

DEPARTMENT OF TAXATION
ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period from July 1, 2016 through June 30, 2017

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.

The Department wishes to highlight the significant accomplishments of the Special Enforcement Section during FY 2017, with an increase of over 50% in total tax revenues over FY 2016, and its breakthrough in initiating data mining projects in FY 2017, to identify non-filers and under-reporters of Transient Accommodations Taxes (TAT), resulting in the near doubling of such revenue through the first five months of FY 2018. We project TAT revenue to increase from about \$1 million in FY 2017, to about \$2 million in FY 2018.

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 was initially allowed to retain the first \$500,000 to fund the Section's operations, with the remaining fiscal year collections being deposited into the General Fund. 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. Effective January 1, 2016, the legislature authorized the Department to retain an additional \$200,000 and one additional position for a total of \$700,000 and seven FTE positions to support SES's operations. See HRS §235-20.5, as amended by Act 204, Session Laws of Hawaii 2015.

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. The Department has been increasingly successful in identifying non-compliance, securing voluntarily filed returns, and collecting General Excise Tax (GET) revenues.

In FY 2016, SES was given an additional assignment of increasing Transient Accommodations Tax (TAT) compliance by short-term rental or transient accommodations operators. SES responded to the challenges initially by dedicating two investigators and recently a third investigator to TAT compliance enforcement. The third investigator was added to respond to a large number of non-compliant transient accommodations operators identified through the use of data analytics.

SES's FY 2017 accomplishments include:

- Conducted outreach and informational briefings regarding the SES and the GET and TAT laws of the State of Hawaii on the islands of Oahu, Maui, Hawaii, Kauai and Molokai through various business fairs and other interested 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. (SES has found increased voluntary compliance following contact with SES Investigators.);
- Reviewed referrals, complaints and other 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 and evaluate for possible investigation;
- Using various investigative techniques, conducted complex tax investigations to identify income sources and determine the amount of income subject to taxation;
- 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 and evidentiary material collected to Office Audit for assessment and collection;
- Initiated projects that utilize publicly available and confidential database sources to develop leads on taxpayers who are potentially not compliant with GET and TAT laws. These projects utilized new resources to evaluate large amounts of data. As a result, significant numbers of leads have been and continue to be generated indicative of unreported and under-reported income subject to GET and TAT.

- Sent informational letters to over 300 transient accommodation operators advising them of registration and advertising requirements under Act 204.

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

In FY 2017, SES expenditures were as follows:

Category	FY 2017
Personnel	\$416,834
Other Expenses	\$168,443
Total	\$585,277

As of November 14, 2017, FY 2018 total expenditures to date were \$202,445, consisting of \$191,694 in personnel costs and \$10,751 in other expenses. SES is currently staffed with six investigators and one supervisor.

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In FY 2017, SES continued to achieve significant gains in bringing taxpayers into compliance and collecting more than \$9 in tax revenues for every dollar of its operational costs. This does not fully include the immeasurable long-term educational benefits and positive impact on future taxpayer compliance generated.¹ SES collected \$5,268,362 in total revenue, including TAT of \$1,025,866, in FY 2017, as compared with \$3,505,618 in total revenue in FY 2016, an increase of over 50%. Furthermore, with the assistance of Office Audits, \$487,245 in taxes were also assessed in FY 2017. Additional details of SES's accomplishments are as follows:

	<u>FY 2017</u>	<u>FY 2016</u>	<u>FY 2015</u>
Complaints Received	307	364	391
Vendors Educated on Compliance of Tax Laws	1,331	1,470	1,554
Number of Events Visited Throughout the State	25	28	60
Number of Extensive Investigations Completed	76	31	34
Total Tax Revenue Collected from Taxpayers	\$5,268,362	\$3,505,618	\$1,619,235

LOOKING AHEAD

Beginning in FY 2018, largely as a result of the previously mentioned data mining projects, SES has been realizing significant additional TAT and GET revenues. Through the five months ended November 30, 2017, we have already nearly equaled FY 2017's annual TAT revenue of over \$1 million. We project FY 2018 annual TAT revenue of about \$2 million. GET results are

¹ SES continues to recognize as revenue, collections from taxpayers for 18 months after they fulfill all account tax return filing and payment obligations.

also on the rise with five months revenue at \$2.3 million and a projected FY 2018 annual GET revenue of about \$5 million.

Our data mining projects have also led to the identification of hundreds of additional transient accommodations operators not only for tax compliance verification purposes but also to educate about the registration and advertising requirements of Act 204. We have also identified a large number of community associations who we will be asking assistance from for tax compliance educational purposes.