES continues to visit the neighbor islands to ensure coverage of the entire state.

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In Fiscal Year 2016, the SES generated \$3,505,618 in revenues. Additional relevant information follows:

	<u>FY2014</u>	<u>FY2015</u>	<u>FY2016</u>
Complaints filed by anonymous persons	195	391	364
Business entities educated on compliance	1,005	1,554	1,470
Site visitations throughout the state	18	60	28
Number of investigations completed	31	34	31
Number of referrals sent for assessment	22	7	30
Total liability on secured returns – SES Project	\$996,211	\$2,322,782	\$2,944,583
Total liability on secured returns – TAT Project	N/A	N/A	\$1,638,607
Revenue Collected	\$805,776	\$1,619,235	\$3,505,618