

DEPARTMENT OF TAXATION
ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period from July 1, 2017 through June 30, 2018

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:

- I) The state resources committed to implementing the Cash Economy Enforcement Act; and
- II) The additional tax revenues raised as a result of the Act.

The Department wishes to highlight the significant accomplishments of the Special Enforcement Section during FY 2018, with continued year over year gains of over 50% in total tax revenues since FY 2015, and its doubling of Transient Accommodations Tax collections over the previous year.

BACKGROUND

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the "cash economy" through education and conduct of civil tax investigations. 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 substantially fund the unit. The SES is allowed to identify taxes collected from any taxpayer, assessment, investigation, or collection 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.

Section 8 of the Act authorized establishing 6 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 1 additional position for a total of \$700,000 and 7 FTE positions to support SES's operations and help with enforcement of Transient Accommodations Tax laws. 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 expanding SES's operations and effectiveness and has been increasingly successful in identifying non-compliance, securing voluntarily filed tax returns, and collecting general excise (GET) and transient accommodation taxes (TAT).

SES's FY 2018 accomplishments include:

- Conducted 46 site visit and compliance survey campaigns at retail districts, shopping malls, industrial parks, farmers' markets, craft fairs, and single and multi-dwelling residential neighborhoods involving 2,359 retail, wholesale, and restaurant businesses and short-term rental establishments throughout the state. Educated business operators of Hawaii's GET and/or TAT laws. Issued written warnings for various compliance violations, and requests for inspection of books and records of non-compliant businesses. SES has found increased voluntary compliance following these campaigns.
- Reviewed 419 complaints and referrals provided by the public and other departments and utilized investigative and analytical methods to identify business operators showing indications of noncompliance with GET and/or TAT laws and evaluate for possible investigation.
- Using various investigative techniques, conducted tax investigations of varying complexities 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 evidence of income subject to tax to Office Audit for assessment and collection.
- Sent informational letters to over 300 transient accommodation operators advising them of registration and advertising requirements under Act 204.
- Furthered projects on vacation rental/transient accommodation businesses utilizing publicly available and confidential database sources to develop leads on taxpayers who appear to be out of compliance with GET and TAT laws. These projects utilized new resources made available by the Tax System Modernization Program (TSM) 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.

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

In FY 2018, SES incurred the following expenditures to support its compliance activities:

<u>Category</u>	<u>FY 2018</u>
Personnel Costs	\$580,437
Other Expenses	<u>58,035</u>
Total Expenditures	\$638,472
No. of Staff	7

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In FY 2018, SES continued to bring positive change by educating an increasing number of taxpayers and bringing them into compliance. As a result, significant tax revenue gains of more than 50% over FY 2017, were realized in tax collected from delinquent returns secured by SES. This was accomplished through increased levels of compliance campaigns and surveys, education, and compliance investigations.

In addition, as taxpayers brought into tax compliance by SES were largely non-filers, an estimate of SES's potential impact on tax revenues was asserted. This is because had SES not brought taxpayers into tax compliance, there is a strong likelihood that their non-compliance would have continued indefinitely. The potential impact tax revenues were based on tax collections remitted by taxpayers for a post compliance period of 18 months after they were brought into tax compliance. Delinquent return period tax collections and post compliance period collections aggregate to Impact Revenue. Accordingly, SES Total Impact Revenue grew to \$7,973,436 in FY 2018, as compared with \$5,268,362 in FY 2017, and \$3,505,618 in FY 2016. The gains reflect a 50% year over year increase and a return of more than \$12 in Impact Revenue for every dollar of SES's operational costs. The following is a summary of SES's FY 2018, performance measures:

	<u>FY 2018</u>	<u>FY 2017</u>
Number of Compliance Campaigns Conducted	46	25
Businesses Educated on Compliance of Tax Laws	2,359	1,331
Complaints Received and Reviewed	419	307
Number of Extensive Investigations Completed	229	76
General Tax ¹ Revenue Collected from Delinquent Returns	\$2,791,847	\$2,086,731
TAT Revenue Collected from Delinquent Returns	<u>1,075,269</u>	<u>442,083</u>
Total Tax Collected from Delinquent Returns	\$3,867,116	\$2,528,814
General Tax Impact Revenue Collected	\$5,754,966	\$4,242,496
No. of Taxpayers Remitting General Tax Payments	1,004	958
Average General Tax Impact Revenue Collected per T/P	\$5,732	\$4,428
TAT Impact Revenue Collected	\$2,218,470	\$1,025,866
No. of Taxpayers Remitting TAT Payments	242	110
Average TAT Impact Revenue Collected per T/P	\$9,167	\$9,326
Total Impact Revenue Collected from Taxpayers	\$7,973,436	\$5,268,362

¹ Includes all tax types (general excise, individual, estate, and corporate income taxes) except for transient accommodations tax.

LOOKING AHEAD

We anticipate FY 2019 to be another progressive year for SES. Through the 4 months ended October 31, 2018, SES Total Impact Revenue Collected was \$2,795,785 as compared with \$2,638,444 for the same period last year.

Most importantly, the 29th Legislature of the State of Hawaii recognized the significant lack of TAT compliance in the vacation rental business. It responded by authorizing additional resources for the SES increasing its budget from \$700,000 to \$2,000,000 in special funds and established 6 additional investigator positions raising it from 7 to 13 positions, effective July 1, 2018. In November 2018, SES recruited 2 new investigators bringing its current staff to 9. As SES fills its newly established positions and trains its new staff, SES will increase the breadth of its transient accommodations investigations through increased levels of TAT compliance initiatives and projects.