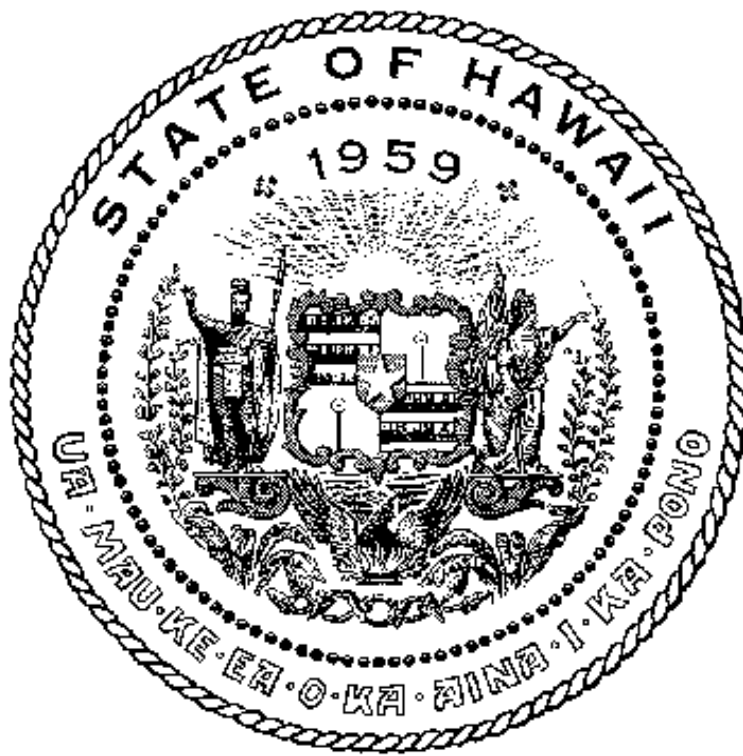


# DEPARTMENT OF TAXATION STATE OF HAWAII



## ANNUAL REPORT 2005-2006

December 27, 2006

The Honorable Linda Lingle  
Governor  
State of Hawaii

Dear Governor Lingle:

I am pleased to present you with this summary of the major accomplishments of the Department of Taxation for the fiscal year ending June 30, 2006.

I wish to again highlight the success of the Department's tax compliance program, which collected \$263.1 million in delinquent taxes in fiscal year 2006. This was an increase of \$28.8 million, or 12 percent over fiscal 2005, which was itself a banner year for delinquent collections. The record for collecting delinquent taxes prior to your administration was \$113 million in one year (fiscal year 2002). Since your administration took office, the Department has exceeded \$113 million each year, collecting an additional \$384 million in delinquent taxes above and beyond what would have been collected if the old record amount had merely been matched each year. \$150 million of this additional amount (\$263 million - \$113 million) was collected in the fiscal year ending June 30, 2006.

In addition to increasing delinquent tax collections, the actual revenue resulting from collections for the general excise tax, the corporation income tax and the individual income tax increased by 10.2%, 51.9% and 12.2%, respectively, from the previous fiscal year. The increases were due to continued strong growth in the economy, as well as to our compliance efforts in pursuing delinquent taxes.

The Department also completed the Integrated Tax Information Management System begun in 1999, but specific project enhancements continue, for example to administer the new Honolulu County surcharge tax. During the fiscal year, the Department was able to implement an imaging system for a number of its tax forms and to make other improvements to help automate the processing of returns and to encourage more taxpayers to file their returns electronically. Greater automation allows us to administer taxes more efficiently and effectively and to provide better and more timely services to taxpayers.

A total of \$5.1 billion in tax revenues was collected in fiscal year 2006, of which \$4.4 billion, or 86.9%, was deposited into the State General Fund. The balance was distributed to special funds and to the counties, including \$190.6 million to the State Highway Fund, \$149.4 to the Unemployment Trust Fund and \$174.2 million to the counties. This is an increase of 11.0% in total tax collections and of 10.9% in General Fund deposits over the previous fiscal year. In closing, I wish to again acknowledge the excellent work of all Department employees and managers throughout the past fiscal year. With the growing economy, we continue to face challenges in recruiting and retaining personnel we need to perform our duties. We will continue to strive, however, to provide the best possible service to the public and the people of Hawaii.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Kurt Kawafuchi', with a stylized flourish at the end.

KURT KAWAFUCHI  
Director of Taxation

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# **THE YEAR IN REVIEW**

## **TAX SERVICES AND PROCESSING DIVISION**

The Tax Services and Processing Division (TSP) consist of three branches: 1) Document Processing, 2) Taxpayer Services, and 3) Revenue Accounting. The Division performs all functions relating to the centralized processing, editing, and controlling of tax information through paper documents and electronic data. It receives, secures, deposits, and accounts for tax payments. It is also responsible for functions relating to account management and licensing, and for providing taxpayer services to the public.

Using process change, technology and our strategic vision, the TSP Division continues to improve upon the Department's Integrated Tax Information Management System (ITIMS) technology platform. During fiscal year ending June 30, 2006 (sometimes referred to as "fiscal year 2006" or "FY2006"), an important enhancement of ITIMS was the imaging of paper-filed tax returns, known internally as the ITIMS Imaging System (IIS). As tax returns are received and sorted, selected returns are scanned into digital images and stored in a repository as they are processed. The on-line images of the tax returns and payments can be quickly retrieved directly from the tax account. This greatly enhances our ability to provide better and more timely service to the public, and to resolve taxpayer issues quickly. What used to require days, or even weeks to do when we had to retrieve a paper return can now be accomplished with the click of a button in all of the island offices in Hawaii.

Not only has the IIS helped customer service staff by allowing them to retrieve on-line images of tax returns, it has also substantially improved the processing of returns. Through state-of-the-art scanning and character recognition technology, the Department has substantially reduced the time required in data entry. As additional forms are migrated from the current technology, which involves typing in data from paper returns, the Department is experiencing greatly reduced turnaround times for the posting of paper returns and payments, and processing of refunds.

### **Document Processing Branch**

The main objective of the Document Processing Branch (DPB) is to process and control all tax returns and documents in an orderly fashion; to receive, secure, deposit and account for tax payments; and to store, file, and retrieve such documents.

For fiscal year 2006, the DPB processed 3,561,566 returns and payments, of which 533,933 (15%) were electronically transmitted. The DPB processed approximately 1.34 million payments during the year. With the Electronic Funds Transfer (EFT) program, it collected payments of over \$2.55 billion dollars.

The Joint Electronic Filing Program (JELF) (joint with the Internal Revenue Service) is in its sixth year. DPB was pleased to add a new income tax form to the JELF program, Form N-15, Part Time Resident/Nonresident Income tax return. The JELF program allowed certain

taxpayers who file Form N-11 or N-15 to file their Hawaii State returns electronically. A marked improvement in participation was realized this year: 156,199 returns were filed under the program last year versus 189,809 this year, an increase of 21.5%.

In addition to the JELF program, taxpayers may also file their returns electronically through the Department's website. Taxpayers filed over 101,000 returns on our website this year. The total electronic filings increased by 36% this year compared to last year. Electronically filed returns allow the Department to process tax returns more quickly and efficiently.

The implementation of IIS began in August of 2005 and by November 2005, the on-line retrieval function was available statewide. In February 2006, auto-recognition began for Forms G-45, G-49, and HW-14 and in April 2006, estimated payments were captured by the IIS system. The final phase of the IIS project was the auto-recognition of Forms N-11, N-15 and Schedule CR, which was available in June 2006, two-months ahead of schedule and within budget. As of June 30, 2006, with the aid of only seven full time employees assigned to the project, 1,117,295 returns have been processed through IIS. Currently, income tax Forms N-11, N-15, and Schedule CR; general excise tax Forms G-45 and G-49; withholding tax Form HW-14; and all individual estimated payments are being processed through IIS. The IIS has allowed the Department to process documents much more efficiently.

### **Taxpayer Services Branch**

The Taxpayer Services Branch has three main objectives: 1) to provide customers with information on all taxes administered by the Department and other assistance efficiently (Customer Inquiry); 2) to perform computer-based error correction activities to allow for expedient processing, posting or updating of tax returns, payments, and other documents (Account Management); and 3) to process, issue and update all licenses and permits issued by the Department in a timely and efficient manner (Licensing).

#### **Customer Inquiry: 2006 Tax Season Telephone Call Statistics:**

During the January to June 2006 income tax filing season, the total number of calls received was 299,582, of which 65,854 calls or 22% were handled by the Interactive Voice Response (IVR) system, and 83,127 calls or 28% were handled by tax representatives. The overall call answer rate for the 2006 tax season was 50%, which was significantly higher than the 32% call answer rate for the same period in 2005, but lower than the 72% for the same period in 2004.

The primary reason for the large variance in our call answer rate in recent years is the implementation of the Integrated Tax Information Management System (ITIMS). The income tax component was implemented in November 2002, and the integration of the business tax component was implemented in October 2004. As a result of these two major system implementations, the 2003 and 2005 tax seasons, which immediately followed the system implementations, showed tremendous spikes in the number of calls, as shown below.

In late 2005, as a cost-saving measure, approximately 155,000 letters were mailed to business taxpayers informing them that their 2006 general excise, withholding, transient accommodations, rental motor and tour vehicle surcharge tax booklets would not be printed and mailed to them, because they had not filed these returns in recent years. This generated thousands of additional calls during a period when there is normally a low volume of calls. Additionally, with the phased-in implementation of the IIS, two of the primary individual income tax returns (Forms N-11 and N-15), the general excise tax returns (Forms G-45 and G-49) and the withholding tax return (Form HW-14) were modified to allow them to be imaged and data-captured. The modifications generated additional calls when the tax booklets were mailed out.

However, with additional temporary staff hired to assist with phone calls, extended telephone hours provided to the public, and heavier usage of the automated refund status option on the telephone service (59,851 in 2006 as compared to 34,052 in 2005 for the tax season period of January to June), the overall call answer rate went from 32% in 2005 to 50% in 2006. This represents increase of 37,135 calls answered in 2006 compared with 2005.

<u>Year</u>	<u>Total Calls Received</u>	<u>Total Calls Answered</u>	<u>Overall Call Answer Rate</u>
2006*	299,582	148,981	50%
2005*	346,972	111,846	32%
2004*	147,514	106,146	72%
2003*	332,399	76,392	23%

\* Represents the six month period of January through June for each of the years shown.

#### Account Management: Error Correction Statistics

From its inception in October 2004 through June 2005, the staff of ten in the Account Management Section corrected and posted to our Integrated Tax Processing System (ITPS) over 120,000 returns and payments that were removed from the processing cycle due to critical errors. For fiscal year 2006, over 150,000 returns and payments were corrected and posted by the same team. With the implementation of the IIS this fiscal year, the Account Management team was able to post returns quicker, because analysis could be done electronically online instead of waiting for paper copies of the returns to be retrieved by the file maintenance section.

#### Licensing: Statistics on Processing Business License Applications/Cancellations

For the fiscal year ending June 30 2006, the Licensing Section processed over 32,000 registrations for general excise tax licenses, and more than 17,000 cancellations. They also processed 266 permit renewals: 52 for liquor permits, 144 for fuel permits and 70 for tobacco permits.

Expedited registration continues to be a priority for the Section. To this end, the Section has enhanced the Hawaii Business Express on-line application process to allow the direct feed of data and fees into our computer system, thus eliminating daily manual downloads of paper

documents and data (development occurred in fiscal year 2006). It has also extended Licensing services to include applications received at a proposed Maui Business Action Center.

### **Revenue Accounting Branch**

The main objective of the Revenue Accounting (RA) Branch is to maintain revenue control and subsidiary ledgers. This requires maintaining control of, and responsibility for all adjustments, error resolutions, accounting and reconciliation functions of all tax revenues statewide. The Branch also prepares the Preliminary Report and Statement of Tax Operations and related reports. Secondary functions of the Branch include statewide processing and manual accounting activities for all miscellaneous taxes (except the estate & transfer tax); controlling and accounting for all tax refunds that are created by either overpayment or adjustment; maintaining the accounting system for protested payments and tax appeals; correcting all rejected electronic funds transfer payments; and handling all refund exception activities (e.g., returned checks, tracers, forgeries, etc.).

Each month, the RA Branch prepares the Preliminary Report, which is a monthly statewide summary of all the revenues received by the Department net of tax refunds. The Preliminary Report must be prepared by the 5<sup>th</sup> working day of each month. The RA Branch also prepares the Statement of Tax Operations (STO), which is a formal and detailed statewide report based on the Preliminary Report. The STO must be prepared by the 10<sup>th</sup> working day of each month. The RA branch has met these important goals each month.

## **COMPLIANCE DIVISION**

The objective of the Compliance Division is to maximize taxpayer compliance with Hawaii's tax laws in a manner that is consistent, uniform, and fair. The Compliance Division is composed of the Oahu Office Audit Branch, Field Audit Branch, Oahu Collections Branch, and the District Offices of Maui, Hawaii and Kauai. Three programs were established in the Division to meet the needs of our voluntary compliance, self-assessment system: auditing/examination, collection, and taxpayer services (information dissemination).

### **Auditing/Examination**

The Office Audit units and the Field Audit units performed the following examinations and audits during the fiscal year.



	<u>Office Audit</u>		<u>Field Audit</u>	
	Number		Number	
	Audits	Dollars	Audits	Dollars
	<u>Completed</u>	<u>Assessed</u>	<u>Completed</u>	<u>Assessed</u>
Oahu	5,419	\$ 22,265,845	243	\$ 71,888,241
Maui	1,861	2,905,474	10	1,238,971
Hawaii	1,461	1,043,607	19	512,674
Kauai	1,236	2,417,701	19	1,524,371
Total FY 2006	9,977	28,632,627	291	75,164,257
Total FY 2005	7,732	13,948,184	243	93,237,310
Difference	2,245	\$ 14,684,443	48	\$ (18,073,053)

Both the Office Audit and Field Audit units experienced increases in the number of audit cases closed; however, dollars assessed declined in Field Audit. Office Audit increased the number of audits completed and dollar assessments due to cases in areas of non-compliance, such as refundable credits, HARPTA, and professional fields. The Field Audit unit was productive but experienced a decrease in dollars assessed primarily because of staff promotion and retirements, and the assignment of senior staff to train new staff. Staff training of a junior auditor generally requires a 3 to 5 year period. Consequently, the majority of cases closed were at the Junior Auditor level. In addition our Oahu Office Audit, Field Audit and Collection Branches and Sections provided support services to both the District and Oahu Taxpayer Services Areas when requested.

The Office audit and Field Audit units collected \$32.9 million upon the closing of their audits prior to any billing notices being sent.

#### Criminal Tax Unit

This unit increased its activities during the fiscal year and was able to obtain indictments and complaints against 40 taxpayers. These activities resulted in \$225,000 in judicial fines, \$1.3 million in tax assessments, and \$2.3 million in collections (taxes, penalties, interests, and fines) for criminal cases.

#### Taxpayer Assistance Provided

During the fiscal year, District Offices helped taxpayers understand and meet their Hawaii tax obligations by the proper filing of numerous tax returns and other documents through telephone assistance and over the counter service (including tax return preparation and correspondence). Our Oahu Office Audit, Field Audit and Collection Branches provided support services to both the Districts and the Oahu Taxpayer Services Area when requested. The following summarizes the activities of our branches.

## Tax Services and Processing Statistics for Districts (Maui, Hawaii, and Kauai)

	As of June 30, 2006	As of June 30, 2005	Difference	% Change
Counter	69,882	69,398	484	0.70%
Phone Services	58,340	66,901	(8,561)	(12.80%)
Tax Clearances	5,524	7,254	(1,730)	(23.85%)
Correspondence	16,903	21,294	(4,391)	(20.62%)

The reduction in phone services, tax clearances, and correspondence is due to centralization in the Oahu Tax Service and Processing area and the shift to a one-stop service concept.

The assistance provided to taxpayers is part of our emphasis on taxpayer education and problem resolution in all of our contacts with taxpayers. The Division continues to feel that it is important to maintain taxpayer willingness to accurately and properly comply with the State tax laws. We will continue to emphasize this "taxpayer enabling and empowering activity."

### Delinquent Tax Collections

The operations of the Compliance Division Tax Enforcement Program (conducted by the Oahu Collections Branch and the Collections Sections in each of the district offices in Maui, Hawaii and Kauai) resulted in increases in several key performance measures. The most notable increase was in the amount of cash collected for delinquent taxes, which rose \$28.8 million from \$234.3 million in FY 2005 to \$263.1 million in FY 2006. This represents a 12.3% increase in cash collections of delinquent taxes. The total delinquency balance decreased by 8.0% as compared to 1.9% in fiscal year 2005. A table of major performance measures is presented below.

<u>Measurement</u>	<u>FY 2006</u>	<u>FY 2005</u>	<u>Change</u>	
			<u>Amount</u>	<u>%</u>
Total delinquent tax balance (\$millions)	\$319.7	\$347.5	(27.8)	(8.0)
Total new delinquent referrals (\$millions)	248.8	247.1	1.7	0.7
Total cash collected (\$millions)	263.1	234.3	28.8	12.3
Uncollectible tax write-offs (\$millions)	8.4	6.2	2.2	35.5
Payment plans initiated	14,438	12,245	2,193	17.9
Tax liens filed	5,744	4,892	852	17.4
Levies served	3,025	1,813	1,212	66.9

## Special Projects

The Oahu Field Audit Branch continued the following ongoing special projects:

- Federal Contractors Project - During the fiscal year, 56 audits were completed and resulted in \$8,243,297.20 in assessments.
- Mainland Audit Project - During this fiscal year, 56 cases were completed and resulted in \$20,811,134.60 million in assessments.
- Referral Cases from Criminal Investigation Unit - During this fiscal year, 64 cases were completed and resulted in \$6,710,187.61 million in assessments.
- Fuel Tax Credits - During this fiscal year, 2 cases were completed and resulted in \$541,562.30 million in assessments.
- Research Tax Credit - During this fiscal year, 15 cases were completed and resulted in \$10,425,422.69 million in assessments.

## **STAFF OFFICES**

### **Administrative Services Office**

#### Fiscal Office

The Administrative Services Office submitted the supplemental budget for fiscal year 2007 to the 2006 legislature. For fiscal year 2007, \$21.8 million was appropriated for the Department.

In discharging its duties and responsibilities, the Department of Taxation incurred operating expenses of \$21.7 million for fiscal year 2006. Gross collections (before appeals, payments under protest and refunds) of taxes administered and collected by the Department were \$5.33 billion in fiscal year 2006. As a result, the cost to collect \$100.00 of taxes was slightly less than \$0.41.

#### Personnel Management

For fiscal year 2006, the Department was authorized 366.5 positions, up from 332 positions the previous year. Employees were geographically distributed as follows: Oahu, 270; Hawaii, 26; Maui/Molokai, 22; and Kauai, 14.

Personnel actions included 41 new civil service hires, 6 retirements, 128 temporary hires, 45 promotions, 8 transfers, and 15 resignations. Other personnel actions included temporary assignments of employees to higher levels, mainly to substitute for employees temporarily assigned to the ITIMS project.

STAFFING PATTERN  
(Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Headquarters Administration	67.0	57.0	57.0
Tax Services and Processing Division	110.0	88.5	88.5
Compliance Division	<u>189.5</u>	<u>186.5</u>	<u>186.5</u>
TOTAL	366.5	332.0	332.0

### **Rules Office**

The Rules Office is comprised of the Rules staff and the Technical Section.

#### **Rules Staff**

The Rules staff serves as the Department's advisory arm to the Director of Taxation on tax policy. In addition to drafting, analyzing, and researching Hawaii tax proposals, the Rules staff develops Hawaii tax policy through drafting administrative rules.

For the 2006 legislative session, the Rules staff drafted and submitted 11 administration-sponsored bills. Prior to the start of the legislative session, the Rules staff also reviewed and commented on proposed tax legislation submitted by other executive departments.

After reviewing 2,757 bills introduced to the 2006 Legislature (1,474 House Bills and 1,283 Senate bills), the Rules staff determined that approximately 800 measures proposed tax law changes and analyzed them in depth. These measures were also tracked throughout the legislative session. The Rules staff prepared 362 written testimonies for measures scheduled for public hearings by legislative committees, 203 for the House and 159 for the Senate. Letters to legislative committee chairs were also drafted after the public hearings to respond to specific questions or to address certain concerns of committee members. In addition, the Rules staff was asked to submit comments and recommendations to the Governor on 22 bills passed by the Legislature with possible impact on the Department.

During the fiscal year, the Rules staff prepared letters for the Governor and the Director, announcements, tax information releases, directives, and other publications.

The Rules staff reviewed and certified 810 requests for the High Technology Business Investment Tax Credit and 390 requests for the Credit for Research Activities in accordance with Act 215, Session Laws of Hawaii 2004. The staff also responded to 55 requests for ruling on qualified high technology business activities.

The Rules staff also testified at legislative committee hearings on behalf of the Director, reviewed rules of other agencies, provided training for Department employees, and spoke at several workshops for practitioners.

## **Technical Section**

In addition to answering questions received in telephone calls, emails, and letters, the Technical Section develops and revises tax forms and instructions to incorporate annual changes in the Hawaii tax law and federal tax law. During the past year the Technical Section reviewed 276 tax forms and 38 instructions, developed 2 new tax forms and one new set of instructions, and determined and made obsolete 3 tax forms and 3 instructions.

The Technical Section is also responsible for reviewing applications for certain tax exemptions. Staff members approved 125 nonprofit (general excise tax) applications and 3,387 conveyance tax exemptions.

The Technical Section staff provided training for Department employees and spoke at several workshops for practitioners and new entrepreneurs.

## **External Training and Outreach**

External Training and Outreach (ETO) is the administrative title of an office attached to the Director of Taxation that has four main functions. The primary function of the office is to be an operations-oriented tax training resource for the Department. A second function is to promote voluntary compliance by updating and distributing plain language tax information to the public. A third function is to support the Department's outreach efforts by hosting the Department's summer and year-end workshops. A fourth function is to serve as a focal point to receive media contacts and help prepare appropriate responses.

In May of 2006, following a subsequent Presidential Disaster Declaration, the ETO office provided support to the Disaster Recovery Centers (DRCs) that were supported by the Federal Emergency Management Agency (FEMA). The ETO office provided tax information at Kahala Mall, where 289 people went to receive disaster relief information, assistance, and services.

The ETO office continues to promote annual summer and year-end workshops in Honolulu, Lihue, Kona, Hilo and Kahului. The summer and yearend workshop both have about 400 attendees. Plans have been made to provide outreach and informational briefings to the general public on the new county surcharge tax that will become effective January 1, 2007.

Along with the outreach to the general public, the ETO office also facilitated workshops for the district offices on Oahu, Kauai, Maui and Hawaii between July and August of 2006. These in-house workshops presented information on the county surcharge, legislative updates and other informal reports on the current status of the Department's operations.

## **Information Technology Services Office**

The Information Technology Services Office (ITSO) is responsible for the developing, modifying, and maintaining the Department's computerized tax systems and components. The

Integrated Tax Information Management System (ITIMS) project that began in 1999 with a performance-based contract was officially completed with the end of the vendor warranty for the business taxes integration. ITIMS enhancements continue as DOTAX has contracted additional ITIMS initiatives and completed other in-house projects.

Two major ITIMS contracted initiatives were the implementation of an imaging system and the cutover to a new integrated cashiering system. The ITIMS Imaging System (IIS) was implemented in February 2006 for general excise tax (Forms G-45 and G-49) and withholding tax (Form HW-14) returns, followed by the net income tax (Forms N-11, N-15, and Schedule CR) in June 2006. The cashiering system, which links directly to the ITIMS, was implemented in December 2005. These initiatives automate much of the processing of returns and payments, including retrieval, which provides more efficient service to users and customers.

Some of the other ITIMS-related initiatives included the first phase of a "care of " project, billing notice process improvement, and a new booklet bypass process. Phase one of the "care of " project improved the system's handling of the "care of" field for all addresses. The ITIMS Collection System (ICS) was modified to create a 23:59:59 timestamp to prevent premature routing and insure that billing notices have the correct Notice Dates, in the event the ITIMS nightly batch processing runs past 12:00 a.m. and into the next day. The booklet bypass process first sent letters to taxpayers who had not filed business taxes for a number of years. It then automatically suppressed the printing and mailing of booklets to those who did not respond. The process resulted in a substantial cost savings and encouraged many non-filers to become current on their accounts.

Additional electronic processing-related initiatives were delivered that further increase the number of electronic filing options available to the public. Electronic filing results in faster and more accurate processing. Form N-15 (nonresident tax return, and related attachments), and Schedule CR were added to the Joint Electronic Filing (JELF) program. Also, the transmission mode to the Internal Revenue Service (IRS) was changed from modem to Secure Socket Layer. Net income payments were added to the Electronic Funds Transfer (EFT) program. These enhancements contributed to the increase in JELF filings, which grew to 185,798 in fiscal 2006 from 156,238 in the previous fiscal year.

The Department participated in the successful implementation of Hawaii Compliance Express in September 2005. The project, which was undertaken jointly with the State Procurement Office, the Department of Commerce and Consumer Affairs, the Department of Labor and Industrial Relations, the IRS, and the Hawaii Information Consortium, provides a new online resource for vendors and State buyers. The website enables vendors to obtain their compliance documents online, and it also allows State buyers to check the compliance status of vendors before entering into purchasing agreements.

In addition to providing ongoing support of the ITIMS applications development/fixes, and production maintenance, other notable DOTAX projects completed include the archiving and release of all old mainframe system resources (allows State resources to be redistributed to other agencies); a new service on the DOTAX website that allows taxpayers to check the status of their refunds online (provides an added convenience to the public and helps alleviate the number of

phone calls); a new Tax Review Commission page was also added to the website (provides notices, agendas, and minutes of Commission meetings to the public); and tax law changes.

Also many database improvements were achieved in support of ITIMS, such as changing database backup strategies (which eliminated the system downtime during normal business and nightly batch processing hours), implementing stored procedures to reset passwords (which allowed more delegation of password resetting, reduced the time of users passwords reset, and eliminated the problem of keeping passwords synchronized), increasing paging space (which increased overall system performance), applying appropriate indexes (which resolved application performance issues), and applying the latest database operating system security patches.

The technical infrastructure and network resources continue to be improved in support of Departmental users in all district offices. New higher capacity routers, switches, CSU/DSU, application servers, file servers, and personal computers were procured to replace their aging counterparts. Other upgrades included migrating to Open Enterprise Server OS, providing CSU/DSU redundancies, and improving network security in compliance with IRS safeguards.

Other initiatives in progress are the development of the County Surcharge tax, an automation of uncollectible debts write-off, and fraud/detection processing. Planning is also underway for a potential expansion of bulk filing and for other technology initiatives.

### **Tax Research and Planning Office**

The Tax Research and Planning Office (TR&P) assessed the potential revenue consequences of over 360 separate tax-related legislative proposals during the 2006 legislative session. In addition, the Office prepared monthly tax collection reports, reporting preliminary and final collections for the general excise tax, the transient accommodations tax, fuel taxes, and liquor taxes. TR&P assembles and edits the Department of Taxation's Annual Report, and it publishes annual statistical reports on the individual income tax, the corporation income tax, and tax credits.

TR&P also provides administrative support for the Council on Revenues (COR). The COR consists of seven economic experts who are responsible for forecasting the State General Fund revenues and the State total personal income. The forecasts are used to determine the General Fund expenditure limits. TR&P assists the COR by providing advanced econometric modeling techniques and processing data from the Department's files. For fiscal year 2006, the Council estimated that General Fund collections would grow by 9.5%, while actual collections deposited into the Fund amounted to \$4.4 billion, an increase of 10.9% over the previous fiscal year. The Council estimated that personal income would grow by 8.2% in calendar year 2005, while the United States Bureau of Economic Analysis reported that personal income in Hawaii was \$44.0 million in calendar year 2005, an increase of 6.9% over calendar 2004.

In addition to the Annual Report, TR&P staff worked concurrently on four publications during the fiscal year: "Tax Credits Claimed by Hawaii Taxpayers – 2003," "Hawaii Income Patterns – Individuals – 2003," and "Hawaii Income Patterns – Corporation, Proprietorship, Partnership –

2002." All of these reports have been approved by the director of Taxation and have been submitted for printing.

In addition to its regular duties, this fiscal year TR&P has been heavily involved in assisting the Tax Review Commission (TRC) of 2005-2007. The TRC charged with producing a comprehensive review of the States tax structure every five years. TR&P has provided administrative support for the work of the TRC and has produced a number of reports requested by the Commission, including studies on the adequacy of Hawaii's tax structure, the revenue costs of selected general excise and use tax exemptions, the distribution of the burden of Hawaii's taxes among people in different income groups, the effects of replacing Hawaii's income taxes with an increase in the general excise tax, the effects of increasing the standard deduction and expanding the income tax brackets, the effects of enacting a Hawaii earned income tax credit, and the effects of providing income tax credits for food, medical services and nonprescription drugs.

### **Taxpayer Advocacy Program**

The Taxpayer Advocacy Program is administered by the Department's Taxpayer Advocate under the direction of the Director of Taxation. The Taxpayer Advocate assists taxpayers who were not able to resolve their problems through the normal channels. The position is a one-person operation whose main focus is on the needs of the taxpayer on a case-by-case basis. In January 2006, the prior Taxpayer Advocate accepted a promotion to become a supervisor in Office Audit.

For the fiscal year ending 2006, the Advocacy Program helped 281 taxpayers resolve their tax problems. Problems can consist of erroneous billings, non receipt of refunds, waiver requests for penalty and interest, verifications of tax liabilities, explanations of letters and assessments, non-filed returns, collection issues, delay in responses to inquiries, inability to access the information/communication phone lines, appeal, and general tax information. Additional cases did not require intervention from the Advocate, but mainly required guiding the taxpayer to the right management personnel.

The Taxpayer Advocacy Office also coordinates the Department's joint outreach venture, which provides tax services to communities that do not have ready access to these services. A variety of tax services are provided, such as acceptance of the General Excise Tax license applications, explaining assessment notices, arranging payment plans, voluntary compliance, requests for waiver of penalties and interest amounts, preparation of individual income tax and general excise tax returns, and answering general tax questions.

During the 2006 tax season, DOTAX partnered with the Internal Revenue Service in bringing tax assistance to the island of Molokai. DOTAX also partnered with the American Association of Retired People (AARP) through their Tax Aide Program to bring tax assistance to the Waianae community. Under the AARP program, volunteer counselors are trained and IRS-certified to assist the elderly, low income, limited English speaking, or disabled taxpayers in preparing their Federal and State income tax returns. The joint outreach assisted approximately 55 taxpayers on



Molokai and 50 taxpayers at Waianae. At each outreach, the Taxpayer Advocate was on hand to assist taxpayers with their questions and to resolve their tax concerns.

In April, the Taxpayer Advocate participated at the Oahu Disaster Assistance and Recovery Center, providing disaster relief information, assistance, and services to taxpayers who were affected by the heavy rains and floods.

In general, the majority of the taxpayers were satisfied with the outcome of their cases, regardless of whether the decision was made in their favor. The Taxpayer Advocacy program focuses on taxpayers' needs while maintaining taxpayer confidence that Hawaii's tax laws are administered in a consistent, uniform and fair manner.

## MANAGEMENT PERSONNEL

(FY 2005 – 2006)

### OFFICE OF THE DIRECTOR

Director of Taxation.....Kurt Kawafuchi  
Deputy Director of Taxation..... Sandra Yahiro

### STAFF OFFICES

Rules Officer..... Johnnel Nakamura  
Tax Research & Planning Officer..... Tu Duc Pham  
Information Technology Services Officer.....Clay Sato  
Administrative Services Officer ..... Suzanne Efhan  
Personnel Officer.....Sharon Iwamura

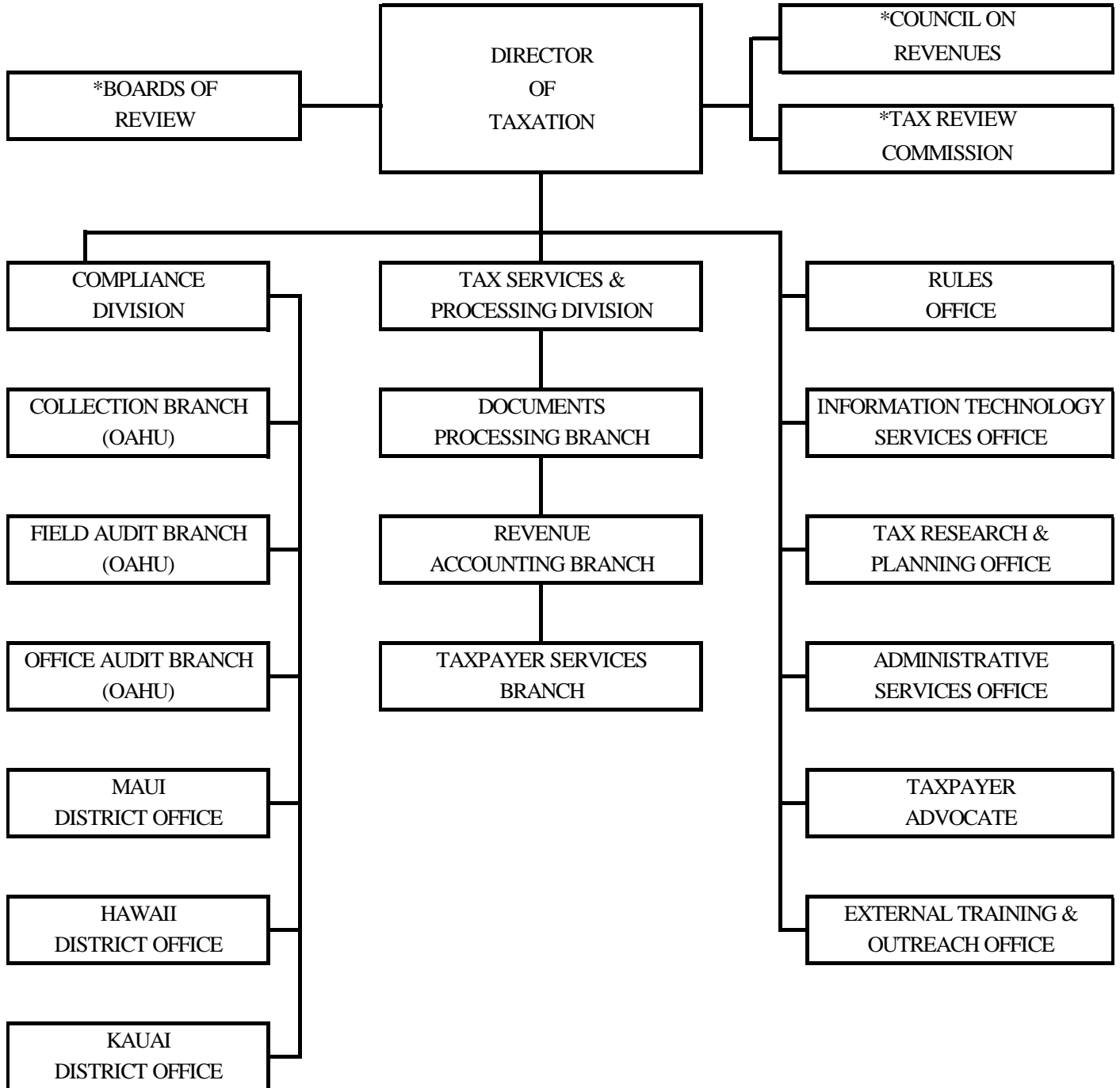
### OPERATIONS STAFF

Compliance Division Chief..... Ronald Randall  
Tax Audit Technical Coordinator.....Richard Chiogioji  
Tax Collection Technical Coordinator.....Wayne Kinoshita  
Oahu Field Audit Branch Chief..... Vacant  
Oahu Office Audit Branch Chief..... Kenneth Cook  
Oahu Collection Branch Chief ..... Lynne Kaneta  
Maui District Tax Manager ..... Frederick Pablo  
Hawaii District Tax Manager..... Lincoln Fujimori  
Kauai District Tax Manager..... Dulcie Yano

Tax Services and Processing Division Chief..... Joan Bolte  
Taxpayer Services Branch Chief.....Annette Yamanuha  
Document Processing Branch Chief.....Jerry Ebesu  
Revenue Accounting Branch Chief.....Deanne Obatake

# ORGANIZATION CHART

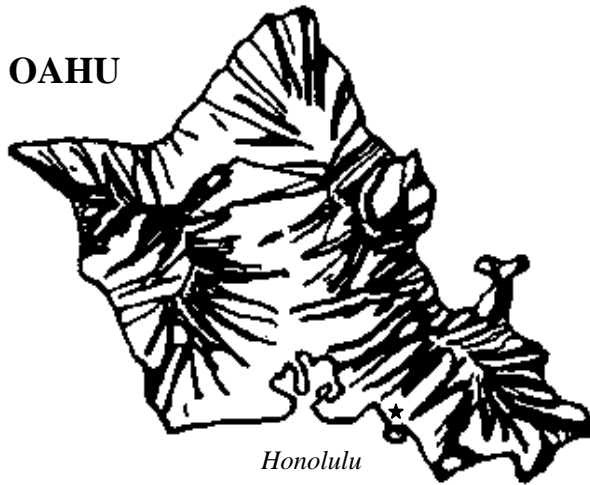
Department of Taxation  
State of Hawaii



\* For Administrative Purposes

## FIRST TAXATION DISTRICT

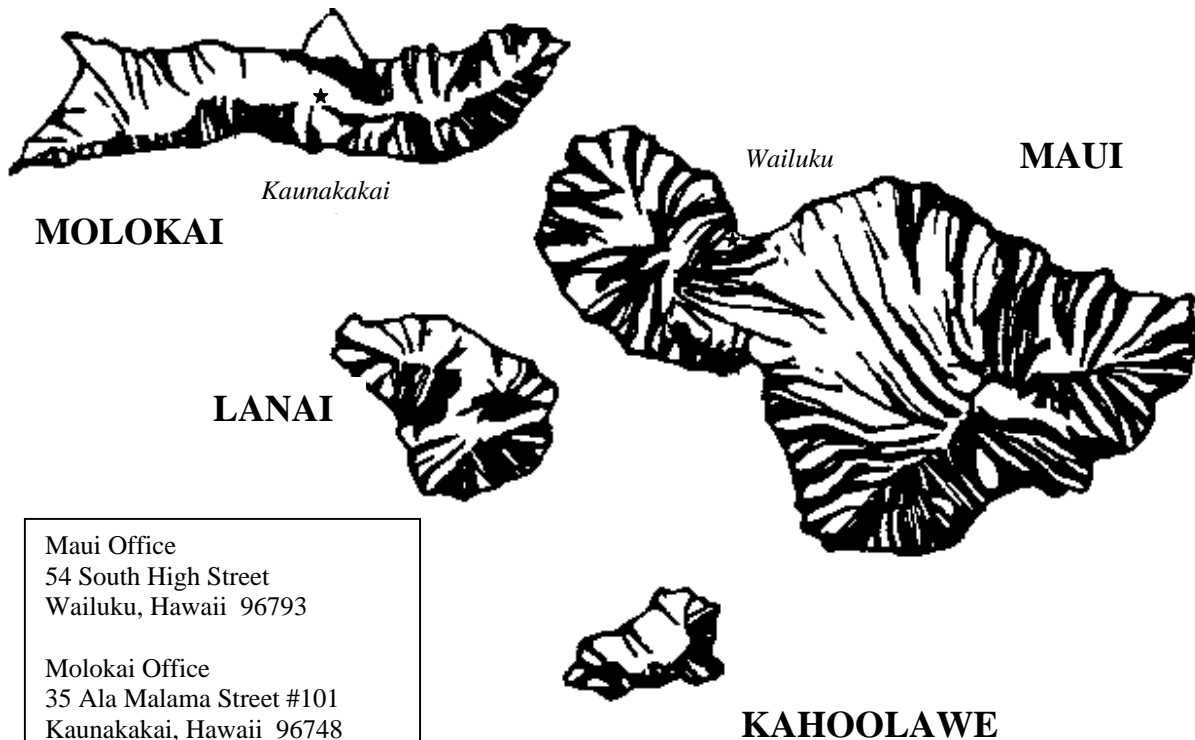
Island of Oahu



Oahu Office  
830 Punchbowl Street  
Honolulu, Hawaii 96813

## SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



Maui Office  
54 South High Street  
Wailuku, Hawaii 96793

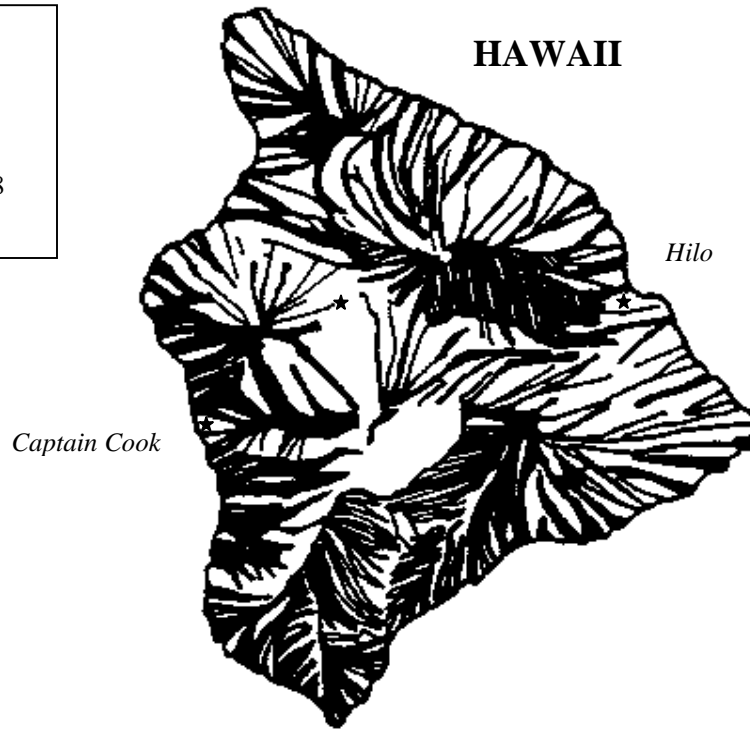
Molokai Office  
35 Ala Malama Street #101  
Kaunakakai, Hawaii 96748

## THIRD TAXATION DISTRICT

Island of Hawaii

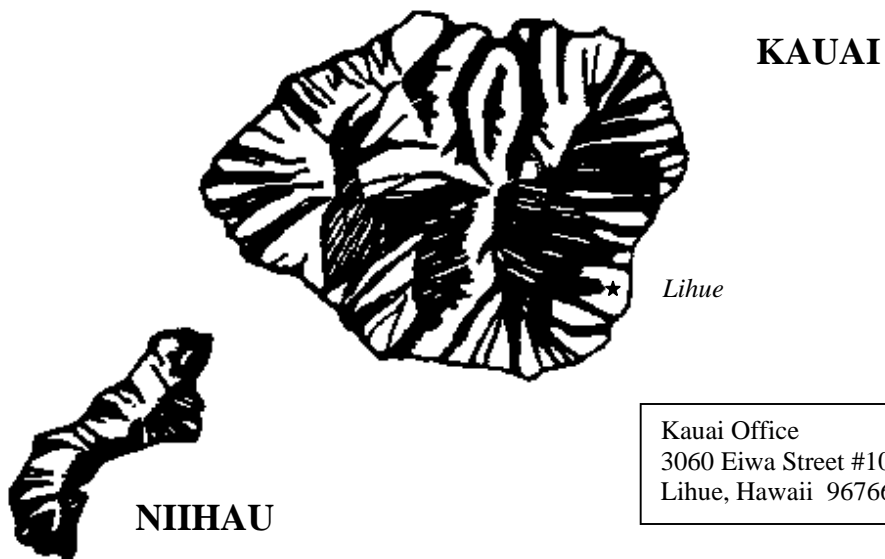
Hilo Office  
75 Aupuni Street  
Hilo, Hawaii 96720

Kona Office  
82-6130 Mamalahoa Highway #8  
Captain Cook, Hawaii 96704



## FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau



Kauai Office  
3060 Eiwa Street #105  
Lihue, Hawaii 96766

## TAX APPEALS AND LITIGATION

### BOARDS OF REVIEW

Each taxation district has a Board of Review consisting of five members. Tax disputes that are not resolved at the district tax office level are presented to the Board of Review. Statewide, the boards began the fiscal year with 90 pending tax appeals. A total of 5 appeals were settled, while 3 new appeals were filed, resulting in a total of 86 appeals pending at the end of the year. The following table summarizes the number of appeals before the boards by tax district:

	<u>Oahu</u>	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals pending (beginning)	62	15	3	7	90
New appeals	1	0	0	2	3
Appeals withdrawn	1	0	1	0	2
Appeals settled	<u>1</u>	<u>2</u>	<u>2</u>	<u>0</u>	<u>5</u>
Appeals pending (ending)	61	13	0	9	86

### COURT DECISION

#### SETTLED CASES

In re Glenn P.K. Akiona, Bk. Case No. 03-01876 (Chapter 11), United States Bankruptcy Court for the District of Hawaii.

The Department agreed to a plan in which the Debtor would file returns and pay estimated taxes for 2004 and 2005 by making payments of \$16,000.00 per month to a disbursing agent who makes proportional distributions to the IRS and the Department.

In re Aloha Airgroup, Inc., et al., Bk. Case No. 04-03063 (Chapter 11, Jointly Administered), United States Bankruptcy Court for the District of Hawaii.

The Department and the Debtors agreed to a structured compromise of the Department's claim, including an initial downpayment and a return to the Department of a percentage of any refund of fuel taxes paid.

In the Matter of the Tax Appeal of Dreyers, T.A. No. 05-0067, Tax Appeal Court, State of Hawaii.

The Department assessed the use tax on Taxpayer's business income derived from distributing ice cream products to Hawaii merchants and to military commissaries between 1988 through 2003, inclusive. Taxpayer was also assessed for general excise tax for years 2002 and 2003 on its income derived from its storage and delivery service.

In the Matter of the Tax Appeals of Patrick Fujieki, T.A. Nos. 05-0071 through 0074, Tax Appeal Court, State of Hawaii.

These tax appeals involve complaints for refund of conveyance taxes on the transfer of property from a trust to the trust beneficiaries' single member limited liability company. The taxpayer dismissed the cases after the Department filed a motion for summary judgment.

In the Matter of the Tax Appeal of Pitney Bowes, Inc., T.A. No. 03-0182, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer additional general excise taxes based on the difference in income reported on its net income and general excise tax returns. The Department has settled this case. The parties have filed a stipulation to dismiss.

In the Matter of the Tax Appeal of Proservice Hawaii Business Development Corporation, T.A. No. 00-0036, Tax Appeal Court, State of Hawaii.

Taxpayer, a professional employment organization, appealed from a general excise tax assessment for tax year 1998. Taxpayer only paid twenty percent of the general excise taxes for that year, claiming that it was a business development company ("BDC"). The Department disallowed the special tax rate for BDCs because it determined that Taxpayer was not a BDC, which was intended to make primarily "last resort" loans as outlined and clarified by Haw. Rev. Stat. §§ 420-2(a) and (b). The Department determined that Taxpayer was actually engaged in the service business subject to general excise tax under Haw. Rev. Stat. Ch. 237. The Tax Appeal Court denied cross motions for summary judgments on the BDC issue, reasoning that the matter involved a question of fact. The amount in controversy was \$717,458.91. The parties settled the matter. The stipulation to dismiss the appeal was filed on March 3, 2006.

#### COMPLETED CASES

In re Hawaiian Airlines, Inc., Bk. Case No. 03-00817 (Chapter 11), United States Bankruptcy Court for the District of Hawaii.

The Department assessed the Debtor for unpaid general excise taxes. The Debtor objected to the Department's priority claim. After investigation, the Debtor agreed to the full amount of the priority claim, over \$1 million.

In the Matter of the Tax Appeal of Innovation Data Processing, Case No. 05-0051, Tax Appeal Court, State of Hawaii.

Taxpayer appealed income tax assessments for tax years 1974-1980. Taxpayer claimed that the assessments violated the Commerce Clause because Taxpayer did not have substantial nexus in Hawaii. The Notice of Appeal was not properly served. The Department filed a motion to dismiss on the following bases: (i) improper service; (ii) because Taxpayer is a corporation, it may not appear *pro se*; and (iii) although a complaint under Haw. Rev. Stat. § 40-35 may have been timely, a tax appeal was untimely. The Tax Appeal Court granted the motion and the matter was dismissed. The order and judgment was entered on October 3, 2005.

In the Matter of the Tax Appeal of Steven J. Newinsky, Case No. 05-0056, Tax Appeal Court, State of Hawaii.

Taxpayer filed a notice of appeal disputing an income tax assessment for tax year 2001 claiming that the full amount he received in a settlement of a civil case he filed against his employee was not income because the settlement was for personal injury. However, the Department received a W-2 form in which the employer characterized the entire amount as income. The Department filed a motion to dismiss on the basis that the Tax Appeal Court lacked subject matter jurisdiction because Taxpayer failed to pay the tax assessment as required by law and failed to serve the tax assessor. The motion was granted and the matter was dismissed. The order and judgment was filed on April 11, 2006.

Kurt Kawafuchi v. Jeffrey Roache, Civ. No. 06-1-0154-01, Circuit Court of the First Circuit, State of Hawaii.

The Department brought suit for a declaratory judgment that the taxpayer filed false or fraudulent returns so that the Department could make an assessment under § 235-111(c), Haw. Rev. Stat. The Court granted the Department's motion for summary judgment.

Kurt Kawafuchi v. John P. Souza, Civ. No. 05-2173-12, Circuit Court of the First Circuit, State of Hawaii.

The Department brought suit for a declaratory judgment that the taxpayer filed false or fraudulent returns so that the Department could make an assessment under § 235-111(c), Haw. Rev. Stat. The Court granted the Department's motion for summary judgment.

In the Matter of the Tax Appeal of Subway Real Estate Corp., S. Ct. No. 26488, Supreme Court of the State of Hawaii.

The Department assessed Taxpayer for subleasing income for 1992. Taxpayer appealed the assessment to the Tax Appeal Court. The Tax Appeal Court determined that the Department could assess general excise taxes on the value of services Taxpayer provided pursuant to In re C. Brewer & Co., Ltd., 65 Haw. 240 (1982), but not on Taxpayer's subleasing income. The Supreme Court of Hawaii held that the Department's assessments were correct and that Taxpayer was subject to the general excise tax on its subleasing income. The Supreme Court of Hawaii further held that the Department could assess the general excise on the value of services Taxpayer provided.

## PENDING APPEALS

### Hawaii Supreme Court

#### In the Matter of the Tax Appeal of Henry F. Johnson and International Resource Recovery, Inc.,

S. Ct. No. 27738, Supreme Court of the State of Hawaii.

After he received an unfavorable ruling from the Board of Review, Taxpayer, a *pro se* litigant, did not prepay his net income taxes earned from his S corporation that performed federal rubbish removal work in Hawaii. The Tax Appeal Court dismissed Taxpayer's case based on Lewis v. Kawafuchi, 108 Haw. 69 (2005). Taxpayer appealed to the Hawaii Supreme Court. After initially dismissing the case based on Jenkins v. Cades Schutte, 76 Haw. 115 (1994), the Court reversed itself and allowed Taxpayer to file a late jurisdictional statement and Opening Brief. A motion to dismiss for lack of jurisdiction is pending.

#### In the Matter of the Tax Appeal of Medical Underwriters, S. Ct. No. 27023, Supreme Court of the State of Hawaii.

The Department assessed Taxpayer the four percent general excise tax on income for providing management services to certain insurance companies. Taxpayer argued that it was exempt from the general excise tax because it was an insurance company. After the filing of various motions for summary judgment, the Tax Appeal Court held that Taxpayer was not exempt from the general excise tax and the income it received as commissions or compensation for services rendered as an attorney-in-fact to the insurance companies was taxable at the 0.15 percent general excise tax rate with taxes totaling \$3,943.95. The Department and Taxpayer appealed to the Hawaii Supreme Court.

#### In the Matter of the Tax Appeal of Bobby R. Narmore, S. Ct. No. 26812, Supreme Court of the State of Hawaii.

Taxpayer filed an appeal to the Hawaii Supreme Court arguing that the Tax Appeal Court should not have dismissed his case. Taxpayer argued that the Department could not collect the taxes owed for the years in question because the statute of limitations for the Department to assess had expired. The case is fully briefed and awaiting disposition.

### Tax Appeal Court, State of Hawaii

#### In the Matter of the Tax Appeal of the Director of Taxation v. ATM Cash Systems, LLC, T.A. No. 06-0029, Tax Appeal Court, State of Hawaii.

Taxpayer paid franchise taxes on the income from an automated teller machine provider service. The Department asserted Taxpayer should have paid general excise taxes and made assessments on the difference. This case has not been set for trial.

#### In the Matter of the Tax Appeals of Central Pacific Bank, T.A.Nos. 02-0075, 03-0155, and 05-0041, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from assessments of franchise taxes resulting from the disallowance of a deduction for dividends it received from a wholly owned real estate investment trust (REIT). Taxpayer claimed that because IRC § 857(c) (which is operative in Hawaii and denies the deduction for dividends paid by a REIT) refers to IRC § 243 (which is inoperative), it was entitled to take a deduction for \$89 million in dividends it received from a REIT.

#### In the Matter of the Tax Appeal of Kurt Kawafuchi v. Jeanette Cochrane, T.A. No. 06-0078, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on underreported gross receipts related to the sale of postage stamps and postal services. The Department's assessments were based on the sale of postal stamps and postal services as business activities subject to the general excise tax. Taxpayer appealed the assessment to the Board of Review and prevailed. The Department appealed the Board of Review's ruling on July 7, 2006.

#### In the Matter of the Tax Appeal of CompUSA, T.A. No. 05-0065, Tax Appeal Court, State of Hawaii.

The Department assessed the use tax on Taxpayer's business income derived from the importation of products for resale to the general public for the period July 1, 1999 through December 31, 2002. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).



In the Matter of the Tax Appeal of Gold Key Lease, T.A. No. 06-0027, Tax Appeal Court, State of Hawaii.

Based on the amounts reported in Taxpayer's income tax returns, the Department assessed Taxpayer for general excise tax on its motor vehicle leasing business. Taxpayer claims that the assessments are incorrect because the auditor inappropriately relied on the amounts reported in its income tax returns as opposed to the worksheets it provided to the auditor.

In the Matter of the Tax Appeal of Hale Kupuna Heritage Home, LLC, T.A. No. 04-0042, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer for Hale Omao Inc.'s general excise tax liabilities and Benjamin and Mary Aranio's income tax liabilities pursuant to Haw. Rev. Stat. § 237-43 (2001) because no bulk sales report was obtained or filed when Taxpayer bought Hale Omao's 84-bed care home business and the Aranios' real property where the care home business is located.

In the Matter of the Tax Appeal of Honolulu Auto, Inc., T.A. No. 06-0069, Tax Appeal Court, State of Hawaii.

Taxpayer appealed corporate income tax assessments for tax years 2001-2003. The basis of the appeal was left blank in the Notice of Appeal, which was not properly served. The Department filed a motion to dismiss the appeal on the following bases: (i) lack of subject matter jurisdiction as the appeal is untimely; and (ii) the Notice of Appeal is void because it was signed and filed by a person who is not licensed to practice law in the State of Hawaii.

In the Matter of the Appeal of ICH Group, LLC, T.A. No. 05-0070, Tax Appeal Court, State of Hawaii.

Taxpayer filed its Notice of Appeal challenging general excise, use, and income tax assessments for tax years 2001-2003, claiming that: (a) the assessments erroneously treat all amounts deposited into Taxpayer's bank accounts as gross income, although substantial amounts were simply transfers from one bank account held by Taxpayer to another, and thus not includible in gross income; (b) additional amounts were advances from related entities, or repayments of advances to related entities, and were similarly not part of gross income; (c) the assessments wrongly deny tax benefits to which Taxpayer is entitled as an Enterprise Zone business; and (d) the assessments include use tax for which Taxpayer is not actually liable.

In the Matter of the Appeal of Jarrett Technology Solutions, Inc., T.A. Nos. 05-0076 and 06-0068 (Consolidated), Tax Appeal Court, State of Hawaii.

Taxpayer filed two appeals for tax years ending June 30, 2000-2003. Taxpayer claims that: (a) the assessments erroneously treat sales of tangible goods to the federal government as taxable transactions, and/or treat sales of goods as if they were sales of services; (b) the use tax cannot apply to Taxpayer as a seller of goods, where title to the goods passed before the goods arrived in Hawaii and the federal government was the owner of the goods at the time they entered Hawaii; (c) any attempt to apply the general excise tax and use tax to sales at issue of the goods involved violates the Due Process Clause, Commerce Clause, Equal Protection Clause, and/or other clauses or provisions of the United States Constitution, and/or other federal law; and (d) the assessments overstate Taxpayer's actual tax liability by (i) assuming that sales took place in Hawaii when in fact they did not; (ii) assuming that all sales were taxable when in fact most sales were exempt; (iii) wrongly treating wholesale transactions as sales at retail, and by wrongly denying all exemptions applicable to services; (iv) assuming Taxpayer imported goods into Hawaii when in fact they did not; (v) basing the use tax assessments on erroneous numbers and inconsistent methods of computation; and (vi) making assumptions unfavorable to Taxpayer to meet the deadline for assessment.

In the Matter of the Tax Appeal of the Director of Taxation, State of Hawaii v. Donald J. Karleen and Barbara Brown-Karleen, T.A. No. 04-0045, Tax Appeal Court, State of Hawaii.

The Department appealed the Board of Review's decision in favor of Taxpayers. Taxpayers claimed the Residential Construction and Remodeling Tax Credit and the General Income Tax Credit for tax year 2001. However, it is unclear when Taxpayers made the claim. The Department denied the claim on the basis that the claim was untimely. The Department has no record of receiving the tax return Taxpayers alleged they submitted until after the deadline for making the claim. Trial is scheduled for the week of March 5, 2007.

Make-up Arts Cosmetics Inc. v. Director of Taxation, State of Hawaii, T.A. No. 03-0259, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer the general excise tax as follows: 0.5 percent for the wholesale of make-up products sold, four percent on services provided at its counters in the stores, and 4.5 percent on the import and sale of furniture and fixtures. The case is currently in discovery to determine the validity of Taxpayer's claims that the

assessments are incorrect for the following reasons: it did not sell nor did it import any products in Hawaii and that it had sharing agreements with the stores concerning the employees at the counters.

In the Matter of the Tax Appeal of Parsons-UXB Joint Venture, T.A. No. 00-0055, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer additional general excise taxes asserting Taxpayer improperly claimed the subcontractor deduction for services other than contracting. Taxpayer has not provided the Department with records to substantiate its deductions.

In the Matter of the Tax Appeal of the Director of Taxation, State of Hawaii v. Sunamerica Securities, Inc., T.A. No. 05-0075, Tax Appeal Court, State of Hawaii.

Taxpayer is a mainland securities dealer with local independent contractors providing sales services to its Hawaii customers. Taxpayer buys securities from underwriters and facilitates sales to Hawaii consumers through its independent contractors located here. The Department assessed general excise taxes on Taxpayer's gross receipts based on its commissions received from the underwriters.

In the Matter of the Tax Appeal of Takeno Group, LLC, T.A. No. 05-0069, Tax Appeal Court, State of Hawaii.

Taxpayer filed its notice of appeal challenging general excise taxes for tax years 2002-2004 and a withholding tax assessment for tax year 2005. In the Notice of Appeal, Taxpayer claims: (a) the assessments overstate Taxpayer's liability by making assumptions; (b) Taxpayer did not pay employees in 2004 and therefore did not owe any withholding tax; and (c) Taxpayer operates in the Enterprise Zone.

In the Matter of the Tax Appeal of WV Sub, LLC and Campbell Hawaii Investor LLC, T.A. No. 05-0078, Tax Appeal Court, State of Hawaii.

Taxpayers/Plaintiffs filed a complaint for refund of or notice of appeal from conveyance taxes paid under protest. The amount in controversy is \$339,407.40. Act 156, Hawaii Session Laws 2005, increased the applicable conveyance tax rate from .1 percent to .3 percent for properties with a value of \$1 million or greater unless it is a condominium or a single-family residence. Act 156 is effective as of July 1, 2005. The parties in this case allegedly entered into a Disposition Agreement dated November 29, 2004 for the sale of a shopping mall in Maui. The actual sale of the property, however, took place on November 1, 2005. Taxpayers/Plaintiffs argue that the old rate applies.

## MISCELLANEOUS CASES

State of Hawaii v. Petala Lakatani aka Pete Lakatani, Cr. No. 05-1-0294, Circuit Court of the First Circuit, State of Hawaii.

Defendant was a tax preparer criminally charged with several counts of false and fraudulent statements and several counts of theft in the second degree. During the criminal proceeding, the Department was served with a *subpoena duces tecum* for all tax returns, audit files, etc. pertaining to all of Defendant's clients. The Court denied the Department's motion to quash subpoena. The Department produced the requested documents for an *in camera* review. The Court determined during the *in camera* review that all of the documents produced was discoverable. The Department filed a Writ of Mandamus and/or Prohibition ("Writ") (Department of Taxation v. Honorable Michael A. Town, S.C. No. 27641). In addition, the Department filed a "Motion to Stay the Order" and a Notice of Appeal with the Hawaii Supreme Court. On June 1, 2006, Defendant entered a change of plea to guilty with sentencing scheduled for August 15, 2006. On June 26, 2006, the Hawaii Supreme Court denied the Department's Motion to Stay and its Writ based on Defendant's guilty plea and that the Department had a valid Notice of Appeal on record with the Supreme Court.

## CRIMINAL CASES

During fiscal year 2005-2006, the Criminal Justice section of the Department of the Attorney General filed complaints or indictments against forty taxpayers<sup>1</sup> for violating Hawaii state tax laws as set out in Haw. Rev. Stat. §§ 231-34, 231-35, and 231-36. The complaints and indictments filed against the forty taxpayers accounted for over \$1,344,430.00 in unpaid taxes (excluding civil assessments, penalties, and interest.) To date, the courts have imposed criminal fines of \$225,000.00.<sup>2</sup>

During fiscal year 2005-2006, Criminal Tax Collector, Ms. B. Yamada, set a new all time record by collecting over \$2,305,236.56 in unpaid taxes, penalties, and interest. The amount collected beat last year's record fiscal year, increasing by over 32 percent.

Nineteen of the forty taxpayers were real estate agents who were not filing their general excise tax returns despite earning substantial commission income as a result of the booming real estate market. The highest amount grossed was over \$1,154,453.00 in unreported commission income over six years. The majority of the real estate agents plead to misdemeanor, failure to file, charges; however, one of the 19 agents plead guilty to felony, false statements, charges for underreporting his commission income on his annual general excise tax returns.

## OTHER CASES

Identity Theft has become no stranger to the Department. A return preparer on Maui was indicted for sending in false N-11s and having the refund checks mailed to his personal residence in Texas. And the first electronically filed returns case involved a student tax return preparer indicted for Identity Theft stemming from her electronic filing of State tax returns and depositing the refunds into her own bank account, unbeknownst to the students she helped prepare the returns for.

Two (2) Maui companies (and the responsible person(s)) were indicted for failing to file withholding tax returns. Although failure to file is a misdemeanor charge, felony theft was also charged due to the nature of withholding taxes. The trust fund nature of withholding taxes warrants the theft charge due to the companies' failure to remit, to the State, the monies withheld from the employees' paychecks.

During the last fiscal year, the Tax Division closed 440 Tax Department related legal matters, not including legislative matters which have not yet been closed in our case management system by the Department's Legislative Division.

### OTHER MATTERS CLOSED

Appeals	-	10
Bankruptcies	-	245
Foreclosures	-	72
Subpoenas	-	12
Opinions	-	32
Contracts	-	6
Legislation	-	n/a
Miscellaneous	-	63

### AMOUNTS COLLECTED

Tax Appeals	\$1,210,193
Foreclosures	65,719
Bankruptcies	6,535,870
Trusts	0
Miscellaneous	<u>725,985</u>
TOTAL	\$8,537,768

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<sup>1</sup> Although the number of complaints/indictments has fallen from the 2004-2005 fiscal year, there are 34 pending cases that have been referred to the Attorney General's Criminal Justice Division.

<sup>2</sup> Criminal fines are imposed at sentencing; to date, eight (8) taxpayers have yet to be sentenced.

## LEGISLATION

The 2006 legislature enacted the following tax-related measures:

<u>Act</u>	<u>Brief Description</u>
------------	--------------------------

- |     |   |
|-----|---|
| 88  | <b>Motion Picture Production Income Tax Credit.</b> Increases the tax credit to 15% of qualified production costs incurred in counties with a population over 700,000 and to 20% of qualified production costs incurred in counties with a population of 700,000 or less. Eliminates the 7.25% tax credit for qualified transient accommodation costs. Establishes qualifications for productions and creates prequalification standards. Prohibits a production cost from qualifying for the tax credit if the cost has been paid for with money for which a high technology business investment tax credit was claimed. Sets an \$8 million cap per production on tax credit. <i>Effective on July 1, 2006; provided that the tax credit only applies to qualified production costs that were incurred on or after July 1, 2006 and before January 1, 2016; provided that the Act is repealed on January 1, 2016, and is reenacted in the same form prior to the enactment of this Act.</i> |
| 100 | <b>Rental Housing Trust Fund.</b> Increases the allocation of conveyance tax revenues deposited into the rental housing trust fund from 30% to 50%. <i>Effective on July 1, 2006; provided that the Act is repealed on June 30, 2007, and is reenacted in the same form prior to the enactment of this Act.</i>   |
| 110 | <b>Income Tax Relief.</b> Increases the individual income tax standard deduction to approximately 40% of the 2005 federal standard deduction. Widens the individual income tax brackets by approximately 20% for married persons filing jointly, heads of household, surviving spouses, married persons filing separately, and unmarried person. Provides generally a one-time nonrefundable income tax credit equal to 10% of the qualified unreimbursed damage costs incurred as a result of the 2004 Manoa and First Quarter 2006 statewide flooding. Provides that the tax credit shall be refundable if the taxpayer has income of \$20,000 or less or all of the taxpayer's income is exempt pension income. Limits the tax credit to \$10,000 per taxpayer. <i>Upon approval; applicable to taxable years beginning after December 31, 2006; provided that the tax credit applies to taxable years beginning after December 31, 2003 and ending before January 1, 2007.</i>            |
| 124 | <b>IRS Conformity.</b> Amends Hawaii's Income Tax Law to conform with the changes to the Internal Revenue Code with exceptions. <i>Upon approval; applicable to taxable years beginning after December 31, 2005, except as otherwise provided.</i>  |
| 142 | <b>Rental Motor Vehicle Surcharge Tax.</b> Allows either the lessor or the repair dealer to retain a record of the repair order in order for the lessor to be exempt from the rental motor vehicle surcharge tax. Amends the records retention requirement for the repair order to two years to be consistent with repair dealer records retention laws. <i>Effective on July 1, 2006.</i>  |
| 180 | <b>Tax Exemption.</b> Section 201G-116 provided a general excise tax exemption for persons or firms involved with the construction of affordable housing. This tax exemption continues unamended and recodified as HRS 201H-____. Section 201G-117 provided that certain income earned and obligations issued by a nonprofit entity that qualifies as a "public housing agency" under federal law, are exempt from all taxes imposed by the State. This tax exemption continues unamended and recodified as HRS 201H-____. Section 201G-459 provided a general excise tax exemption for certain providers of services rendered to homeless facilities or individuals. This tax exemption continues unamended and recodified under a new chapter yet to be determined. <i>Effective on July 1, 2006.</i>   |
| 209 | <b>Convention Center Enterprise Special Fund.</b> Raises the ceiling on deposits of transient accommodation tax revenues into the convention center enterprise special fund from \$31 million to \$33 million. <i>Effective July 1, 2006; provided that the amendments shall remain in effect when Act 235, SLH 2005, takes effect on July 1, 2007.</i>   |

- 240     **Renewable Energy Tax Credits.** Increases the tax credit limits for single-family residential solar thermal energy systems to \$2,250, for commercial wind-powered energy systems to \$500,000, for single-family residential photovoltaic energy systems to \$5,000, and for commercial photovoltaic energy systems to \$500,000. Eliminates the deduction from the calculation of the installation cost of any new, similar federal energy tax credit for taxable years beginning after December 31, 2005. Eliminates the sunset date established in Act 207, SLH 2003. *Upon approval; applicable to taxable years beginning after December 31, 2005; provided that the increased tax credits shall be available only to eligible renewable energy technology systems installed after July 1, 2006.*
- 304     **Educational Facilities Improvement Special Fund.** Increases the amount of funds to be deposited into the State educational facilities improvement special fund, which is the difference between \$90 million and any general obligation bond financing for educational facilities. Clarifies that use of the funds is for improvement of educational facilities capital improvement program needs. *Effective on July 1, 2006; provided that the Act is repealed on June 30, 2007, and is reenacted in the same form prior to the enactment of this Act.*
- 316     **Cigarette Tax.** Increases the excise tax per cigarette by one cent per year over a six-year span (an increase of \$0.20 per pack per year) starting on and after September 30, 2006. Creates the Hawaii cancer research special fund and the community health centers special fund. Deposits portions of the cigarette excise tax revenues into the Hawaii cancer research special fund, the trauma system special fund, the emergency medical services special fund, and the community health centers special fund, starting on and after September 30, 2006. *Effective on July 1, 2006.*

## INCOME ASSESSMENT AND AUDIT

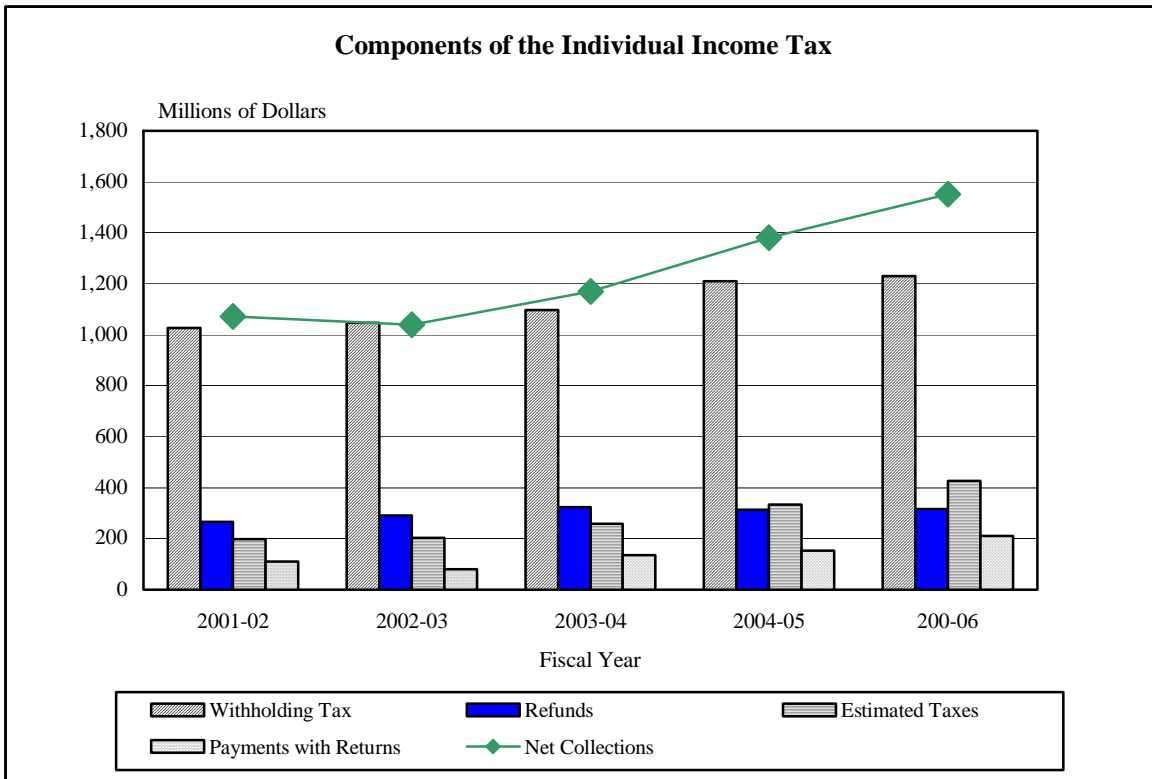
### INDIVIDUAL INCOME TAX

Increased amounts of estimated taxes, payments with returns and withheld taxes over last year contributed to a \$172.0 million growth in individual income taxes; however, increased refunds reduced this sum by \$2.9 million. Overall, net individual income tax increased by 12.2% from \$1.4 billion in fiscal year 2005, to \$1.6 billion in fiscal year 2006, mainly due to the strong growth of the economy, as well as increases in delinquent tax collections. As shown in the following chart, this was the highest net in the past five fiscal years.

#### TAXES PAID BY INDIVIDUALS (In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 426,864	\$ 332,808	\$ 94,056	28.3
Payment with Return	210,629	152,919	57,710	37.7
Withholding Tax on Wages	1,230,018	1,209,740	20,278	1.7
Subtotal	\$1,867,511	\$1,695,467	\$ 172,044	10.1
Refunds	316,915	313,987	2,928	0.9
NET	\$1,550,596	\$1,381,480	\$ 169,116	12.2

NOTE: Due to rounding, details may not add to totals.



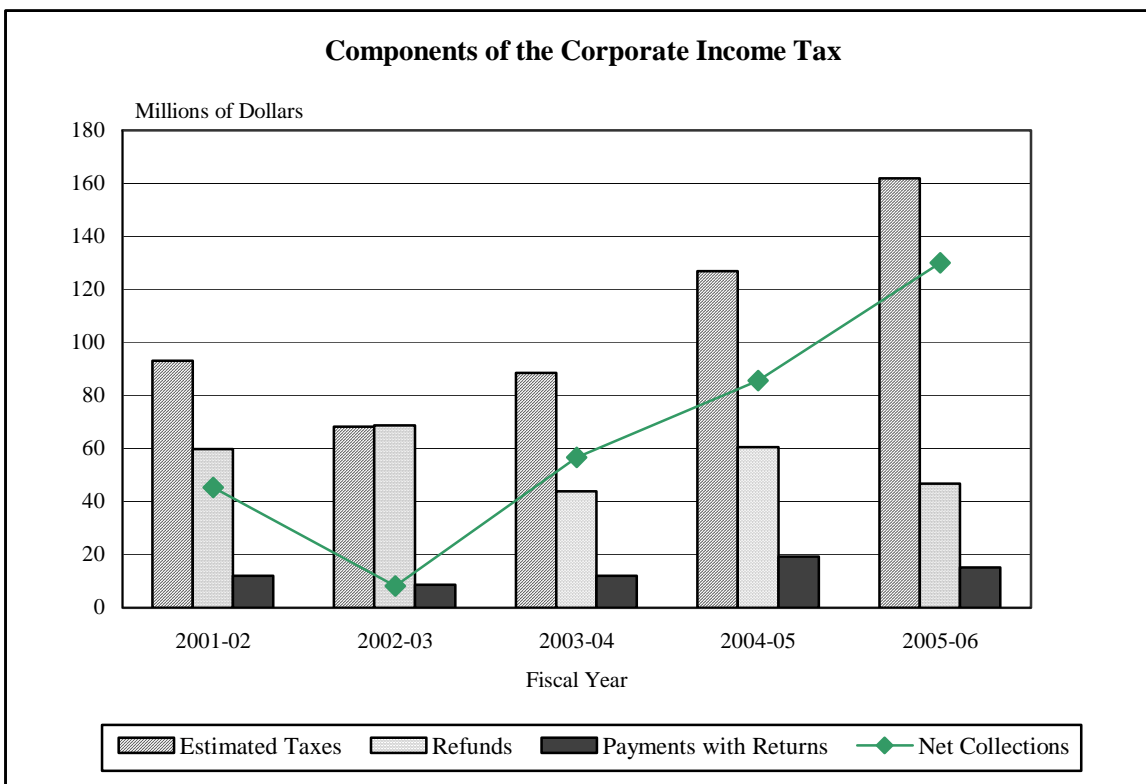
## CORPORATE INCOME TAX

Net corporate tax collections totaled \$130.0 million for fiscal year 2006, increasing a sizable \$44.4 million over the previous year's total of \$85.6 million. The increase was mainly due to strong economic growth, as well as increases in delinquent tax collections. A significant part of the increase was also due to a large one-time estimated tax payment. This was the highest net over the last five fiscal years, as shown in the following chart.

### TAXES PAID BY CORPORATIONS (In Thousands of Dollars)

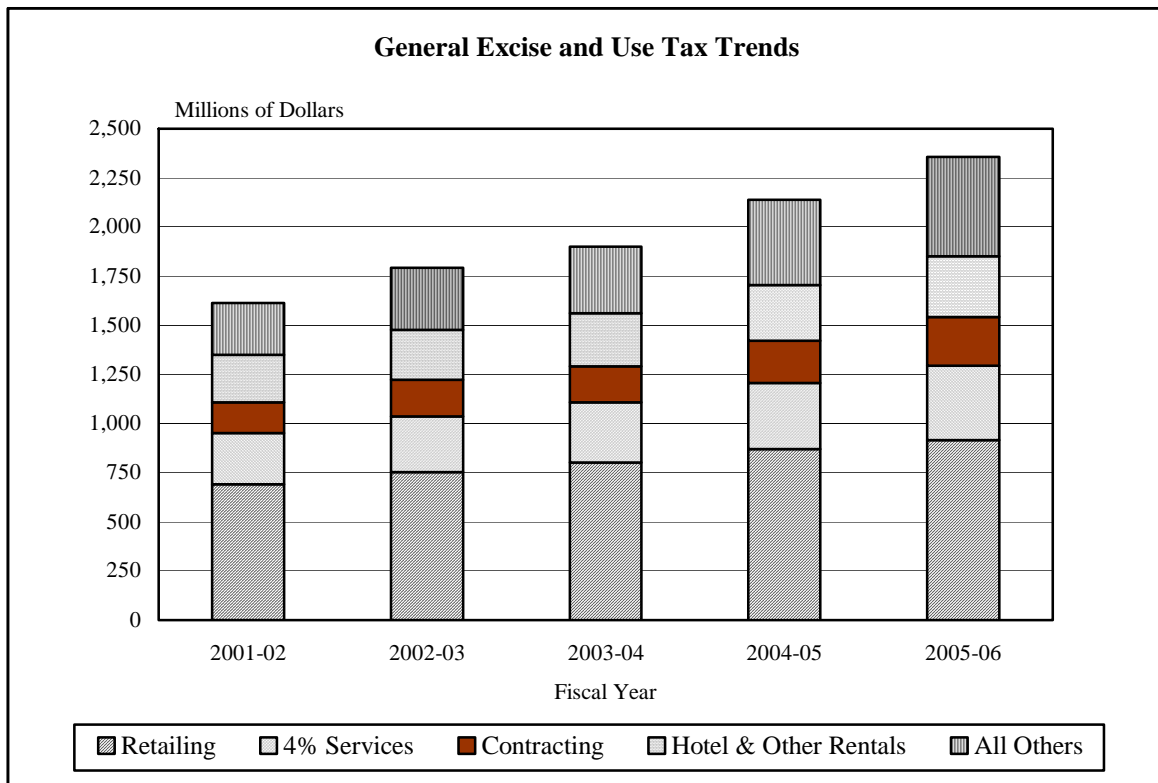
	FY 2006	FY 2005	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 161,795	\$ 126,863	\$ 34,932	27.5
Payment with Return	15,118	19,413	(4,295)	(22.1)
Subtotal	\$ 176,913	\$ 146,276	\$ 30,637	20.9
Refunds	46,904	60,672	(13,768)	(22.7)
NET	\$ 130,009	\$ 85,604	\$ 44,405	51.9

NOTE: Due to rounding, details may not add to totals.



## GENERAL EXCISE AND USE TAXES

General excise and use taxes made up 46.2% of total tax collections. The total \$2.4 billion collected represents a 10.2% growth over the prior fiscal year. Major components of the general excise taxes showed healthy increases over the last fiscal year – contracting rose 14.5%, services 12.5%, hotel rentals 10.3%, all other rentals 9.5% and retailing 5.3%.





GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 2006 AND 2005  
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2006	FY 2005	Difference	
				Amount	% Change
<u>TAX BASE</u>					
Retailing		\$ 22,892,951	\$ 21,747,790	\$ 1,145,161	5.3
Services		9,456,656	8,408,796	1,047,860	12.5
Contracting		6,165,875	5,384,758	781,118	14.5
Hotel Rentals		2,861,311	2,593,054	268,257	10.3
All Other Rentals		4,882,268	4,458,742	423,527	9.5
All Others (4%)		<u>4,693,711</u>	<u>4,176,458</u>	<u>517,253</u>	<u>12.4</u>
Subtotal		\$ 50,952,773	\$ 46,769,598	\$ 4,183,175	8.9
Sugar Processing		\$ 1,955	\$ 1,037	\$ 918	88.5
Pineapple Canning		4,766	3,035	1,731	57.0
Producing		528,430	565,046	(36,616)	(6.5)
Manufacturing		656,261	660,025	(3,764)	(0.6)
Wholesaling		11,978,457	11,205,509	772,947	6.9
Use (1/2%)		6,571,106	5,868,988	702,118	12.0
Intermediary Services		520,771	316,661	204,110	64.5
Insurance Commissions		<u>454,715</u>	<u>487,929</u>	<u>(33,215)</u>	<u>(6.8)</u>
Subtotal		\$ 20,716,460	\$ 19,108,230	\$ 1,608,230	8.4
TOTAL – ALL ACTIVITIES		<u>\$ 71,669,233</u>	<u>\$ 65,877,828</u>	<u>\$ 5,791,405</u>	<u>8.8</u>
<u>TAX</u>					
Retailing	4.00%	\$ 915,718	\$ 869,912	\$ 45,806	5.3
Services	4.00%	378,266	336,352	41,914	12.5
Contracting	4.00%	246,635	215,390	31,245	14.5
Hotel Rentals	4.00%	114,452	103,722	10,730	10.3
All Other Rentals	4.00%	195,291	178,350	16,941	9.5
All Others (4%)	4.00%	<u>187,748</u>	<u>167,058</u>	<u>20,690</u>	<u>12.4</u>
Subtotal		\$ 2,038,111	\$ 1,870,784	\$ 167,327	8.9
Sugar Processing	0.50%	\$ 10	\$ 5	\$ 5	88.5
Pineapple Canning	0.50%	24	15	9	57.0
Producing	0.50%	2,642	2,825	(183)	(6.5)
Manufacturing	0.50%	3,281	3,300	(19)	(0.6)
Wholesaling	0.50%	59,892	56,028	3,865	6.9
Use (1/2%)	0.50%	32,856	29,345	3,511	12.0
Intermediary Services	0.50%	2,604	1,583	1,021	64.5
Insurance Commissions	0.15%	<u>682</u>	<u>732</u>	<u>(50)</u>	<u>(6.8)</u>
Subtotal		\$ 101,991	\$ 93,833	\$ 8,157	8.7
Unallocated*		\$ 215,214	\$ 171,986	\$ 43,229	25.1
TOTAL – ALL ACTIVITIES		<u>\$ 2,355,316</u>	<u>\$ 2,136,603</u>	<u>\$ 218,713</u>	<u>10.2</u>

\*Included are collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements, etc.

NOTE: Due to rounding, details may not add to totals.

## TRANSIENT ACCOMMODATIONS TAX

Increases in the average hotel room rate and in visitor arrivals contributed to the 9.2% jump in transient accommodations tax (TAT). All TAT funds are distributed as follows: approximately 44.8% to the counties; 17.3% to the Convention Center Fund, provided that the revenues in excess of \$31.0 million in any calendar year are deposited into the General Fund; 32.6% to the tourism special fund, provided that if the revenue projections are below \$63,292,000 in any fiscal year, monies will be tapped from the TAT Trust Fund for the difference; and 5.3% to the TAT Trust Fund provided that the amounts not tapped by the Tourism Special Fund are transferred to the General Fund. After these allocations, \$16.4 million remained in the General Fund for fiscal year 2006.

### TRANSIENT ACCOMMODATIONS TAX (In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
Trans. Accom./Time Share Occ. Tax	\$ 216,996	\$ 198,774	\$ 18,222	9.2
Trans. Accom./Time Share Occ. Fees	<u>12</u>	<u>10</u>	<u>2</u>	<u>20.0</u>
Total	\$ 217,008	\$ 198,784	\$ 18,224	9.2
Counties Share	\$ 97,214	\$ 89,051	\$ 8,163	9.2
Convention Center Fund	32,663	32,534	129	0.4
Tourism Special Fund	70,741	64,800	5,941	9.2
General Fund	<u>16,390</u>	<u>12,399</u>	<u>3,991</u>	<u>32.2</u>
Total	\$ 217,008	\$ 198,784	\$ 18,224	9.2

NOTE: Due to rounding, details may not add to totals.

## FUEL AND MOTOR VEHICLE TAXES

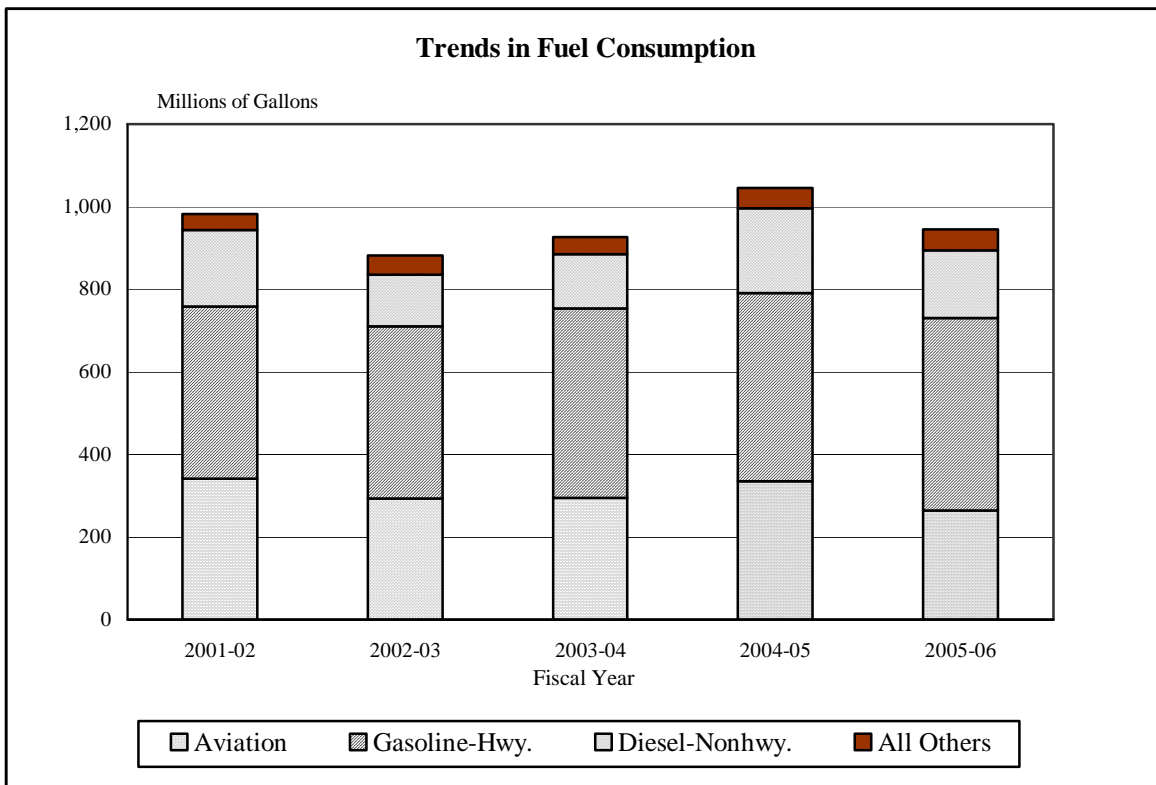
Fuel consumption decreased 9.6% to 944.6 million gallons in fiscal year 2006. As seen in the table below, the decline was attributable primarily to a drop of 70.9 million gallons in the aviation fuel consumption and a drop of 42.3 million gallons in the off highway diesel oil consumption. On the other hand, gasoline consumption increased by 2.3%, or 10.7 million gallons. An environmental response tax of five cents is imposed on each barrel of petroleum product sold by a distributor to any retail dealer or end user. A total of 36.2 million barrels of petroleum was subject to the environmental response tax in fiscal year 2006, representing a decline of 3.1% from last year.

**GALLONS OF FUEL CONSUMED**  
(In Thousands of Gallons)

	FY 2006	FY 2005	Difference	
			Amount	%
Gasoline	466,524	455,835	10,689	2.3
Diesel Oil – Nonhighway	162,939	205,242	(42,303)	(20.6)
Diesel Oil – Highway	48,464	44,129	4,335	9.8
Liq. Pet. Gas - Off Highway	607	3,121	(2,514)	(80.6)
Liq. Pet. Gas - Highway	235	273	(38)	(14.0)
Small Boats - Gasoline	18	11	6	58.4
Small Boats - Diesel Oil	45	36	9	24.2
Aviation Fuel	264,048	334,992	(70,944)	(21.2)
Other Fuel*	<u>1,715</u>	<u>1,698</u>	<u>17</u>	<u>1.0</u>
Total Gallons	944,594	1,045,337	(100,743)	(9.6)
Environmental Tax (Barrel)	36,158	37,312	(1,154)	(3.1)

\*Includes ethanol, methanol, biodiesel.

NOTE: Due to rounding, details may not add to totals.



The revenues from fuel taxes are distributed to several special funds. The State Boating Fund receives 1% of the State and county fuel taxes exclusive of aviation fuel taxes. The State Airport Fund receives all of the tax revenues from aviation fuel. Monies from the environmental response tax is deposited into the Environmental Response Revolving Fund, which is

administered by the Department of Health for oil spill prevention and remediation programs. The remaining State fuel tax revenues are deposited into the State Highway Fund, while the remaining county fuel tax revenues are deposited into the County Highway Fund. The State Highway Fund also receives monies from the motor vehicle weight taxes and fees, which are administered and collected by the counties, and rental motor vehicle and tour vehicle surcharge taxes.

**ALLOCATION OF FUEL TAXES**  
(In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Gasoline	\$ 73,726	\$ 72,017	\$ 1,709	2.4
Diesel Oil – Non-highway	1,614	2,032	(419)	(20.6)
Diesel Oil - Highway	7,677	6,990	687	9.8
Liq. Pet. Gas – Off highway	6	31	(25)	(80.6)
Liq. Pet. Gas – Highway	12	14	(2)	(14.1)
Other Fuel	<u>68</u>	<u>72</u>	<u>(5)</u>	<u>(6.2)</u>
Subtotal	\$ 83,102	\$ 81,157	\$ 1,945	2.4
Motor Vehicle	59,435	56,328	3,107	5.5
Rental Vehicle	<u>48,092</u>	<u>43,950</u>	<u>4,142</u>	<u>9.4</u>
Total	\$190,629	\$181,435	\$ 9,195	5.1
COUNTY HIGHWAY FUND:				
City & County of Honolulu	\$ 52,385	\$ 51,354	\$ 1,031	2.0
County of Maui	12,659	11,982	676	5.6
County of Hawaii	8,118	7,484	633	8.5
County of Kauai	<u>3,809</u>	<u>4,102</u>	<u>(294)</u>	<u>(7.2)</u>
Total	\$ 76,970	\$ 74,923	\$ 2,047	2.7
BOATING SPECIAL FUND:	\$ 1,617	\$ 1,577	\$ 40	2.6
STATE AIRPORT FUND:				
Aviation Fuel	\$ 2,640	\$ 3,350	\$ (709)	(21.2)
ENVIRONMENTAL TAX FUND:	\$ 1,808	\$ 1,867	\$ (59)	(3.2)

NOTE: Due to rounding, details may not add to totals.

The State legislature sets the State fuel tax rates while the county councils set the county rates. The effective rates for fiscal year 2006 are shown below:

### FUEL TAX RATES PER GALLON<sup>1</sup>

GASOLINE AND DIESEL OIL (HWY. USE): <sup>2</sup>	<u>State</u>	<u>County</u>	<u>Total</u>
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui	16.0¢	18.0¢	34.0¢
County of Hawaii	16.0¢	8.8¢	24.8¢
County of Kauai	16.0¢	13.0¢	29.0¢
LIQUID PETROLEUM GAS (HWY. USE):			
City & County of Honolulu	5.2¢	5.4¢	10.6¢
County of Maui	5.2¢	4.3¢	9.5¢
County of Hawaii	5.2¢	2.9¢	8.1¢
County of Kauai	5.2¢	4.3¢	9.5¢
ETHANOL:			
City & County of Honolulu	2.4¢	2.4¢	4.8¢
County of Maui	2.4¢	3.8¢	6.2¢
County of Hawaii	2.4¢	1.3¢	3.7¢
County of Kauai	2.4¢	1.9¢	4.3¢
METHANOL:			
City & County of Honolulu	1.9¢	1.8¢	3.7¢
County of Maui	1.9¢	2.9¢	4.8¢
County of Hawaii	1.9¢	1.0¢	2.9¢
County of Kauai	1.9¢	1.4¢	3.3¢
BIODIESEL:			
City & County of Honolulu	4.0¢	8.3¢	12.3¢
County of Maui	4.0¢	0.0¢	4.0¢
County of Hawaii	4.0¢	2.2¢	6.2¢
County of Kauai	4.0¢	0.0¢	4.0¢
ENVIRONMENTAL RESPONSE TAX (PER BARREL):			
All Counties	5.0¢	0.0¢	5.0¢

<sup>1</sup>Gasoline used for agricultural equipment off highways, aviation fuel, and all other fuels used off highways are taxed by the State at 1¢ per gallon.

<sup>2</sup>Includes 1¢ State license tax on diesel oil.

## PUBLIC SERVICE COMPANY TAXES

Public utilities paid public service company taxes totaling \$120.7 million, including penalty and interest. Act 9, Third Special Session, SLH 2001, allowed motor carrier-contract carriers to pay the 4% general excise tax instead of the public service company tax, effective October 1, 2001, thus, transferring certain revenue from public service company taxes to general excise tax.

### PUBLIC SERVICE COMPANY TAXES (In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
Public Service Company Taxes	\$ 116,460	\$ 108,853	\$ 7,607	7.0
Penalty & Interest	<u>4,219</u>	<u>(167)</u>	<u>4,386</u>	<u>n/m</u>
<b>TOTAL</b>	<b>\$ 120,679</b>	<b>\$ 108,686</b>	<b>\$ 11,993</b>	<b>11.0</b>

NOTE: Due to rounding, details may not add to totals.  
n/m = not meaningful

## ESTATE AND TRANSFER TAXES

During fiscal year 2006, a total of 1,337 estates were settled, of which 129 were taxable. Estate tax collections totaled \$4.0 million, compared to \$12.7 million the year before.

The decline in estate and transfer taxes was due to the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which gradually phases out the estate and transfer taxes and replaces the federal credit for state death taxes with a deduction. Hawaii's tax was effectively eliminated for decedents dying after December 31, 2004 when the federal credit was replaced with a deduction.

### ESTATE AND TRANSFER TAXES (In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
Estate Tax	\$ 3,894	\$ 12,603	\$ (8,709)	(69.1)
Penalty & Interest	<u>123</u>	<u>108</u>	<u>15</u>	<u>13.9</u>
<b>TOTAL</b>	<b>\$ 4,017</b>	<b>\$ 12,711</b>	<b>\$ (8,694)</b>	<b>(68.4)</b>

NOTE: Due to rounding, details may not add to totals.

## OTHER TAXES

Total revenues from other miscellaneous taxes amounted to \$449.6 million, \$39.6 million higher than for the previous year. Employment security contributions exceeded last year's total by

\$14.9 million, while tobacco tax collections increased \$3.0 million, and insurance premium tax collections rose \$5.0 million. Conveyance taxes collected by the Bureau of Conveyances under the Department of Land and Natural Resources rose significantly to \$59.2 million, \$34.6 million more than the previous year. Act 156, SLH 2005, increased conveyance tax rates based on a sliding scale, provided that 10% of all conveyance tax revenues should be deposited into the Land Conservation Fund, and increased the amount deposited into the Rental Housing Trust Fund to 30% from 25%, effective July 1, 2005. As a result, the amount of conveyance tax revenues paid into the General Fund decreased from 50% to 35% while the amount allocated to the Natural Area Reserve Fund remained at 25%. Liquor tax collections rose 5.1%, or \$2.2 million. Franchise taxes collected from banks and other financial corporations decreased 52.4 % to \$18.3 million. The fiscal year 2005 franchise tax collections was higher than normal due to a settlement that resulted in an additional payment of \$12.0 million from a taxpayer as well as a transfer of \$16.5 million from the Litigated Claims Fund back to the General Fund.

**MISCELLANEOUS TAXES\***  
(In Thousands of Dollars)

	FY 2006	FY 2005	Difference	
			Amount	%
Banks & Other Financial Corp.	\$ 18,324	\$ 38,520	\$ (20,196)	(52.4)
Conveyance	59,201	24,583	34,618	140.8
Empl. Security Contributions	149,388	134,459	14,929	11.1
Insurance Premiums	88,068	83,077	4,991	6.0
Liquor & Permits	45,955	43,737	2,218	5.1
Tobacco & Licenses	88,261	85,245	3,016	3.5
General Excise Licenses & Fees	405	427	(22)	(5.2)
<b>TOTAL</b>	<b>\$ 449,602</b>	<b>\$ 410,048</b>	<b>\$ 39,554</b>	<b>9.6</b>

\*Includes allocation to special funds.

NOTE: Due to rounding, details may not add to totals.

## COLLECTION AND ACCOUNTING OF TAXES

### TAX COLLECTIONS

Total tax collections in fiscal year 2006 amounted to \$5.1 billion, 11.0% more than the \$4.6 billion collected in the previous year. While the Department of Taxation collected the majority of taxes, the counties collected \$59.4 million in State motor vehicle weight taxes and registration fees, Department of Commerce and Consumer Affairs collected \$88.1 million in insurance premium taxes, and the Department of Land and Natural Resources collected \$59.2 million in conveyance taxes.

**TAX COLLECTIONS**  
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2006		FY 2005	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corps.	\$ 18,324	0.36	\$ 38,520	0.84
Conveyance	59,201	1.16	24,583	0.53
Employment Security Contrib.	149,388	2.93	134,459	2.92
Fuel	166,138	3.26	162,873	3.54
General Excise & Use	2,355,316	46.17	2,136,603	46.47
Income – Corporations	130,010	2.55	85,605	1.86
Income – Individuals	1,550,596	30.40	1,381,480	30.05
Inheritance and Estate	4,017	0.08	12,712	0.28
Insurance Premiums	88,068	1.73	83,077	1.81
Liquor & Permits	45,955	0.90	43,737	0.95
Motor Vehicle Tax*	107,527	2.11	100,278	2.18
Public Service Companies	120,679	2.37	108,686	2.36
Tobacco & Licenses	88,261	1.73	85,245	1.85
Trans. Accom. Fees	12	0.00	10	0.00
Trans. Accom. Tax	216,996	4.25	198,774	4.32
All Others**	522	0.01	770	0.02
<b>TOTAL</b>	<b>\$ 5,101,011</b>	<b>100.00</b>	<b>\$ 4,597,415</b>	<b>100.00</b>

\*Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental vehicle registration fees, and rental vehicle surcharge tax.

\*\* Includes fuel retail dealer permits, fuel penalty and interest, and general excise fees.

NOTE: Due to rounding, details may not add to totals.

## **DISTRIBUTION OF TAXES**

Of the total \$5.1 billion in tax revenues collected, \$4.4 billion, or 86.9% was deposited into the State General Fund. The counties received 3.4%, or \$174.2 million, which came from county fuel taxes and a portion of the transient accommodations tax. The remaining \$491.8 million was distributed among several State special funds. The State Highway Fund received the largest portion, or \$190.6 million. All of the employment security contributions, or \$149.4 million, went into the Unemployment Trust Fund for unemployment benefits. Portions of TAT went to the next two largest special funds: \$70.7 million to the Tourism Special Fund and \$32.7 million to the Convention Center Fund.

There were several new special funds in fiscal year 2006. Act 228, SLH 2004 authorized an individual income tax check-off of \$5 (\$10 for joint filers) with one-third of the proceeds going to the Hawaii Children's Trust Fund and two-third to be divided equally among the Domestic Violence Prevention Special Fund and the spouse and child abuse special accounts, effective January 1, 2005. Act 156, SLH 2005 created the Land Conservation Fund, into which will be deposited 10% of the conveyance tax revenues, effective July 1, 2005. Act 156 also increased the amount of conveyance tax revenues allocated to the Rental Housing Trust Fund from 25% to



30%. Due to the reallocations of the conveyance tax revenues, the amount deposited into the General Fund decreases from 50% to 35%. Distribution of collections is shown in the following table.

**DISTRIBUTION OF COLLECTIONS**  
(In Thousands of Dollars)

	FY 2006		FY 2005	
	Amount Collected	% of Total	Amount Collected	% of Total
<b><u>STATE FUNDS</u></b>				
State General Fund	\$ 4,434,993	86.94	\$ 3,997,539	86.95
State Highway Fund	190,629	3.74	181,435	3.95
State Airport Fund	2,640	0.05	3,350	0.07
Boating Special Fund	1,617	0.03	1,577	0.03
Environmental Fund	1,808	0.04	1,867	0.04
Cigarette Stamp Admin/Enf. Fund	1,434	0.03	1,166	0.03
Compliance Resolution Fund	2,000	0.04	2,000	0.04
Unemployment Trust Fund	149,388	2.93	134,459	2.92
Election Campaign Fund	186	0.00	220	0.00
Tourism Special Fund	70,741	1.39	64,800	1.41
Rental Housing Fund	17,760	0.35	6,146	0.13
Natural Area Reserve Fund	14,800	0.29	6,146	0.13
Convention Center Fund	32,663	0.64	32,534	0.71
Public Libraries Fund	60	0.00	87	0.00
School Repair & Maint. Fund	74	0.00	114	0.00
Land Conservation Fund	5,920	0.12	-	-
Domes. Violence\Child Abuse Fund	111	0.00	-	-
Subtotal - State	\$ 4,926,826	96.59	\$ 4,433,441	96.43
<b><u>REVENUES TRANSFERRED TO COUNTIES</u></b>				
Fuel	\$ 76,970	1.51	\$ 74,923	1.63
Trans. Accom. Tax	97,214	1.91	89,051	1.94
Subtotal – Counties	\$ 174,185	3.41	\$ 163,974	3.57
<b>TOTAL</b>	<b>\$ 5,101,011</b>	<b>100.00</b>	<b>\$ 4,597,415</b>	<b>100.00</b>

NOTE: Due to rounding, details may not add to totals.

## **BRIEF SUMMARY OF HAWAII'S TAX SYSTEM**

Two notable characteristics of Hawaii's tax structure are the high degree of centralization at the State level and the broad-based nature of its primary revenue source, the general excise tax. Hawaii's general excise tax is imposed on most sales of goods and services. Some transactions

are exempted because they are subject to other taxes or because the legislature wished to encourage certain economic activities.

Qualified residents may claim several different tax credits. Among the most common credits claimed by Hawaii residents are the low-income credit, the renter's credit, the dependent care credit, the energy device credit, and the child passenger restraint credit. The low-income credit, which is available to individuals with adjusted gross income (AGI) of \$20,000 or less, is inversely related to a taxpayer's AGI. The renter's credit is a flat \$50 credit per exemption, including age exemptions, is available to qualified resident renters with AGI under \$30,000. Like its federal counterpart, Hawaii's dependent care credit reimburses a portion of expenses paid for the care of qualified dependents in order to allow the taxpayer to hold gainful employment. The energy device credit is available to taxpayers who purchase qualified alternate energy devices. A flat \$25 credit per return is allowed to individuals who purchase qualifying child passenger restraint systems. Among businesses, the most commonly claimed tax credit is the capital goods excise tax credit.

Hawaii has 17 separate tax laws, of which 14 are administered by the State. The remaining 3 – real property tax, motor vehicle weight tax, and public utility franchise tax – are administered by the counties. The revenue from county motor vehicle weight taxes is vested in the counties with the revenue accruing to the State and county highway funds.

Revenues from 11 of the State-administered taxes go into the State General Fund and are used to provide government services. Although the fuel tax is administered by the State, it is a source of revenue for both the State and county highway funds. The employment security tax is a dedicated tax used exclusively to provide benefits to cover unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the State Highway Fund.

STATE GENERAL FUND\*  
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2006		FY 2005	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corps.	\$ 16,324	0.37	\$ 36,520	0.91
Conveyance	20,720	0.47	12,292	0.31
General Excise & Use	2,355,316	53.11	2,136,603	53.45
Income – Corporations	130,010	2.93	85,605	2.14
Income – Individuals	1,550,164	34.95	1,381,058	34.55
Inheritance and Estate	4,017	0.09	12,712	0.32
Insurance Premiums	88,068	1.99	83,077	2.08
Liquor & Permits	45,955	1.04	43,737	1.09
Public Service Companies	120,679	2.72	108,686	2.72
Tobacco & Licenses	86,827	1.96	84,079	2.10
Trans. Accom. Tax	16,378	0.37	12,389	0.31
All Others**	<u>534</u>	<u>0.01</u>	<u>781</u>	<u>0.02</u>
TOTAL	\$ 4,434,993	100.00	\$ 3,997,539	100.00

\* Net of transfers to special funds.

\*\* Includes fuel retail dealer permits, fuel penalty and interest, general excise fees, and trans. accom. fees.

NOTE: Due to rounding, details may not add to totals.

# OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2006

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(1) Net Income  Chapter 235 — Section 235-1 to 235-130	For taxable years beginning after December 31, 2001, the tax rates for individuals as well as estates and trusts range from 1.4% to 8.25% of taxable income. The allowable standard deduction amounts vary by filing status. The standard deduction amount for married filing joint return or surviving spouse with dependent child is \$1,900; single is \$1,500; head of household is \$1,650; and married filing separately is \$950. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000 of taxable income. For taxable years beginning after December 31, 2006, Act 110, Session Laws of Hawaii 2006, (1) expands the individual income tax brackets, and (2) increases the standard deduction as follows: married filing joint return or surviving spouse with dependent child is \$4,000; single or married filing separately is \$2,000; and head of household is \$2,920.	Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$5,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.	In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th. See Booklet A, Employer's Tax Guide, for the withholding requirements for employers who are required to pay the taxes withheld by electronic funds transfer (EFT).
(2) Estate and Transfer (for decedents dying after 6/30/83 and before 1/1/05)  Chapter 236D — Section 236D-1 to 236D-18	Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For nonresident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions. <b>Note:</b> For estates of decedents dying after December 31, 2004, there will be no estate and transfer tax since the federal credit for state death taxes was repealed effective January 1, 2005.	Report (Form M-6) must be filed by person responsible for filing federal Estate Tax Return (federal Form 706). No report required and no tax due when federal Form 706 not required. To obtain release of property, file Request for Release (Form M-6A).	On or before the due date for filing federal Form 706, including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.
(3) General Excise (Gross Income)  Chapter 237 — Section 237-1 to 237-49	For generation-skipping transfers after June 30, 1994, a tax in an amount equal to the federal credit is imposed on every generation-skipping transfer of (1) property located in Hawaii and (2) property from a resident trust. <b>Note:</b> For generation-skipping transfers after December 31, 2004, there will be no generation-skipping transfer tax since the federal credit for state death taxes was repealed effective January 1, 2005.  This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 1/2 of 1% on wholesaling and wholesaler services, producing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed at 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at 15%. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20. Effective January 1, 2007, a county surcharge of 0.5% will be added to the State's 4% general excise tax for business conducted in the City and County of Honolulu.	Report (Form M-6GS) must be filed by person responsible for filing Generation-Skipping Transfer Tax Return for Distributions (federal Form 706GS(D)) or Generation-Skipping Transfer Tax Return for Terminations (federal Form 706GS(T)).  Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	On or before the due date for filing federal Form 706GS(D) or 706GS(T), including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.  At time of filing returns.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(4) Transient Accommodations Tax  Chapter 237D — Section 237D-1 to 237D-16	This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 7.25%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units. Effective January 1, 1999, plan managers are liable for and pay to the State the transient accommodations tax of 7.25% that is imposed on the fair market rental value of time share vacation units.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.
(5) Use  Chapter 238 — Section 238-1 to 238-16	This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: ½ of 1%, if for resale at retail; 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4. The use tax is imposed on the value of services or contracting that are performed by an unlicensed seller at a point outside the State and imported or purchased for use in the State, effective for use taxes accruing after December 31, 1999. Effective January 1, 2007, a county surcharge of 0.5% will be added to the State's 4% use tax for the importation or purchase of tangible personal property or services for use in the City and County of Honolulu.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.	At time of filing returns.
(6) Public Service Company  Chapter 239 — Section 239-1 to 239-25	Nature of Tax—Public utility business in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, ½ of 1%. (iii) All other revenues: 4% of gross income. Beginning with January 1, 2001 filings, the sale of telecommunications services by a public utility to an interstate or foreign telecommunications services provider that is subject to the general excise tax and that resells the services to retail customers, is subject to a 5.5% PSC tax rate, reduced by 0.5% each January 1st until a 0.5% rate is fully phased-in on January 1, 2007.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations  Chapter 241 — Section 241-1 to 241-7	(1)(a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax (in lieu of net income and general excise taxes) on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.



KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel  Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 1c per gallon on aviation fuel, an initial 1c per gallon on diesel oil, .25c per gallon on alternative fuels for operation of an internal combustion engine and at the rates specified below per gallon on alternative fuels, and from 24.8c to 32.5c per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 23.8c to 31.5c per gallon on diesel oil used to operate motor vehicles upon the public highways, however, they are not required to pay the additional tax on diesel oil and the tax on alternative fuels if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways, diesel oil used for motor vehicles not operated upon the public highways, and alternative fuels used for motor vehicles and internal combustion engines not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5c per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed. Effective July 1, 2004, the fuel tax is adjusted to reflect the energy content of alternative fuels as follows: ethanol- 0.145 times the rate for diesel; methanol- 0.11 times the rate for diesel; biodiesel- 0.25 times the rate for diesel; liquefied petroleum gas- 0.33 times the rate for diesel; and for other alternative fuels, the rate is based on the energy content of the fuels as compared to diesel fuel, using a lower heating value of 130,000 BTUs per gallon as a standard for diesel, so that the tax rate, on an energy content basis, is equal to one-quarter the rate for diesel fuel.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor  Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon "dealers" as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$.85 on cooler beverages, \$.93 on beer other than draft beer, and \$.54 on draft beer.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(10) Cigarette and Tobacco  Chapter 245 — Section 245-1 to 245-63	"Wholesalers" and "dealers" as defined in the law must pay an excise tax on sale or use of tobacco products equal to 40% of the wholesale price and a fixed tax rate of 7c on each cigarette sold, used, or possessed after June 30, 2004. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year. Effective January 1, 2001, cigarette and tobacco wholesalers and dealers are required to affix stamps to individual cigarette packages as proof of payment of cigarette taxes. Act 316, Session Laws of Hawaii 2006, increases the tax on cigarettes to 8c per cigarette sold on and after September 30, 2006. Beginning December 1, 2006, every <b>retailer</b> engaged in the retail sale of cigarettes and other tobacco products is required to obtain a \$20.00 retail tobacco permit that must be renewed before December 1st of each year.	Returns are due monthly on or before the last day of the following month.	At time of filing returns. Cigarette tax paid through the purchase of cigarette tax stamps by licensees.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(11) Conveyance  Chapter 247 — Section 247-1 to 247-13	<p>This tax is imposed on all documents transferring ownership or interest in real property and is based on the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction.</p> <p>Effective July 1, 2005, The conveyance tax is imposed as follows:</p> <ul style="list-style-type: none"> <li>(1) 10c per \$100 for properties with a value of less than \$600,000,</li> <li>(2) 20c per \$100 for properties with a value of at least \$600,000, but less than \$1,000,000, and</li> <li>(3) 30c per \$100 for properties with a value of \$1,000,000 or greater.</li> </ul> <p>For the sale of a condominium or single family residence for which the purchaser is ineligible for a county homeowner's exemption on property tax, the conveyance tax is imposed as follows:</p> <ul style="list-style-type: none"> <li>(1) 15c per \$100 for properties with a value of less than \$600,000,</li> <li>(2) 25c per \$100 for properties with a value of at least \$600,000, but less than \$1,000,000, and</li> <li>(3) 35c per \$100 for properties with a value of \$1,000,000 or greater.</li> </ul> <p>(Documents of certain conveyances are exempted.)</p>	<p>A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.</p>	<p>At time of filing the certificate, but no later than 90 days after the taxable transaction.</p>
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax  Chapter 251 — Section 251-1 to 251-15	<p>There is a rental motor vehicle surcharge tax of \$3 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee.</p> <p>Effective September 1, 2007, the rental motor vehicle surcharge tax is decreased to \$2 a day or any portion of a day that a rental motor vehicle is rented or leased.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
(13) Unemployment Insurance  Chapter 383 — Section 383-1 to 383-176	<p>This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.4%.</p> <p>There is also an additional employment and training (E &amp; T) fund assessment on taxable wages paid to an employee. The percentage rate for this additional tax is .01%. The E &amp; T assessment is applicable to all employing units with unemployment insurance contribution rates greater than 0.00% and less than 5.4%.</p> <p>There is a limitation of the tax on wages paid to an employee called the "tax base". The tax base represents 100% of the state's average annual wages reported by employers contributing to the unemployment trust fund.</p>	<p>On a quarterly basis, employers submit Form UC-B6, "Quarterly Wage, Contribution and Employment and Training Assessment Report." The report must be filed on or before the last day of the month following the report quarter.</p>	<p>At time of filing returns.</p>
(14) Insurance Premiums  Chapter 431 — Section 431:7-201 to 431:7-209	<p>Tax on insurance companies (Underwriters) based on premiums written in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property, Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.</p>	<p>Quarterly tax statement is due on or before the last day of the calendar month following the quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.</p>	<p>At time of filing statements.</p>

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