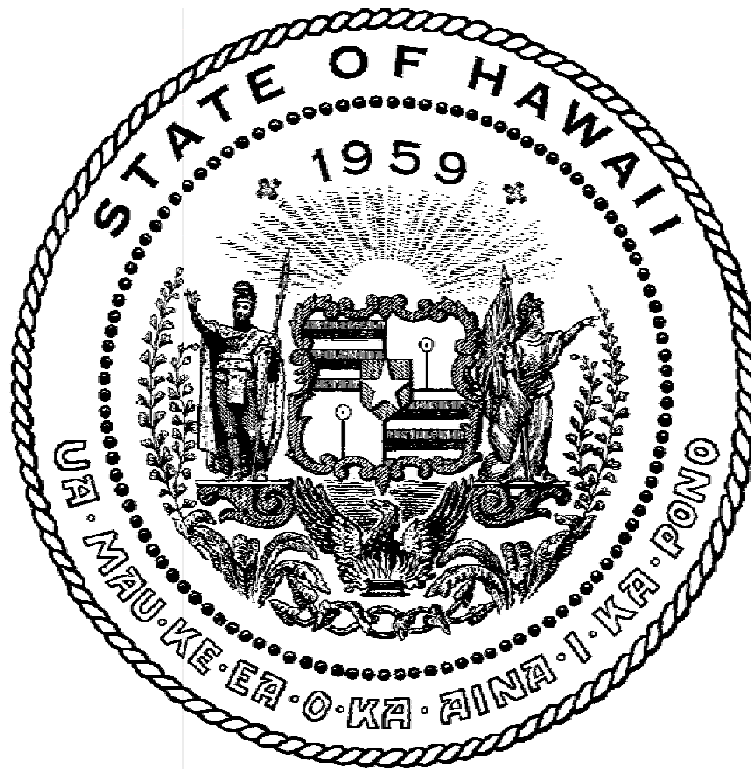


# DEPARTMENT OF TAXATION STATE OF HAWAII



## ANNUAL REPORT 2007–2008



**LINDA LINGLE**  
GOVERNOR

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LT. GOVERNOR



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March 6, 2009

The Honorable Linda Lingle  
Governor, State of Hawaii  
Executive Chambers  
State Capitol, Fifth Floor  
Honolulu, HI 96813

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, 2008.

We have much to be proud of, including winning the Best Customer Service Solution award at the IBM Information on Demand Conference in October 2007 for the successful implementation of the Department's document imaging system. This award reflects the combined efforts of the entire Department, including both our operating divisions and our staff offices, and is but one of a myriad of ongoing projects to leverage limited resources to increase Department efficiencies and staff productivity. It is only because of the extraordinary dedication of all of our employees that such projects are able to be conceptualized, planned, and implemented.

The technological improvements to our tax information management system (ITIMS) have not only benefitted our Tax Services and Processing Division and the thousands of taxpayers they serve, but it has reaped rewards for the auditors and collectors in our Compliance Division as well. The dollars assessed by our office and field auditors combined increased over fiscal year 2007 by \$58.0 million for a total of \$217.1 million in fiscal year 2008. Our collectors met their collection goals despite the declining economy, and significantly increased the number of payment plans initiated, tax liens filed, and levies served.

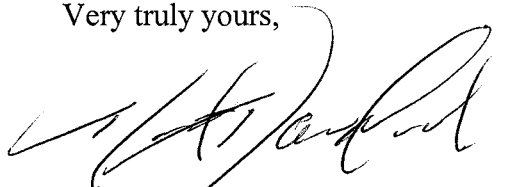
Our staff offices have also played key roles in the success of our operations. The Information Technology Services Office worked closely with the operating divisions to bring technology-related projects to fruition. Our Rules Office has increasingly assumed a larger role in representing the Department in appeals brought before the various administrative boards of review. The Tax Research and Planning Office has been tasked with added responsibilities with respect to studying the high technology business investment credit and, as the national and global economies continue to decline and impact Hawaii's economy, their work with the Council on Revenues assumes ever greater importance.

The Honorable Linda Lingle  
March 6, 2009  
Page 2

Through the efforts of all of our employees, a total of \$5.5 billion was collected in fiscal year 2008. Although not a State tax realization, the \$187.9 million of county surcharge tax collected on behalf of the City and County of Honolulu is included in the collection totals. Of the total tax collected, \$4.6 billion (86.3%) was deposited into the State General Fund.

Perhaps nobody knows more than our employees how much effort it takes to collect each dollar of tax revenue. We understand that our job will be increasingly difficult in the coming year given current economic forecasts. However, I am confident that our Department will meet those challenges and continue to provide the highest possible level of service to the public.

Very truly yours,

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

KURT KAWAFUCHI  
Director of Taxation

## TABLE OF CONTENTS

### LETTER OF TRANSMITTAL TO THE GOVERNOR

THE YEAR IN REVIEW .....	1
Tax Services and Processing Division .....	1
Compliance Division .....	4
Staff Offices .....	7
MANAGEMENT PERSONNEL.....	13
ORGANIZATION CHART.....	14
DISTRICT OFFICES.....	15
TAX APPEALS AND LITIGATION .....	17
Boards of Taxation Review .....	17
Civil Decisions, Settlements, and Other Legal Matters .....	17
Criminal Cases .....	27
LEGISLATION .....	29
COLLECTION AND DISTRIBUTION OF TAXES .....	33
Individual Income Tax .....	33
Corporate Income Tax .....	34
General Excise and Use Taxes.....	35
Transient Accommodations Tax .....	37
Fuel and Motor Vehicle Taxes.....	37
Public Service Company Taxes .....	41
Estate and Transfer Taxes .....	41
Other Taxes .....	41
Total Tax Collections.....	43
Distribution of Taxes .....	44
BRIEF SUMMARY OF HAWAII'S TAX SYSTEM.....	47
Outline of the Hawaii Tax System.....	49
ADMINISTRATIVELY ATTACHED ENTITIES.....	53
Council on Revenues .....	53
Boards of Taxation Review .....	53



## **THE YEAR IN REVIEW**

### **TAX SERVICES AND PROCESSING DIVISION**

The Tax Services and Processing (TSP) Division consists of three branches: 1) Document Processing, 2) Taxpayer Services, and 3) Revenue Accounting. Each branch's objectives are unique to its specific functions, with an overall division objective to perform all functions relating to the centralized processing, editing, and controlling of tax information through paper documents or electronic data; receiving, securing, depositing, and accounting for tax payments; and functions relating to account management, licensing, and providing taxpayer services to the public.

Using process change, technology, and our strategic vision, the TSP Division continues to improve upon its operations and enhance the Department's Integrated Tax Information Management System (ITIMS) technology platform, especially in terms of our very successful ITIMS Imaging System (IIS). The implementation of the IIS, an integrated scan, recognition, and storage platform for the Department of Taxation, won the Best Customer Service Solution at the IBM Information on Demand Conference (October 14, 2007, through October 19, 2007) in Las Vegas, Nevada. The On Demand Innovation Awards ceremony honored best-in-class applications and solutions from IBM Information Management customers and the customers of its business partners. With IIS, the State of Hawaii, Department of Taxation, was recognized in the Best Customer Service Solution category for solutions that significantly improved the level of customer service offered by an organization.

Further expanding upon the scalable IIS technology, the Department introduced 2D Barcodes for one of the major net income forms (2007 N-11) during the 2008 tax season. The use of 2D Barcodes speeds up the processing of paper tax returns by eliminating the manual keyed-entry of taxpayer information from the forms. The read rate for processed 2D Barcode returns was an incredible 96.6% and far surpassed the industry standards. The 2007 N-11 Web-fillable version was also made available with 2D Barcode capabilities and was available on the DOTAX website and CD.

An increasing number of selected paper tax returns and payments were made available for scanning into digital images and storing in a repository during processing. In fiscal year (FY) 2008, over 2.1 million paper returns and payments were processed through the IIS. These on-line images of tax returns and payments can be quickly retrieved by a user directly from the tax account, greatly enhancing the user's ability to resolve taxpayer issues quickly at any of our offices statewide with the click of a button.

Through IIS's state-of-the-art scanning and character recognition technology, the Department continues to reduce the time required for data entry by an order of magnitude. In FY 2008, the IIS processing of returns and payments represented 65% of the total volume, electronic processing 22%, and 2D Barcodes 2% of the total volume of 3.3 million. As additional forms are migrated from the current key-from-paper technology, the Department will continue to reduce the time needed to post paper returns and process refunds.

In our quest to continuously improve our customer service to the public, the TSP Division upgraded all of its counter service windows with a new numbering system in September 2007 to provide greater efficiency and improved customer service for our walk-in customers. The new numbering system provides management with additional statistical information that allows for more informed decision-making to further streamline our operations and provide our customers with a more pleasant experience.

In June 2008, the Department mailed approximately 405,000 postcards to active taxpayers, notifying them that their hardcopy paper booklets would no longer be automatically mailed to them unless they specifically requested that this service be continued. This action was taken as a cost-cutting and environmentally-friendly initiative as we move towards a paperless environment. During the same period, the Department also launched a General Excise Tax Non-Filer Project. Both initiatives generated a significant number of additional telephone calls, customer visits, e-mails, and correspondence for our Taxpayer Services Branch to handle during the last month of FY 2008.

### **Document Processing Branch**

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

For FY 2008, the DPB processed 3,322,891 returns and payments, 713,941 (21.5%) of which were electronically transmitted. The DPB processed approximately 1.41 million electronic payments for a total of more than \$2.61 billion during the year.

The Joint Electronic Filing Program (JELF) with the Internal Revenue Service is in its eighth year. The JELF program allows certain individual taxpayers who file either the N-11 or N-15 forms to file those returns electronically. The number of Hawaii returns filed through JELF increased significantly by 21.1% from 228,312 returns last year to 276,481 returns this year.

Taxpayers may also electronically file some returns through the Department's website. In FY 2008, taxpayers filed 171,661 returns for various taxes through our website. Filing electronically allows tax return data to flow into internal systems with a minimal amount of manual contact, which enhances operational efficiency.

Overall, through the multiple options available for filing, the Document Processing Branch processed 66% of all returns and payments within 13 calendar days in FY 2008, compared to 46% in FY 2007, an increase in overall efficiencies of 20%.



## **Taxpayer Services Branch**

The major objectives of the Taxpayer Services Branch are three-fold: 1) to provide efficient customer assistance and information on all taxes administered by the Department (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: 2008 Tax Season Telephone Call Statistics:**

During the January through June 2008 income tax filing season, the total number of calls received was 193,131, of which 45,639 calls or 24% were handled by the Interactive Voice Response (IVR)'s automated system, and 105,515 calls or 55% were handled by tax representatives. As a result, the overall call answer rate for the 2008 tax season was 79%, which was lower than the 90% call answer rate for the same period in 2007, but significantly exceeded the 50% call answer rate for the same period in 2006.

<u>Year*</u>	<u>Total Calls Received</u>	<u>Total Calls Answered</u>	<u>Overall Call Answer Rate</u>
2008	193,131	151,154	79%
2007	181,663	162,576	90%
2006	299,582	148,981	50%

\* Represents the six-month net income tax season period of January through June of years shown.

The primary reason for the decline in our call answer rate from the 2007 tax season to the 2008 tax season is directly attributable to the tax booklet suppression project and General Excise Tax Non-Filer Project. Prior to the June tax booklet suppression initiative, the overall call answer rate was 86%, but with an unprecedented 30,000 calls during the last two weeks in June our call answer rate dropped to 79% for the six-month period of January through June 2008.

### **Account Management: Error Correction Statistics**

For FY 2008, the Account Management Section corrected and posted to our Integrated Tax Processing System (ITPS) a total of 203,451 tax returns, payments, and other tax forms that were "worklisted" (i.e., removed from the processing cycle due to critical errors), compared to less than 200,000 in FY 2007. With the implementation of IIS, the Account Management team was able to post returns quicker, because analysis could be done on line instead of waiting to receive hard copies of the returns. Additionally, with sound planning and a most efficient and effective work group, the volume of tax returns on the worklist just prior to the July 20, 2008, deadline for processing refund returns without paying interest was just over 500, compared to the same period in 2007 when the volume of worklisted returns was over 50,000 due to processing and other system delays.

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

For FY 2008, the Licensing Section processed nearly 30,000 applications for general excise tax licenses and over 15,000 cancellations. Fiscal year 2008 also saw the first retail tobacco permit renewals for the Licensing Section, and the Licensing team was able to process approximately 94% of all pending renewals on or before the November 30, 2008, due date.

## **Revenue Accounting Branch**

The major objective of the Revenue Accounting (RA) Branch is the maintenance of revenue control and subsidiary ledgers. This requires the control of and responsibility for all adjustment, error resolution, accounting, and reconciliation functions of all tax revenues statewide. This objective also includes the preparation of the Preliminary Report, Statement of Tax Operations, and related reports. Secondary functions of this branch include statewide processing and manual accounting activities of all miscellaneous taxes (except the estate and transfer tax); controlling and accounting for all tax refunds statewide that result from either overpayments or adjustments; maintaining the statewide accounting records and preparing journal entries associated with the Delinquent Tax Project's administratively-established trust account; responsibility for maintaining the manual accounting system for statewide protested payments and tax appeals; and handling all refund exception activities statewide (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 fifth 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 tenth working day of each month. The RA Branch has met these urgent goals each month.

## **COMPLIANCE DIVISION**

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

## **Auditing/Examination**

To support the voluntary compliance, self-assessment system of taxation, both the Office Audit and the Field Audit units performed the following examinations and audits during the fiscal year.

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits <u>Completed</u>	Dollars <u>Assessed</u>	Number of Audits <u>Completed</u>	Dollars <u>Assessed</u>
Oahu	5,479	\$ 41,881,868	226	\$ 155,166,068
Maui	2,038	6,759,641	28	2,216,689
Hawaii	1,292	1,688,588	39	1,785,254
Kauai	<u>1,921</u>	<u>5,573,203</u>	<u>27</u>	<u>1,994,839</u>
Total FY 2008	10,730	\$ 55,903,300	320	\$ 161,162,850
Total FY 2007	<u>12,447</u>	<u>33,390,301</u>	<u>318</u>	<u>125,724,974</u>
Difference	(1,717)	\$ 22,512,999	2	\$ 35,437,876

The Office Audit units reflected a 13.8% decrease in the number of audits cases closed; however, the total dollars assessed increased by 67.4% for the fiscal year. The Field Audit units reflected an increase of 0.6% in the number of audit cases closed as well as a 28.2% increase in the dollars assessed despite having six vacancies statewide. The Office Audit units' decrease in the number of cases audited is due to the selection of cases with a higher dollar value but also a higher degree of time needed to complete the cases.

The Office Audit and Field Audit units also increased the amount they collected upon the closing of their audits, and prior to any billing notices being sent, from \$36.7 million in FY 2007 to \$37.5 million in FY 2008.

### Criminal Tax Unit

The Criminal Tax unit increased its activities during the fiscal year and was able to obtain indictments and complaints against 34 taxpayers. These activities resulted in \$111,000 in judicial fines and \$1.2 million in tax assessments. In addition, \$1.9 million in taxes, penalties, interest charges, and fines were collected.

### Special Projects

The Oahu Field Audit Branch conducted the following special projects during the fiscal year:

- Federal Contractors Project: This project, which targets unlicensed contractors working on federal installations, was started in 1983 and is an ongoing activity. This fiscal year, 21 audits were completed and resulted in \$7.4 million in assessments.
- Referral Cases from Criminal Investigation Unit: During this fiscal year, 15 cases that were originally considered for possible criminal prosecution or that arose pursuant to a criminal investigation were completed and resulted in \$2.0 million in assessments.
- Research Tax Credit: During this fiscal year, 15 cases involving taxpayer claims for the tax credit for research activities were completed and resulted in \$17.3 million in assessments.

### **Delinquent Tax Collections**

The operations of the Compliance Division's Tax Enforcement Program consist of the Oahu Collections Branch and the Collections Sections in the Maui, Hawaii, and Kauai District Tax Offices. Even though the results showed a decline, the collection areas did meet their goals for the year and did increase payment plans, tax liens, and levies, even with a declining economy. The most notable decrease was in the amount of delinquent tax cash collections, which fell by \$16.0 million from \$202.9 million in FY 2007 to \$186.9 million in FY 2008, a 7.9% decrease.

A table of major performance measures for FY 2008 is presented below:

<u>Measure</u>	<u>FY 2008</u>	<u>FY 2007</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Total Delinquent Tax Balance (\$ Millions)	\$ 374.9	\$ 343.8	\$ 31.1	9.0
Total New Delinquent Referrals (\$ Millions)*	\$ 231.7	\$ 243.8	\$ (12.1)	(5.0)
Total Cash Collected (\$ Millions)	\$ 186.9	\$ 202.9	\$ (16.0)	(7.9)
Uncollectible Tax Write-Offs (\$ Millions)	\$ 13.7	\$ 16.8	\$ (3.1)	(18.5)
Payment Plans Initiated	20,731	17,875	2,856	16.0
Tax Liens Filed	6,071	5,899	172	2.9
Levies Served	10,314	4,675	5,639	120.6

\* Total New Delinquent Referrals for FY 2007 was revised from the \$381.9 million reported in the *Annual Report 2006-2007* to \$243.8 million.

### **Taxpayer Assistance Provided**

During FY 2008, the neighbor island district office personnel assisted taxpayers to properly file numerous tax returns and other documents over the telephone, at the service counter, and via correspondence. The Oahu Office Audit, Field Audit, and Collection units also provided support services to the neighbor island district tax offices and the Oahu TPS Branch when requested.

The following summarizes the taxpayer assistance activities of the Maui, Hawaii, and Kauai District Tax Offices:

	<u>FY 2008</u>	<u>FY 2007</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Counter	74,964	75,313	(349)	(0.5)
Phone Services	51,426	54,061	(2,635)	(4.9)
Tax Clearances	7,197	3,336	3,861	115.7
Correspondence	6,245	8,329	(2,084)	(25.0)

The reduction in telephone services is due to the centralization of customer services within the Oahu TSP Division and continued increases in efficiencies in processing resulting from the scanning of returns and improvements to electronic filing, forms design, and mail processes.

The assistance provided to taxpayers is part of the Compliance Division's continuing emphasis on taxpayer education and problem resolution in all its contacts with taxpayers. The Compliance Division continues to believe in the importance of maintaining taxpayers' willingness to accurately and voluntarily comply with the State tax laws. This "taxpayer enabling and empowering activity" will continue to be emphasized.

## **STAFF OFFICES**

### **Administrative Services Office**

#### **Fiscal Office**

The Administrative Services Office submitted the supplemental budget for FY 2009 to the 2008 Legislature. For FY 2009, \$24.9 million was appropriated to the Department.

In discharging its duties and responsibilities, the Department of Taxation incurred operating expenses of \$25.5 million for FY 2008.

#### **Personnel Management**

For FY 2008, the Department was authorized 407.5 positions, up from 372.5 positions the previous year. Employees were geographically distributed as follows: Oahu, 340.5; Hawaii, 27; Maui/Molokai, 24; and Kauai, 16.

Personnel actions included 37 new civil service hires, 2 retirements, 147 temporary hires, 25 promotions, 13 transfers, and 30 resignations. Other personnel actions included temporary assignments of employees to higher levels.

### **STAFFING PATTERN (Number of Authorized Permanent Positions)**

<b><u>By Organization/Operating Program</u></b>	<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2006</u></b>
Headquarters Administration	74.0	67.0	67.0
Tax Services and Processing Division	138.0	110.0	110.0
Compliance Division	<u>195.5</u>	<u>195.5</u>	<u>189.5</u>
<b>TOTAL</b>	<b>407.5</b>	<b>372.5</b>	<b>366.5</b>

## **Rules Office**

The Rules Office is currently comprised of the Rules staff and the Technical Section. The function of the Rules Office is to serve as a resource for complex policy recommendations and complex taxpayer support.

### **Rules Staff**

The Rules staff serves as the Department's advisory arm to the Director of Taxation on tax policy and counsels the Director's Office and Department on legal and tax issues. The Rules staff also assists, counsels, and represents the Department's compliance personnel with tax disputes and other administrative tax controversies. For example, the Rules staff provided assistance and counsel to the Department's compliance function in settlement negotiations and closings. The Rules staff also made appearances on behalf of the Department in front of the Taxation Board of Review. Assistance was also provided to the Tax Division Deputy Attorneys General in support of the Department's tax cases being litigated.

For the 2008 legislative session, the Rules staff drafted and submitted seven 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 2,746 bills introduced to the 2008 Legislature, 1,483 House Bills and 1,263 Senate bills, the Rules staff determined that over 300 measures proposed tax law changes and analyzed them in depth. These measures were also tracked throughout the legislative session. The Rules staff prepared 346 written testimonies for measures scheduled for public hearings by legislative committees, 171 for the House and 175 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 33 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 and Technical Section staff reviewed and certified 1,723 requests for the high technology business investment tax credit and 1,090 requests for the credit for research activities in accordance with Act 215, Session Laws of Hawaii (SLH) 2004. The Rules staff also responded to 65 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**

The Technical Section answers questions raised in telephone calls, e-mails, and letters, and also 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 258 tax forms and 53 instructions, and terminated 13 forms that were determined to be obsolete.

The Technical Section is also responsible for reviewing applications for certain tax exemptions. Staff members approved 164 applications filed by nonprofit organizations for an exemption from the general excise tax and 3,371 conveyance tax exemptions.

The Technical Section staff provided training for Department employees and spoke at several workshops for practitioners and new entrepreneurs. The Technical Section staff also reviews, researches, analyzes, and provides comments and recommendations on the technical and procedural aspects of the drafts of legislative bills, administrative rules, and Tax Information Releases.

## **External Training and Outreach**

The External Training and Outreach (ETO) Office is attached to the Director of Taxation and 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 coordinating 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.

The ETO Office continues to promote annual summer and year-end workshops in Honolulu, Lihue, Kona, Hilo, and Kahului. The summer and year-end workshops generally have a combined total of more than 500 attendees, most of whom are tax practitioners.

The ETO Office also continues to facilitate a dialogue between tax professionals and the Department via the annual practitioners' forum, which was held in June 2008.

## **Information Technology Services Office**

The Information Technology Services (ITS) Office is responsible for the development, modification, and maintenance of the Department's computerized tax systems, network, and related components.

Several Department website projects were undertaken in FY 2008. In January 2008, the Department's homepage was redesigned using the open source Plone Content Management System to conform to new standards set by the Governor's Office, and migrated to the open source Zope platform established by the Department of Accounting and General Service's

Information and Communication Services Division. Two months later, the online submittal of Form N-317, a survey required of qualified high technology businesses that receive investments eligible for the qualified high technology business investment tax credit, was enabled in compliance with the provisions of Act 206, SLH 2007.

Significant technical enhancements continued during FY 2008 to improve the collection and processing of taxes and to help the Department reduce operational costs. The Department issued contracts for several significant ITIMS enhancements, and the ITS Office provided both implementation assistance and ongoing support for those enhancements.

The ITS Office assisted Department compliance efforts by implementing in August 2007 an enhancement that allows Collection staff to schedule automated electronic payments of past due taxes at the request of taxpayers who are on installment payment plans, and by facilitating the June 2008 General Excise Tax Non-Filer Project.

This office also participated in a number of projects to improve the Department's processing and operating efficiency, including two that were mentioned earlier in this report. The first is the January 2008 implementation of the 2D Barcode Project that greatly improved the Department's efficiency in processing, scanning, and capturing the information reported on Form N-11 individual income tax returns submitted. The second is the June 2008 Booklet Suppression Project, which also entailed adding a new "Online Booklet Request" function to the Department's website so that taxpayers could submit requests to continue receiving tax booklets via the Internet. Other such projects included one to remove the Neighbor Island district post office box addresses from automated correspondence as part of the Department's centralization of processing and customer support on Oahu, and another to provide technical support as the Department eliminated the now obsolete Form N-12, individual income tax return.

Significant technical system enhancements included the addition in January 2008 of the corporation income tax return, Form N-30, and various transient accommodation tax return forms to the list of forms that are machine readable and that no longer require manual data entry. The ITS Office also completed a project in February 2008 to enable the recovery of scanned IIS document images, if needed, and, in May 2008, completed another project to provide highly secured, around-the-clock access to ITIMS by authorized persons.

Future planned initiatives include continued implementations of 2D Barcode scanning capabilities, upgrades of critical software versions, upgrades of the ITIMS application system software suite version levels, and continued additions of new functionality to improve the automation and collection of taxes.

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

The Tax Research and Planning (TRP) Office prepares analytical and statistical reports on statewide tax collections, income patterns of businesses and households, and tax credits claimed by Hawaii taxpayers; prepares long-range and short-range forecasts of various tax revenues for State budget planning purposes; develops tax plans to meet administrative policies and programs;



and prepares analytical reports on the revenue effects of proposed tax legislation for the governor, legislature, and other agencies.

In FY 2008, the TRP Office published the following annual reports: *Tax Credits Claimed by Hawaii Taxpayers 2005*, December 2007; and *Hawaii Income Patterns—Individuals 2005*, February 2008. In addition, the TRP Office assembled and edited the Department of Taxation's *Annual Report 2006–2007*, which was released in December 2007. The TRP Office also prepared and disseminated monthly preliminary General Fund tax collection reports and monthly final reports on State tax collections and distributions, revenue trends, general excise and use tax collections, fuel tax collections and allocations, liquor tax collections, and tobacco tax collections. Summary final reports were also prepared for both the calendar and fiscal years.

In preparation for and during the 2008 Legislative session, TRP staff reviewed over 400 separate tax-related legislative bills, almost 340 of which required staff to prepare estimates of the bills' potential revenue impacts. New revenue impact statements were prepared for each draft of these bills as new information became available or as requested by the Administration, legislators, and others.

One of the major responsibilities of the TRP Office is to provide technical and administrative support services for the Council on Revenues (COR). The COR is composed of seven uniquely qualified individuals who are collectively responsible for forecasting State General Fund revenues and the State's total personal income. The COR's General Fund forecasts are required on June 1, September 10, January 10, and March 15, and considered by the Governor and Legislature in developing, passing, and administering the State's budget. The COR's total personal income forecasts are required on August 5 and November 5; the average annual percentage change in total personal income for the preceding three calendar years is the State growth rate that is in turn used to set the State General Fund expenditure ceiling. TRP staff utilize advanced econometric modeling techniques, State tax data, and other economic data to prepare materials that assist the COR members arrive at their forecasts. During this fiscal year, the TRP Office began the process of contracting for services needed to improve the forecast model used to support the work of the COR. The annual report on the efforts to improve revenue forecasting, as required by Act 213, SLH 2007, section 120, was submitted to the Legislature in November 2007.

Pursuant to Act 206, SLH 2007, the TRP Office compiled data previously reported on Forms N-317 that were filed by companies that benefited from the qualified high technology business investment tax credit. Those data were published in the *Report on the Operations of Qualified High Technology Businesses From 2002 Through 2006*, which was submitted to the Legislature in October 2007.

### **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 are not

able to resolve their problems through the normal channels. This position is a one-person operation whose main focus is on the needs of the taxpayer on a case-by-case basis.

During FY 2008, the Taxpayer Advocacy Program assisted 240 taxpayers with the resolution of their tax matters. 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, inability to access the information/communication telephone lines, delays in responses to inquiries, appeals, and general tax information. Additional cases did not require intervention by the Taxpayer Advocate, but guidance to the appropriate management personnel.

The Taxpayer Advocacy Program also coordinates the Department's joint outreach venture that provides tax services to communities that do not normally have access to these services. A variety of tax services are provided, such as the acceptance of general excise tax license applications, assessment notice explanations, payment plan arrangements, voluntary compliance, penalty and interest waivers, individual income tax and general excise tax return preparation, and assistance with general tax questions.

During the 2008 tax season, the Department partnered with the AARP through their Tax Aide Program to bring tax assistance to the island of Molokai. Under the AARP program, volunteer counselors are trained and IRS-certified to assist the elderly, low-income, limited-English speaking, and/or disabled taxpayers in the preparation of their federal and State income tax returns. The Department also partnered with the Internal Revenue Service to bring tax assistance to the Waianae community and to the disabled veterans at the Oahu Veterans Center in Foster Village. Approximately 125 taxpayers were assisted at these three joint outreach events. At each outreach event, the Taxpayer Advocate was on hand to assist taxpayers with their questions and with the resolution of their tax concerns.

In general, the majority of the taxpayers were satisfied with the outcome of their cases regardless of whether a 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 2007–2008)

### OFFICE OF THE DIRECTOR

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

### STAFF OFFICES

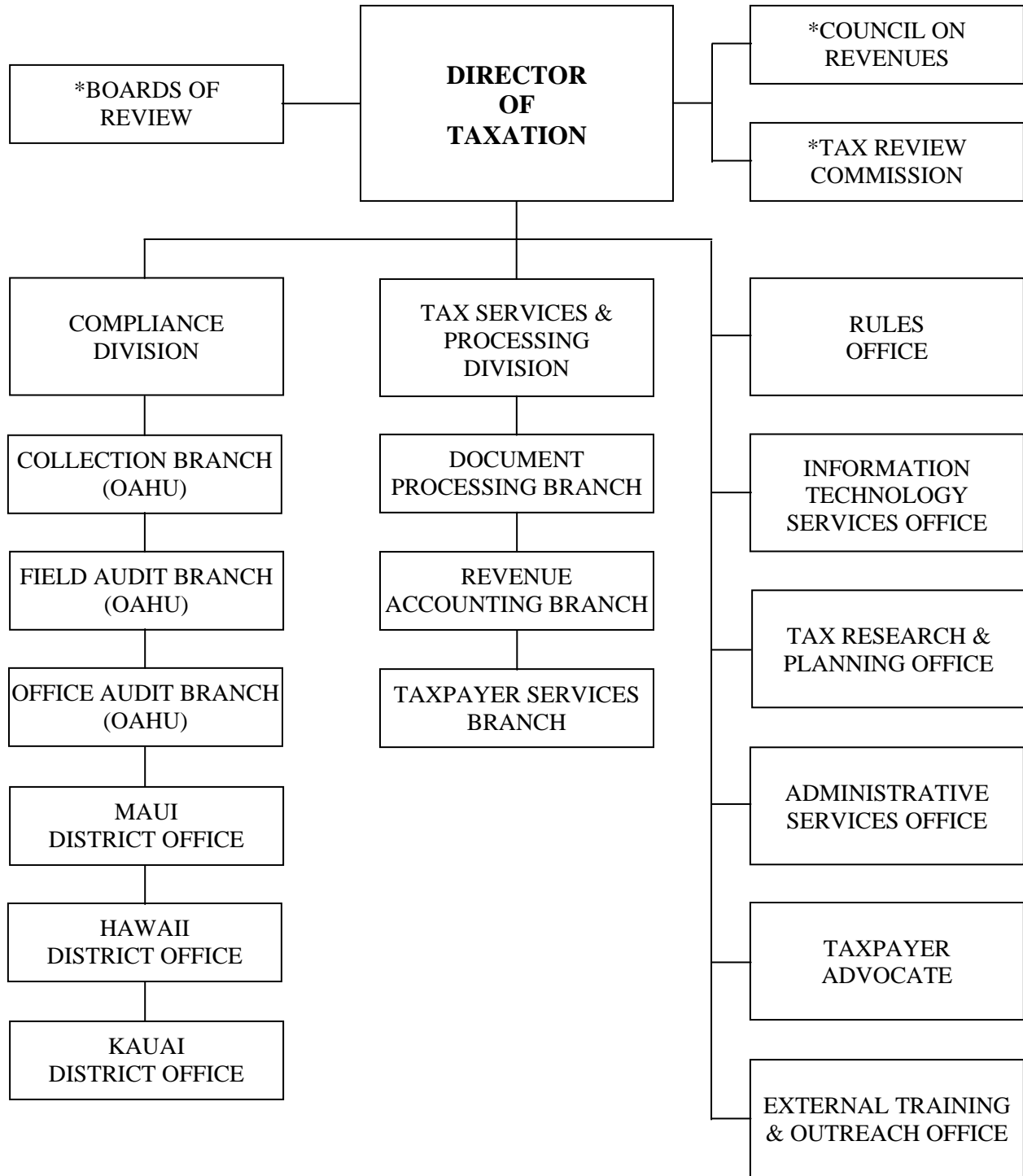
Rules Officer..... Johnnel Nakamura  
    Technical Section Supervisor..... Denise Inouye  
Tax Research & Planning Officer..... Tu Duc Pham  
    Economist..... Yvonne Chow  
Information Technology Services Officer..... Robert Su  
Administrative Services Officer..... Suzanne Eghan  
    Personnel Officer..... Sharon Iwamura  
Taxpayer Advocate..... Fern Elizares  
External Training & Outreach Officer..... Frank Kuresa

### OPERATIONS STAFF

Compliance Division Chief.....Ronald Randall  
    Tax Audit Technical Coordinator..... Vacant  
    Tax Collection Technical Coordinator..... Wayne Kinoshita  
    Oahu Field Audit Branch Chief..... Gayle Nakagawa  
    Oahu Office Audit Branch Chief..... Kenneth Cook  
    Oahu Collection Branch Chief..... Lynne Kaneta  
    Maui District Tax Manager..... Wayne Fujita  
    Hawaii District Tax Manager..... Roy Hamakawa  
    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

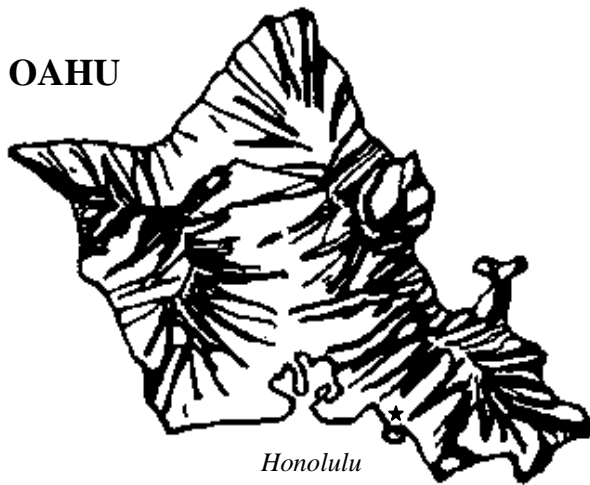
Department of Taxation  
State of Hawaii



\*For Administrative Purposes

## FIRST TAXATION DISTRICT

City & County of Honolulu

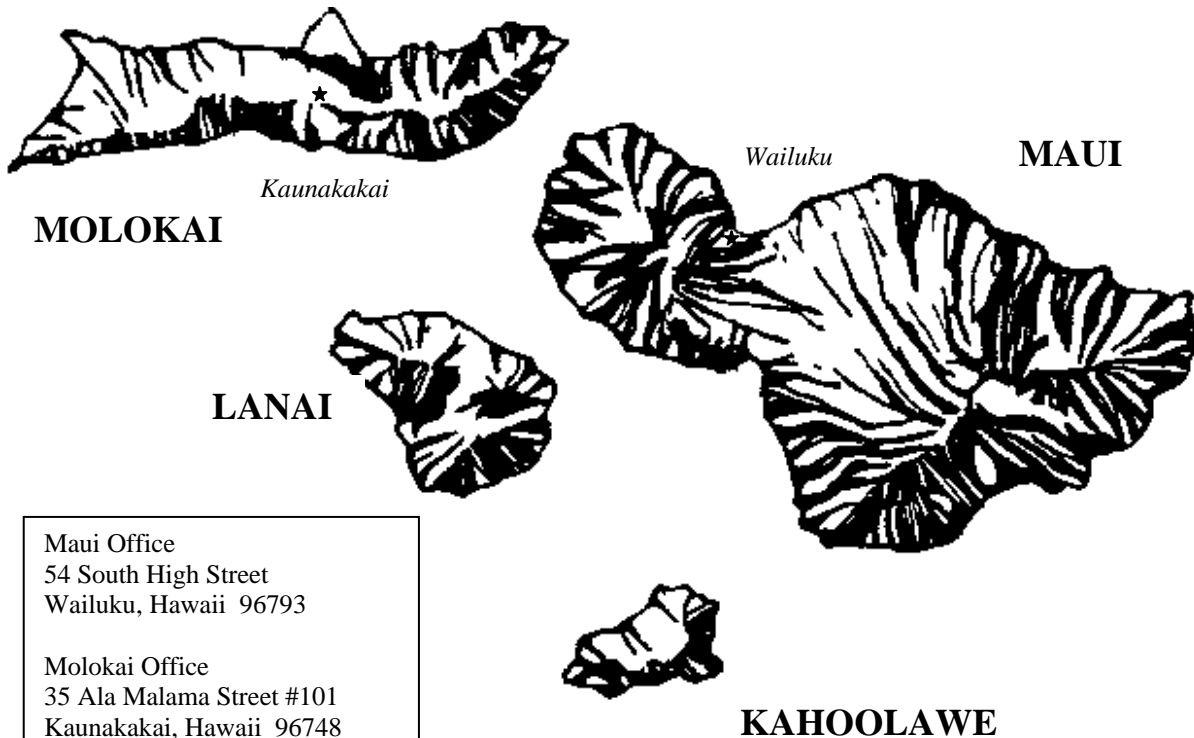


**OAHU**

Oahu Office  
830 Punchbowl Street  
Honolulu, Hawaii 96813

## SECOND TAXATION DISTRICT

Counties of Maui and Kalawao



Maui Office  
54 South High Street  
Wailuku, Hawaii 96793

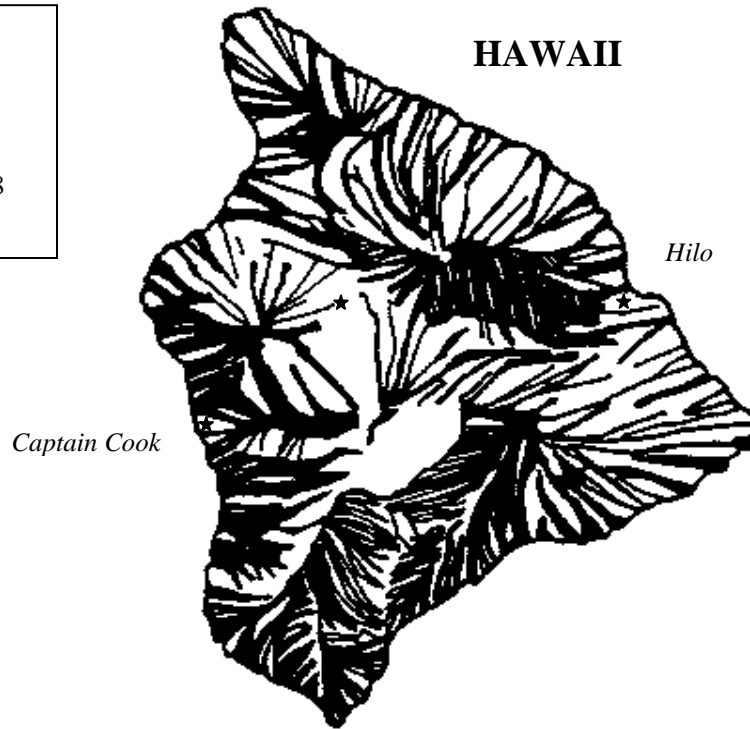
Molokai Office  
35 Ala Malama Street #101  
Kaunakakai, Hawaii 96748

## THIRD TAXATION DISTRICT

County of Hawaii

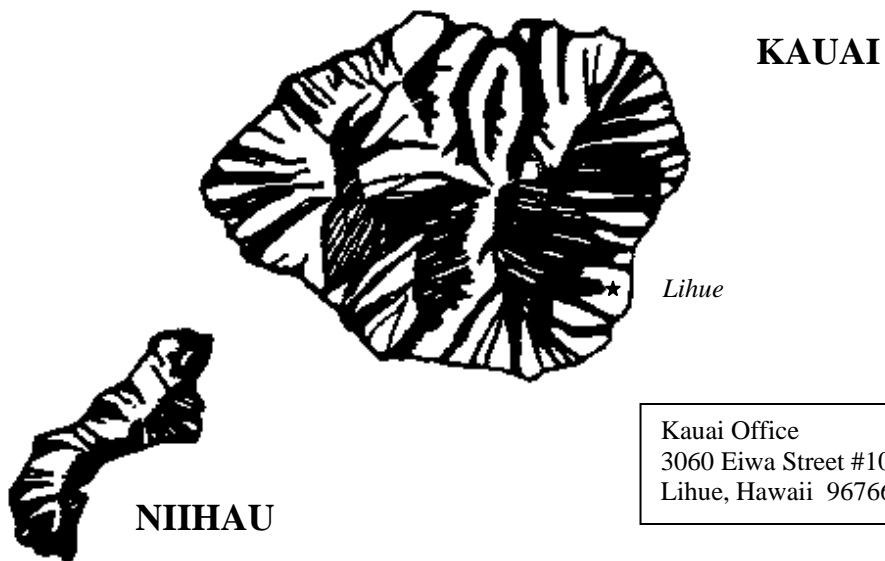
Hilo Office  
75 Aupuni Street  
Hilo, Hawaii 96720

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



## FOURTH TAXATION DISTRICT

County of Kauai



Kauai Office  
3060 Eiwa Street #105  
Lihue, Hawaii 96766

## TAX APPEALS AND LITIGATION

### BOARDS OF TAXATION REVIEW

Each taxation district has an administrative (i.e., non-judicial) Board of Taxation Review consisting of five members. Tax disputes that are not resolved at the district tax office level may be appealed to the Board of Taxation Review unless the dispute involves the Constitution or laws of the United States. Statewide, the boards began the fiscal year with 78 pending tax appeals. During FY 2008, 55 new appeals were filed, 0 appeals withdrawn, and 31 appeals settled; a total of 102 appeals to the Boards of Taxation Review were pending at the end of the fiscal year.

The following table details appeals to the Boards of Taxation Review by taxation district:

<u>Taxation District</u>	<u>First (Office Audit)</u>	<u>First (Field Audit)</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
Appeals Pending (Beginning)	56	7	1	9	5	78
New Appeals	42	0	5	1	7	55
Appeals Withdrawn	0	0	0	0	0	0
Appeals Settled	23	0	5	1	2	31
Appeals Pending (Ending)	75	7	1	9	10	102

### CIVIL DECISIONS, SETTLEMENTS, AND OTHER LEGAL MATTERS

During FY 2008, the Tax Division of the Department of the Attorney General closed 509 legal matters related to the Department of Taxation, excluding legislative matters that have not yet been closed in the case management system by the Department of the Attorney General's Legislative Division. Also not included are all charitable oversight and charitable solicitation matters the Tax Division routinely handles.

#### MATTERS CLOSED

Appeals .....	6
Bankruptcies .....	245
Contracts .....	1
Foreclosures .....	226
Legislation.....	0
Opinions .....	5
Quiet Title .....	3
Subpoenas .....	4
Miscellaneous .....	19

#### AMOUNTS COLLECTED

Tax Appeals	\$ 694,821
Foreclosures	43,491
Bankruptcies	1,015,273
Miscellaneous	<u>4,161</u>
<b>TOTAL</b>	<b><u>\$1,757,746</u></b>

## **Settled Cases**

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 was 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. This case has been settled and the tax appeal dismissed.

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 a notice of appeal from conveyance taxes paid under protest. The amount in controversy is \$339,407.40. Act 156, SLH 2005, increased the applicable conveyance tax rate from 0.1% to 0.3% for properties with a value of \$1 million or greater unless it is a condominium or a single-family residence. Act 156, SLH 2005, 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 on Maui. The actual sale of the property, however, took place on November 1, 2005. Taxpayers/Plaintiffs argued that the old rate applied. The case was settled and the tax appeal dismissed.

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 claimed that the assessments were 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. The case was settled and the tax appeal dismissed.

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 been settled and the tax appeal has been dismissed.

In the Matter of the Tax Appeal of Snorkel Bob Brand, Inc., T.A. No. 06-0081, Tax Appeal Court, State of Hawaii.

Taxpayer failed to report certain items of income listed on its net income return on its general excise tax return and was assessed the difference in corresponding general excise taxes. Taxpayer failed to provide any documentation to support its claims that the unreported income was not taxable. The case was settled and the tax appeal dismissed.



In the Matter of the Tax Appeal of Robert and Anita Wintner, T.A. No. 06-0082, Tax Appeal Court, State of Hawaii.

Taxpayers are the owners of Snorkel Bob Brand, Inc., a company assessed with additional general excise taxes. As a result of adjustments to income made by the auditor to Snorkel Bob Brand Inc.'s net income return, Taxpayers were assessed additional net income taxes. The case was settled and the tax appeal dismissed.

In the Matter of the Appeal of Pihana Pacific, Inc., T.A. No. 07-0017, Tax Appeal Court, State of Hawaii.

Taxpayer filed a Notice of Appeal from the Board of Review's decision in favor of the Department that the research activities tax credits and capital goods tax credits for tax years 2000 and 2001 were incorrect. Taxpayer argued that it conducted qualified research in Hawaii and purchased qualified property to claim the respective credits. The Department found that one project qualified for the research activities tax credit and disallowed the other projects. The case was settled and the tax appeal dismissed.

In the Matter of the Tax Appeal of Navatek, Ltd., T.A. No. 07-0070, Tax Appeal Court, State of Hawaii.

Taxpayer filed an appeal under a new law allowing taxpayers to file a Notice of Appeal to Tax Appeal Court if a refund claim is not answered in 180 days. Taxpayer filed a refund claim for research credits under §235-110.91, HRS, and the Department did not respond within 180 days. The case was settled and the tax appeal dismissed.

### **Completed Cases**

In the Matter of the Tax Appeal of Henry F. Johnson and International Resource Recovery, Inc., S. Ct. No. 27738, Intermediate Court of Appeals, 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, which sent the case to the Intermediate Court of Appeals. The Intermediate Court of Appeals dismissed the case. Taxpayer had until September 5, 2007, to file a writ of certiorari to the Hawaii Supreme Court. No writ was filed.

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. Taxpayer appealed the assessment to the Board of Review and prevailed. The Department appealed the Board of Review's ruling on July 7, 2006. After additional investigation by the attorney general's office, the Department dismissed this case because the taxpayer had a contract with the United States Postal Service stating that it was a contract postal unit and thus exempt from taxes.

Richard A. Meyer v. Kurt Kawafuchi, T.A. No. 07-0071, Tax Appeal Court, State of Hawaii.

Plaintiff filed a complaint for refund from taxes paid under protest. The amount in controversy was \$4,506.74. Plaintiff believed that the automatic extension to file his 2005 net income tax return and to pay the attendant liabilities extended to October 2006. However, Plaintiff did not file a Form N-101B specifying reasonable cause as to why he should be allowed the additional two months to file his return. The Department assessed Plaintiff for the additional taxes and penalties in dispute. Plaintiff agreed to dismiss the case by stipulation and to pay all additional taxes.

In the Matter of the Tax Appeal of Kulakane Rental, Inc., T.A. No. 07-0077, and In the Matter of the Tax Appeal of Polynesian Shores Rental Association, T.A. No. 07-0078, Tax Appeal Court, State of Hawaii.

The Director filed motions to dismiss for lack of jurisdiction based on the Taxpayer-Appellants' failure to pay the amounts in controversy prior to filing their appeals. The Tax Appeal Court dismissed both cases.

### **Pending Appeals**

#### Hawaii Supreme Court

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 for tax years 2000 through 2006. 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.

#### Tax Appeal Court, State of Hawaii

In the Matter of the Tax Appeal of Bobby R. Narmore, T.A. No. 02-0066, Tax Appeal Court, State of Hawaii.

The Hawaii Supreme Court (S. Ct. No. 27023) remanded the case back to the Tax Appeal Court, holding that the Tax Appeal Court has jurisdiction over Taxpayer's case. Taxpayer appealed the Board of Review's decision in favor of the Department. Taxpayer argued that the Department failed to assess him within the three-year period after he presented his federal income tax return and return information to the Department, despite the fact that he had submitted an income tax return to the Department for processing.

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 §857(c), Internal Revenue Code (IRC), which is operative in Hawaii and denies the deduction for dividends paid by a REIT, refers to §243, IRC, which is inoperative, it was entitled to take a deduction for \$89 million in dividends it received from a REIT. The Department won a motion for summary judgment and in January 2007, the Taxpayer filed a motion for reconsideration that the Tax Appeal Court has yet to respond to.

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% for the wholesale of make-up products sold, 4.0% on services provided at its counters in the stores, and 4.5% 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 any products in Hawaii, it did not import any products into Hawaii, and it had sharing agreements with the stores concerning the employees at the counters. The parties have reached a tentative settlement on the issues concerning the 0.5% tax on wholesale sales of make-up products sold and the 4.5% tax on the import and sale of furniture and fixtures. The Court granted partial summary judgment for the Taxpayer on the issue concerning the 4% tax on services provided at its counter in the stores. The entry of a judgment reflecting the settlement and the court ruling is pending.

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 §237-43, HRS (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 CompUSA, T.A. No. 05-0065, Tax Appeal Court, State of Hawaii.

The Department assessed 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 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 through 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. The trial has been taken off of the court's calendar. If all issues are not resolved by a pending motion for summary judgment, currently scheduled to be heard on September 29, 2008, then the Tax Appeal Court will set a new trial date.

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. The trial has been taken off of the court's calendar. If all of the issues are not resolved by the pending motion for summary judgment, currently scheduled to be heard on September 15, 2008, then the Tax Appeal Court will set a new trial date.

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. Trial is set for December 5, 2011.

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, through June 30, 2003. Taxpayer claimed 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. This is a substantiation question. The assessments were made based on information available at that time. Trial is currently scheduled for October 20, 2008.

Costco Wholesale Corp. vs. Director of Taxation, State of Hawaii, T.A. No. 06-0001, Tax Appeal Court, State of Hawaii.

Taxpayer filed a complaint for a refund of tax payments made under protest for the period from September 1, 1999, through August 31, 2002, inclusive. Taxpayer is challenging the Department's assessment that reclassified certain wholesale transactions to retail transactions, thereby imposing the 0.5% use tax and 4.0% general excise tax on the importation and sale of the products to a customer.

In the Matter of the Tax Appeal of Nordstrom, Inc., T.A. No. 06-0079, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for the tax period from February 1, 2001, through January 31, 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

In the Matter of the Tax Appeal of Zale Delaware, Inc., T.A. No. 06-0080, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on the use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for the tax period from August 1, 2001, through July 31, 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

In the Matter of the Appeal of Moana Pa'akai, Inc., T.A. No. 06-0094, Tax Appeal Court, State of Hawaii.

Taxpayer, a.k.a. Hawaiian Tug & Barge, filed a notice of appeal and complaint appealing general excise tax assessments for tax years 2001, 2002, 2003, and 2004. Taxpayer argues that the Department failed to apply exemptions or lower tax rates under §§237-4, 237-13, 237-13.3, and 237-24.3, HRS. Trial is currently scheduled for the week of June 29, 2009.

In the Matter of the Tax Appeal of Territorial Mutual Holding Company and Subsidiaries, T.A. Nos. 06-0096 and 07-0079, 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 REIT. Taxpayer claimed that, because §857(c), IRC (which is operative in Hawaii and denies the deduction for dividends paid by a REIT), refers to §243, IRC (which is inoperative), it was entitled to take a deduction for \$89 million in dividends it received from a REIT. The parties are awaiting the Tax Appeal Court's ruling on the motion for reconsideration in the Central Pacific Bank cases. Trial is set for March 16, 2009.

In the Matter of the Appeal of Spirent Holdings Corp. & Subsidiaries, T.A. No. 06-0100, Tax Appeal Court, State of Hawaii.

Taxpayer filed a Notice of Appeal challenging the Department's assessment denying its request for additional research activities credits for tax year 2001. Taxpayer filed an original 2001 corporate income tax return on or about October 21, 2002 (originally due on April 21, 2002). Subsequently, on October 20, 2003, Taxpayer filed an amended return increasing the amount claimed for the research activities credit. The Department denied Taxpayer's amended return because it was not filed within the twelve months after the close of the 2001 tax year.

In the Matter of the Tax Appeal of Ohana Foundation for Technical Development, T.A. No. 07-0009, Tax Appeal Court, State of Hawaii.

Taxpayer filed a refund claim for research credits under §235-110.91, HRS, which the Department denied. Trial is set for July 27, 2009.

In the Matter of the Tax Appeal of Safeway, Inc., T.A. No. 07-0042, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for tax years 2002 through 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

Reel Hooker Sportfishing, Inc. v. Department of Taxation, State of Hawaii; Exact Game Fishing, Inc. vs. Department of Taxation, State of Hawaii; Finest Kind, Inc. vs. Department of Taxation, State of Hawaii, Consolidated T.A. Nos. 07-0072, 07-0073, 07-0074, Tax Appeal Court, State of Hawaii.

Taxpayers filed complaints for refunds of tax payments made under protest for tax year 2004, claiming that they are exempt from the general excise tax pursuant to the Supremacy and Tonnage Clauses of the U.S. Constitution. Taxpayers amended the complaint to consolidate the cases and also to challenge the assessments that the Department issued based on their amended returns.

In the Matter of the Tax Appeal of First Hawaiian Insurance, T.A. Nos. 07-0101 and 07-0103, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund claims for the research credit provided by §235-110.91, HRS. The Department argued that banks are not eligible for the research credit under chapter 241, HRS. The amount in controversy is approximately \$2.7 million. Trial is set for April 27, 2009.

In the Matter of the Appeal of Jarrett Technology Solutions, Inc., T.A. No. 07-0107, Tax Appeal Court, State of Hawaii.

Taxpayer filed an appeal for tax year ending June 30, 2004. Taxpayer claimed 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. This is a substantiation question. The assessments were made based on information available at that time.

In the Matter of the Tax Appeal of American Technologies, Inc., T.A. No. 08-0011, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes after the Department determined that Taxpayer was not a "contractor" as defined in §237-6, HRS, and was not entitled to claim the subcontractor deduction under §237-13, HRS. The amount in controversy is \$1,802,642.90. Trial is set for February 16, 2009.

In the Matter of the Tax Appeal of BHP Hawaii, Inc., T.A. No. 08-0012, Tax Appeal Court, State of Hawaii.

Assessments were made for general excise tax for tax years 2000 and 2001, for which Taxpayer failed to file general excise tax returns. Taxpayer subsequently filed tax returns showing tax liabilities that were less than the amount assessed. Taxpayer paid under protest the difference between the assessments and its returns and filed a complaint for refund under §40-35, HRS. Trial is currently scheduled for April 27, 2009.

In the Matter of the Tax Appeal of Charles Schwab, Inc., T.A. No. 08-0013, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on commissions it earned on sales of financial products. Taxpayer claimed that the bulk of the commissions were passed on to the Hawaii brokers and should not be included in its gross receipts. The amount in controversy is \$1,811,867.07. Trial is set for May 18, 2009.

In the Matter of the Tax Appeal of Medical Underwriters, T.A. No. 08-0014, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer the 4.0% general excise tax on income from providing management services to certain insurance companies. Taxpayer filed an appeal challenging the calculations of the assessment, arguing that only the income from services that are performed in Hawaii is subject to the 4.0% tax. The Department's position is that all services that are attributable to Hawaii, whether it was rendered inside or outside Hawaii, are subject to tax.

In the Matter of the Tax Appeal of UXB International, Inc., T.A. Nos. 08-0020, to 08-0028, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes after the Department determined Taxpayer was not a "contractor" as defined in §237-6, HRS, and was not entitled to claim the subcontractor deduction under §237-13, HRS. The trial date is not set.

Marriott Cases, T.A. Nos. 08-0032, 08-0033, 08-0034, 08-0045, 08-0047, 08-0048, 08-0049, 08-0050, 08-0051, 08-0053, 08-0054, 08-0055, 08-0056, 08-0057, 08-0058, 08-0059, 08-0060, 08-0061, 08-0062, 08-0063, 08-0064, 08-0066, 08-0067, 08-0068, 08-0069, 08-0071, 08-0074, 08-0075, 08-0076, 08-0077, 08-0078, 08-0079, 08-0080, and 08-0082, Tax Appeal Court, State of Hawaii.

Various Marriott entities filed tax appeals challenging the Department's assessments of general excise and transient accommodation taxes on the Marriott Rewards Program and preview packages program, as well as the imposition of the general excise tax on certain management fees, retail sales, royalty income, maintenance fees, and tidy room fees. One entity challenged the assessment related to its income tax return with respect to the dividends received deduction, captive insurance income, the disposition of assets, refund adjustments, the hotel construction and remodeling credit, and the capital goods excise tax credit. Various entities challenged the imposition of penalties and interest, the imposition of tax on reimbursements, and whether certain credits and liabilities should be offset with other entities.

In the Matter of the Tax Appeal of Agnes P. Etscheid, T.A. No. 08-0046, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from assessment of tax on the sale of real property by a nonresident person. Taxpayer claims the denial of her refund was erroneous because she is a resident of Micronesia and is exempt from United States income taxes. The Department maintains the taxpayer is subject to the tax.

In the Matter of the Tax Appeal of Aalapapa Enterprises, L.L.C., T.A. No. 08-0083, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from the assessment of general excise tax for the rental income of property located in Lanikai. Taxpayer maintains that, as a convenience to Seller, it allowed Seller to continue to occupy the property in exchange for a reduction in the purchase price of the property; no rent was paid. The Department's position is that the discount in purchase price constitutes gross income subject to the general excise tax.

In the Matter of the Tax Appeal of James H. Kobayashi, T.A. No. 08-0084, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from Taxpayer's own general excise tax return. Taxpayer now claims that he is not individually liable for general excise taxes owed by the partnership. Taxpayer further claims that the time for assessment had lapsed prior to the Department's assessment against Taxpayer. The Department maintains that Taxpayer cannot appeal a self-assessment, the appeal is improper for failing to serve the director, and Taxpayer failed to pay the full amount upon filing this appeal.



In the Matter of the Tax Appeal of Pacific Communications, LLC, T.A. No. 08-0085, Tax Appeal Court, State of Hawaii.

Taxpayer appealed assessments of general excise tax and withholding tax. Taxpayer maintains that the general excise tax assessments are incorrect because the Department failed to consider equipment reimbursements and chargebacks in computing gross receipts. The Taxpayer also asserts that the Department double counted Form 1099 income and that the withholding tax was improper because the Taxpayer did not have employees, but instead had outside independent contractors.

In the Matter of the Tax Appeal of Kaanapali Beach Vacation Owners Association, LLC, T.A. No. 08-0089, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from the Board of Review regarding the assessment of general excise taxes on condominium maintenance fees. Taxpayer claims the condominium maintenance fees do not constitute gross income but are instead reimbursements of costs that are not subject to the general excise tax.

In the Matter of the Tax Appeal of June H. Kawasaki, Case No. 08-0112, Tax Appeal Court, State of Hawaii.

This tax appeal involves a disputed income tax assessment against Taxpayer covering the tax year ending December 31, 2003. At issue is whether Taxpayer timely claimed the residential construction and remodeling tax credit. Trial is currently scheduled for February 23, 2009.

## **CRIMINAL CASES**

During FY 2008, the Criminal Justice section of the Department of the Attorney General filed complaints or indictments against 34 taxpayers<sup>1</sup> for violating Hawaii state tax laws as set out in §§231-34, 231-35, and 231-36, HRS. The complaints and indictments filed against the 34 taxpayers accounted for over \$1,198,564 in unpaid taxes (excluding civil assessments, penalties, and interest). To date, the courts have imposed criminal fines of \$111,000 based on these complaints and indictments.<sup>2</sup>

During FY 2008, the Department of Taxation collector assigned to criminal cases collected \$1,795,805 in unpaid taxes, penalties, and interest.

Eleven of the 34 taxpayers were real estate agents who were not filing their general excise tax returns despite earning substantial commission income as a result of high real estate sales in past years. The highest agent grossed over \$1,949,000 in unreported commission income over five years. The majority of the real estate agents pled guilty to misdemeanor and failure to file charges.

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<sup>1</sup> In addition, there are 29 cases pending action at the Attorney General's office: 11 cases are pending indictment, ten cases are pending arraignment, and eight cases are pending trial.

<sup>2</sup> Criminal fines are imposed at sentencing; to date, 12 taxpayers have yet to be sentenced.

During the fiscal year, the Department of Taxation's Criminal Investigations Unit sent two investigators to a six-month training program at the Federal Law Enforcement Training Center in Glynco, Georgia. Despite its small size, the Criminal Investigations Unit has been extremely successful in conducting investigations, developing cases, and obtaining charges against taxpayers who had committed criminal violations.

### **Other Cases of Note**

An office manager was indicted on two counts of tax evasion for not reporting amounts embezzled: \$213,000 in 2004 and \$302,000 in 2005, on her income tax returns. The office manager, who was given full access to accounting systems and records, paid off her credit cards, diverted company funds to family members, and fraudulently obtained checks made payable to a consulting company that she created. The total unpaid tax totaled \$48,166.

A taxpayer was sentenced for theft in the first degree for filing electronic returns with fictitious W-2s. The taxpayer filed an erroneous return and received \$27,904 in false refunds. The return preparer instructed the taxpayer to file an amended return showing the correct refund of \$77. However, the taxpayer did not file the amended return and instead spent the erroneous refund on toys, cars, and other items. The taxpayer was ordered to pay back the excess refund received, and to perform 100 hours of community service.

Two tax return preparers had complaints filed against them for failing to file their general excise tax returns. Given the level of trust that clients place in tax preparers to know what the tax laws are and to act in an ethical and responsible manner, it is important that the Department deter preparers who would betray that trust and hold those that do betray that trust accountable.

A criminal complaint was filed against a taxpayer on Hawaii Island for eight counts of failing to file his annual general excise and net income tax returns. This was the first criminal tax case prosecuted by the County of Hawaii, Office of the Prosecuting Attorney.

A criminal complaint was filed against a fuel distributor for multiple fuel tax violations. Both the corporation and the individual responsible for filing fuel tax returns were charged with failing to file the corporation's monthly liquid fuel tax returns for five months in 2004 and three months in 2005.

Despite the number of complaints and indictments during this fiscal year, the Criminal Investigations Unit still receives numerous referrals and reports of potential cases. The unit is a critical part of the Department's Compliance Division and will continue its deterrence efforts through the successful prosecution of tax offenders and regular media exposure.

## LEGISLATION

The Twenty-Fourth Legislature enacted the following major tax-related measures during the 2008 Regular and Special Sessions:

### REGULAR SESSION 2008

<u>Act</u>	<u>Brief Description</u>
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- |            |  |
|------------|--|
| <b>016</b> | <b>Relating to Statutory Revision: Amending or Repealing Various Provisions of the Hawaii Revised Statutes and the Session Laws of Hawaii for the Purpose of Correcting Errors and References, Clarifying Language, and Deleting Obsolete or Unnecessary Provisions.</b> Deletes obsolete provisions and references relating to the sale of tangible personal property to services enacted by Act 70, SLH 1999, and Act 198, SLH 2000, that had repealing language effective January 1, 2006. <i>Effective April 15, 2008.</i>                       |
| <b>028</b> | <b>Relating to Condominiums: Making Various Technical Amendments to the Hawaii Revised Statutes for the Purpose of Correcting Errors and References, and Clarifying Language.</b> Amends various provisions of the HRS relating to condominiums to reflect the existence of two different chapters relating to condominiums. <i>Effective April 22, 2008, retroactive to July 1, 2006. The amendments to §237-24.3, HRS, by §26 of this Act shall not be repealed when that section is reenacted on December 31, 2009, by §4, Act 239, SLH 2007.</i> |
| <b>057</b> | <b>Relating to Intra-County Ferry Service.</b> Provides priority assignment of mooring space for an intra-county ferry service regulated by the public utilities commission servicing Maui County. Exempts fuel purchases for such ferry service from the fuel tax under Chapter 243, HRS. The sale of the fuel remains subject to general excise taxation under Chapter 237, HRS. <i>Effective May 1, 2008, and applies to taxable years beginning after December 31, 2007.</i>   |
| <b>058</b> | <b>Relating to Income Tax Credit.</b> Provides a one-time, refundable, income tax credit of \$1 for each qualified exemption, except additional exemptions for age and disability, claimed by resident individuals to satisfy the requirements of Article VII, section 6, of the Constitution of the State of Hawaii. <i>Effective May 1, 2008.</i>  |
| <b>084</b> | <b>Relating to The Cancer Research Special Fund.</b> Amends the disposition of the cigarette tax revenues deposited into the Cancer Research Special Fund to allow the monies to be used for capital expenditures. <i>Effective May 1, 2008.</i>   |
| <b>089</b> | <b>Relating to the General Excise Tax.</b> Amends the definition of service-to-service transactions qualifying for the wholesale 0.5% general excise tax rate to include the furnishing of goods and services to satisfy the warranty obligations of manufacturers to the purchasers of the manufacturers' goods. <i>Effective July 1, 2008.</i>   |

- 093 Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code.** Amends Hawaii's income tax law to conform with changes to the IRC, with exceptions. *Effective May 22, 2008, and applies to taxable years beginning after December 31, 2007; provided that retroactive and prospective effective dates contained in the congressional acts relating to the IRC and enacted during 2007 shall be operative.*
- 141 Relating to the Armed Services.** Provides an exemption from the vehicle weight taxes for one noncommercial vehicle per member of the National Guard or Reserves. *Effective October 1, 2008.*
- 143 Relating to State Enterprise Zones.** Amends the requirements of the state enterprise zone program to ensure that qualifying agricultural businesses will continue to qualify for state enterprise zone incentives for the duration of a *force majeure* event's effects, and exclude from the general excise tax exemption allowed to qualifying businesses in an enterprise zone gross income from the retail sale of certain agricultural products that are not genetically engineered. *Effective July 1, 2008.*
- 175 Relating to Fraud Prevention.** Affects tax forms that require notarization by requiring notaries to place their seal over the specific phrase describing the document being notarized, and to keep a record describing the nature of the notarized document. *Effective January 1, 2009.*
- 202 Relating to Taxation.** Requires the Department to allow individual taxpayers who electronically file their income tax returns to designate a maximum of three checking or savings accounts into which direct deposits of their refunds may be made, provided that the same accounts are designated on the taxpayers' federal income tax return. Also requires the Director of Taxation to annually visit low-income communities to assist taxpayers in the preparation of their tax returns and other documents; the selection of the specific communities is at the discretion of the director. *Effective June 24, 2008, and applies to taxable years beginning after December 31, 2007.*
- 204 Relating to Energy Resources.** Prohibits, with exceptions, the issuance of a building permit on or after January 1, 2010, for single-family residences that do not include a solar water heater system that meets the standards established by the Public Utilities Commission; restricts the renewable energy technologies credit allowed for solar thermal energy systems installed on single-family residences to properties issued building permits prior to January 1, 2010; and denies renewable energy technologies credit claims by residential home developers for solar thermal, wind, and photovoltaic energy systems that are installed on single-family residences and that are placed in service in 2009. *Effective June 26, 2008, provided that the amendments relating to the renewable energy technology tax credit apply to taxable years beginning after December 31, 2008.*
- 226 Relating to Transportation.** Section 13 of this Act extends the \$3 per day rental motor vehicle surcharge tax to August 31, 2011. *Effective July 1, 2008.*

- 233 Relating to Important Agricultural Lands.** Part III of this Act provides for a new, refundable, important agricultural land qualified agricultural cost income tax credit that may be claimed beginning the taxable year following the taxable year in which the Ko Olina Resort and Marina attractions and educational facilities tax credit is repealed, exhausted, or expired. The credit is computed as follows: Year 1—the lesser of 25% of qualified agricultural costs or \$625,000; Year 2—the lesser of 15% of qualified agricultural costs or \$250,000; Year 3—the lesser of 10% of qualified agricultural costs or \$125,000. The Department of Agriculture may certify, and the Department of Taxation may allow, no more than \$7.5 million of credit in the aggregate per taxable year. *Effective July 1, 2008.*
- 244 Relating to Campaign Spending.** Section 34 of this Act increases the individual income tax check-off from \$2 to \$3 per taxpayer. Married couples filing joint returns may each make this election. *Effective July 8, 2008.*



## COLLECTION AND DISTRIBUTION OF TAXES

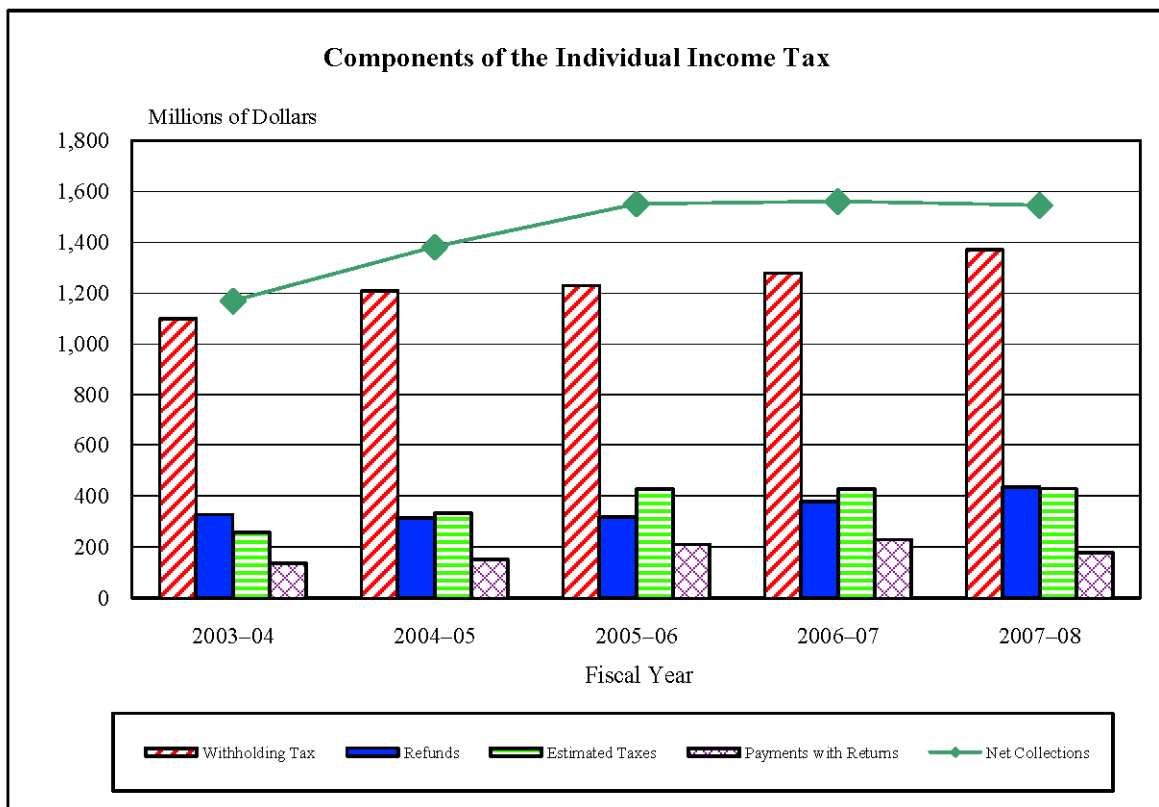
### INDIVIDUAL INCOME TAX

Total estimated individual income tax payments and taxes withheld from wages increased over FY 2007. However, decreased payments with returns and increased refunds reduced those collections by \$108.1 million, for a net decrease of \$15.5 million (-1.0%). This is the first year-over-year net individual income tax loss since the losses in FY 2002 and FY 2003.

#### TAXES PAID BY INDIVIDUALS (In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 430,197	\$ 428,754	\$ 1,443	0.3
Payment with Return	179,209	229,964	(50,755)	(22.1)
Withholding Tax on Wages	1,370,854	1,279,649	91,205	7.1
Subtotal	\$ 1,980,260	\$ 1,938,367	\$ 41,893	2.2
Refunds	435,424	378,081	57,344	15.2
NET	\$ 1,544,835	\$ 1,560,286	\$ (15,450)	(1.0)

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



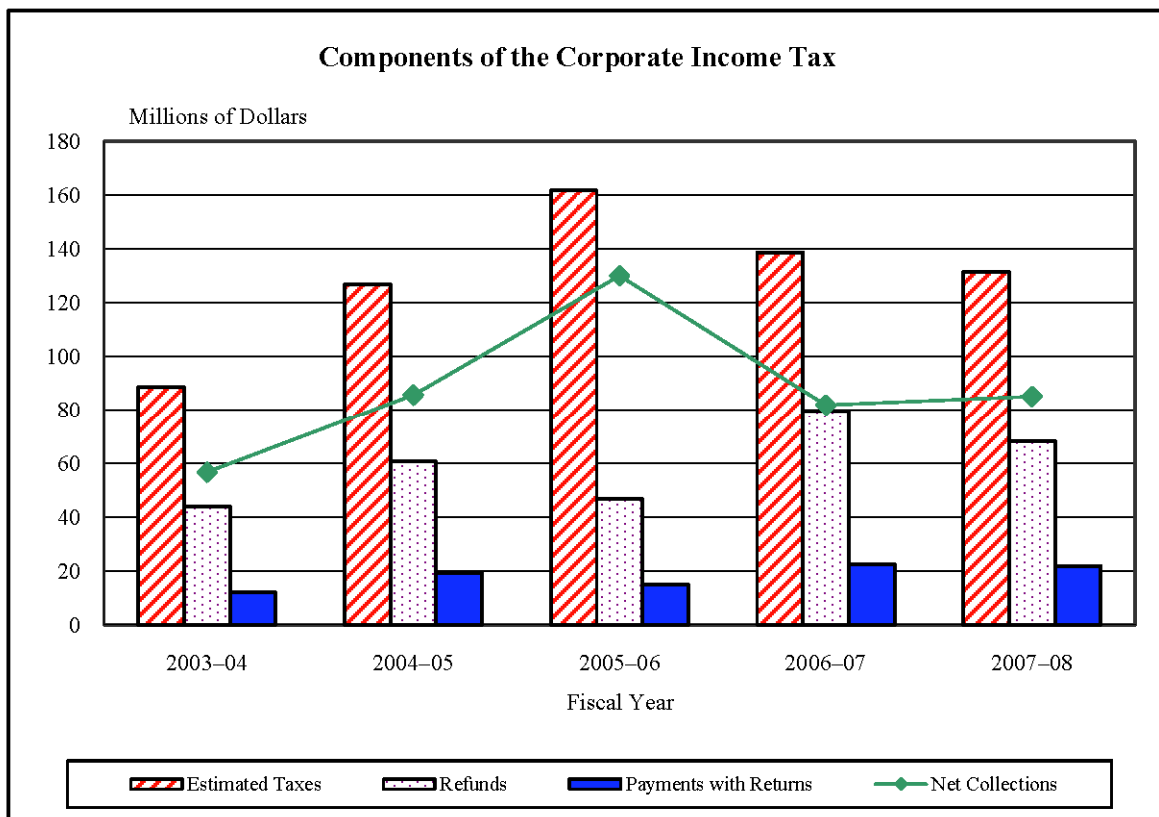
## CORPORATE INCOME TAX

Net corporate income tax collections totaled \$85.1 million for FY 2008, increasing by \$3.2 million over the previous year's total of \$81.8 million. Although there were decreases in both estimated payments and payments with returns, a positive net gain of \$3.3 million (4.0%) resulted due to a significant 14.3% reduction in refunds.

### TAXES PAID BY CORPORATIONS (In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 131,462	\$ 138,769	\$ (7,307)	(5.3)
Payment with Return	21,851	22,653	(802)	(3.5)
Subtotal	\$ 153,313	\$ 161,422	\$ (8,109)	(5.0)
Refunds	68,232	79,588	(11,356)	(14.3)
NET	\$ 85,081	\$ 81,834	\$ 3,247	4.0

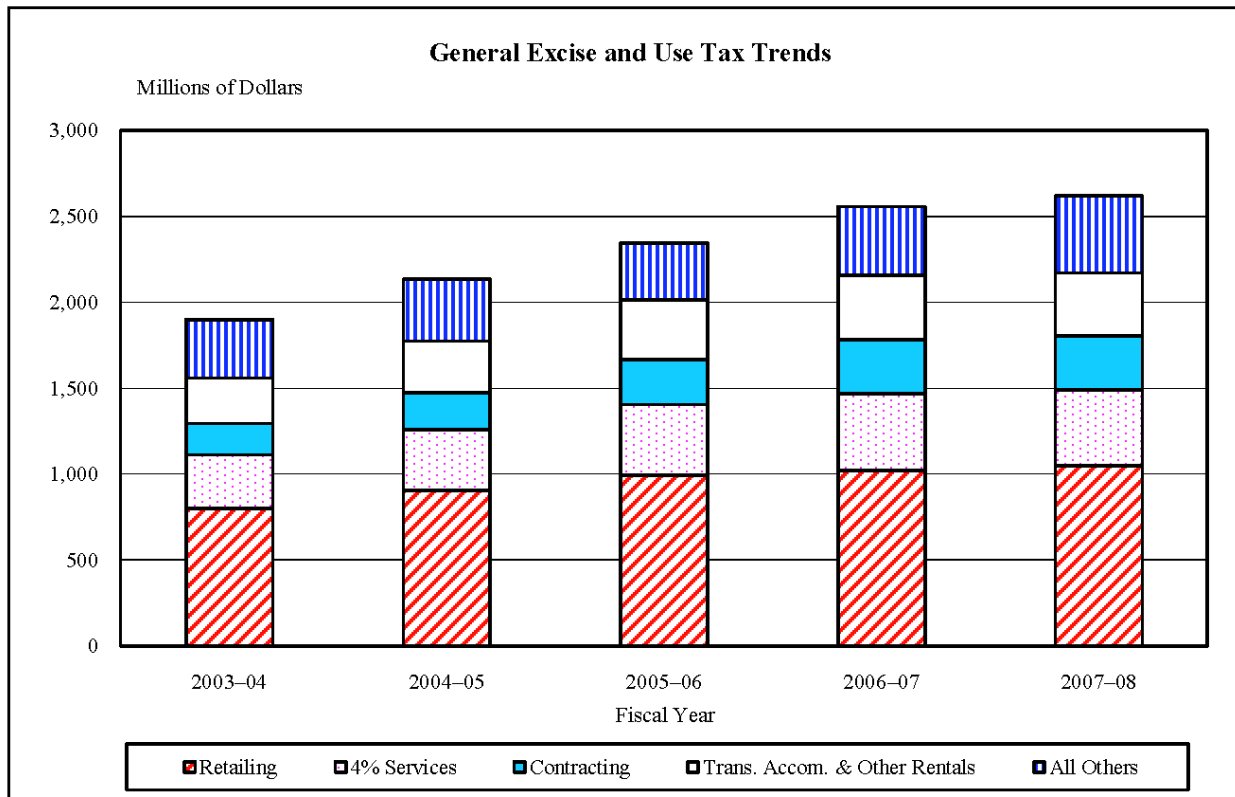
NOTE: Due to rounding, details may not add to totals.





## GENERAL EXCISE AND USE TAXES

General excise and use taxes made up 47.8% of total tax collections. The total \$2.6 billion collected represents a 2.5% growth over the prior fiscal year. Although the largest component, retailing, showed a slight 2.6% gain, revenues from most other major components of the general excise tax were lower in FY 2008 than in FY 2007. Tax revenues from services were down by \$5.3 million (-1.2%), contracting revenues were down by \$1.6 million (-0.5%), and transient accommodation rental revenues were down by \$6.3 million (-4.6%).



GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 2008, AND JUNE 30, 2007  
(In thousands of dollars)

SOURCE OF REVENUE	Rate	FY 2008	FY 2007	Difference	
				Amount	% Change
<u>TAX BASE</u>					
Retailing		\$ 26,183,495	\$ 25,508,930	\$ 674,564	2.6
Services		11,072,727	11,205,056	(132,329)	(1.2)
Contracting		7,863,437	7,903,551	(40,114)	(0.5)
Trans. Accom. Rentals		3,321,011	3,479,662	(158,651)	(4.6)
All Other Rentals		5,817,945	5,813,484	4,462	0.1
All Others (4%)		5,238,402	5,606,262	(367,860)	(6.6)
Subtotal		<u>\$ 59,497,017</u>	<u>\$ 59,516,945</u>	<u>\$ (19,928)</u>	<u>0.0</u>
Wholesaling		\$ 13,745,938	\$ 13,558,019	\$ 187,919	1.4
Manufacturing		760,854	818,284	(57,430)	(7.0)
Producing		457,163	482,234	(25,071)	(5.2)
Wholesale Services		648,415	718,310	(69,895)	(9.7)
Use (1/2%)		7,214,491	7,742,305	(527,814)	(6.8)
Insurance Commissions		543,835	616,660	(72,825)	(11.8)
Subtotal		<u>\$ 23,370,697</u>	<u>\$ 23,935,812</u>	<u>\$ (565,115)</u>	<u>(2.4)</u>
TOTAL—ALL ACTIVITIES		<u><u>\$ 82,867,713</u></u>	<u><u>\$ 83,452,757</u></u>	<u><u>\$ (585,043)</u></u>	<u><u>(0.7)</u></u>
<u>TAX</u>					
Retailing	4.00%	\$ 1,047,340	\$ 1,020,357	\$ 26,983	2.6
Services	4.00%	442,909	448,202	(5,293)	(1.2)
Contracting	4.00%	314,537	316,142	(1,605)	(0.5)
Trans. Accom. Rentals	4.00%	132,840	139,186	(6,346)	(4.6)
All Other Rentals	4.00%	232,718	232,539	178	0.1
All Others (4%)	4.00%	209,536	224,250	(14,714)	(6.6)
Subtotal		<u>\$ 2,379,881</u>	<u>\$ 2,380,678</u>	<u>\$ (797)</u>	<u>0.0</u>
Wholesaling	0.50%	\$ 68,730	\$ 67,790	\$ 940	1.4
Manufacturing	0.50%	3,804	4,091	(287)	(7.0)
Producing	0.50%	2,286	2,411	(125)	(5.2)
Wholesale Services	0.50%	3,242	3,592	(349)	(9.7)
Use (1/2%)	0.50%	36,072	38,712	(2,639)	(6.8)
Insurance Commissions	0.15%	816	925	(109)	(11.8)
Subtotal		<u>\$ 114,950</u>	<u>\$ 117,521</u>	<u>\$ (2,571)</u>	<u>(2.2)</u>
Unallocated*		\$ 123,953	\$ 57,563	\$ 66,390	115.3
TOTAL—ALL ACTIVITIES		<u><u>\$ 2,618,784</u></u>	<u><u>\$ 2,555,762</u></u>	<u><u>\$ 63,022</u></u>	<u><u>2.5</u></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

Transient accommodations tax collections totaled \$229.4 million for FY 2008, an increase of \$4.4 million (2.0%) over last year. Transient accommodations tax funds are distributed as follows: (1) 44.8% to the counties; (2) 17.3% to the Convention Center Enterprise Special Fund, provided that the revenues in excess of \$33.0 million in any calendar year are deposited into the General Fund; (3) 34.2% to the Tourism Special Fund, provided that, of the first \$1.0 million, 90.0% is transferred to the State Parks Special Fund, and 10.0% into the Special Land and Development Fund, and further provided that 0.5% of the 34.2% is transferred to a sub-account in the Tourism Special Fund to fund a safety and security budget, and additional amounts are transferred into the Tourism Emergency Trust Fund, as needed, to maintain a fund balance of \$5.0 million; and (4) 3.7% to the General Fund. The Transient Accommodations Tax Trust Fund, into which 5.3% of the transient accommodations tax revenue was transferred in previous years, was repealed, effective July 1, 2007, by Act 235, SLH 2005. In FY 2008, only \$15.9 million was deposited into the General Fund; a decrease of \$1.1 million (-6.7%) from FY 2007.

### TRANSIENT ACCOMMODATIONS TAX (In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Transient Accommodations Tax	\$ 222,685	\$ 219,831	\$ 2,855	1.3
Time Share Occupancy Tax	6,693	5,101	1,592	31.2
Trans. Accom./Time Share Occ. Fees	10	11	(1)	(12.6)
<b>TOTAL</b>	<b>\$ 229,388</b>	<b>\$ 224,942</b>	<b>\$ 4,445</b>	<b>2.0</b>
Counties' Share	\$ 102,761	\$ 100,769	\$ 1,992	2.0
Convention Center Fund	32,453	33,758	(1,305)	(3.9)
Tourism Special Fund	78,229	73,328	4,902	6.7
General Fund	15,944	17,088	(1,143)	(6.7)
<b>TOTAL</b>	<b>\$ 229,387</b>	<b>\$ 224,943</b>	<b>\$ 4,444</b>	<b>2.0</b>

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

## FUEL AND MOTOR VEHICLE TAXES

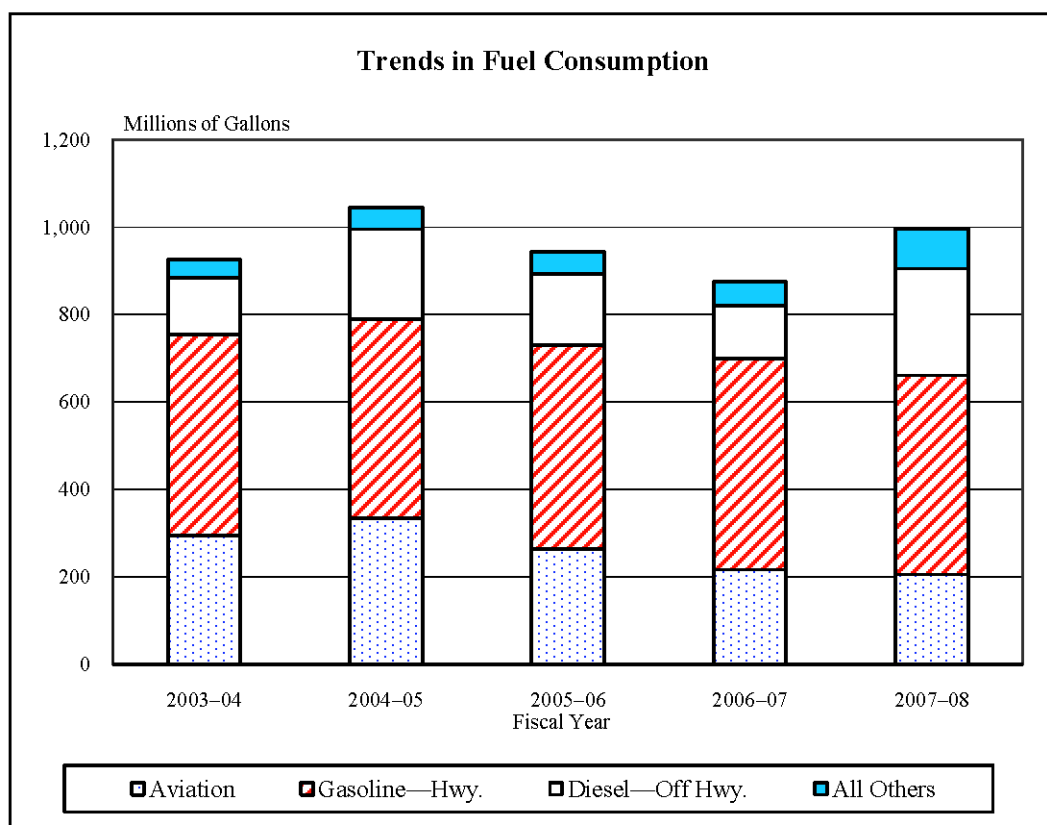
Total taxable fuel consumption increased 13.9% to 997.2 million gallons in FY 2008. Significant year-over-year changes in the taxable fuel consumption data reported in the table below are in part due to changes in the fuel tax law and how the different types of fuel are reported. For example, sales of naphtha, compressed natural gas, and liquefied natural gas are now separately reported, and have been included in the "Other Fuel" category. 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 33.9 million barrels of petroleum was subjected to the environmental response tax in FY 2008, a decline of 2.6% from the previous year.

**GALLONS OF FUEL CONSUMED**  
(In thousands of gallons)

	FY 2008	FY 2007	Difference	
			Amount	%
Gasoline	454,939	483,229	(28,290)	(5.9)
Diesel Oil—Off Highway	224,385	120,378	124,008	103.0
Diesel Oil—Highway	51,184	51,507	(323)	(0.6)
Liq. Pet. Gas—Off Highway	0	1	(1)	n/m
Liq. Pet. Gas—Highway	102	118	(17)	(14.2)
Small Boats—Gasoline	451	45	406	910.1
Small Boats—Diesel Oil	1,172	33	1,140	3,489.5
Aviation Fuel	206,307	217,399	(11,091)	(5.1)
Other Fuel*	38,786	2,821	35,965	1,274.9
<b>TOTAL GALLONS</b>	<b>997,237</b>	<b>875,530</b>	<b>121,796</b>	<b>13.9</b>
Environmental Tax (Barrel)	33,909	34,826	(917)	(2.6)

\*Prior to September 2007, this category included ethanol, methanol, and biodiesel. Beginning September 2007, this category includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

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



The revenues from fuel taxes are distributed to several special funds. Fuel taxes paid on liquid fuel sold for use in or used for small boats are deposited into the State Boating Special Fund. Fuel taxes paid on sales of aviation fuel are deposited into the State Airport Revenue Fund. Environmental response tax collections are deposited into the State 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 respective county's highway fund. The State Highway Fund also receives monies from the motor vehicle weight taxes and registration fees, which are administered and collected by the counties, and the rental motor vehicle and tour vehicle surcharge taxes.

**ALLOCATION OF FUEL TAXES**  
(In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Gasoline	\$ 75,661	\$ 76,415	\$ (754)	(1.0)
Diesel Oil—Off Highway	3,476	1,192	2,284	191.6
Diesel Oil—Highway	8,541	8,159	383	4.7
Liq. Pet. Gas—Off Highway	0	0	0	0.0
Liq. Pet. Gas—Highway	5	6	(1)	(15.0)
Other Fuel	452	98	354	362.4
Subtotal	\$ 88,135	\$ 85,869	\$ 2,266	2.6
Motor Vehicle	63,251	62,932	319	0.5
Rental Vehicle	49,197	49,479	(283)	(0.6)
TOTAL	\$ 200,583	\$ 198,281	\$ 2,302	1.2
COUNTY HIGHWAY FUND:				
City & County of Honolulu	\$ 50,633	\$ 52,221	\$ (1,588)	(3.0)
County of Maui	11,383	11,837	(454)	(3.8)
County of Hawaii	8,006	8,240	(234)	(2.8)
County of Kauai	4,218	5,973	(1,755)	(29.4)
TOTAL	\$ 74,240	\$ 78,270	\$ (4,030)	(5.1)
BOATING SPECIAL FUND:	\$ 1,640	\$ 1,658	\$ (18)	(1.1)
STATE AIRPORT FUND:				
Aviation Fuel	\$ 4,216	\$ 2,174	\$ 2,042	93.9
ENVIRONMENTAL TAX FUND:	\$ 1,695	\$ 1,741	\$ (46)	(2.6)

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 FY 2008 are shown below:

FUEL TAX RATES PER GALLON\*

TYPE OF FUEL	State	County	Total
Gasoline & Diesel Oil (Highway Use)			
City & County of Honolulu	17.0¢	16.5¢	33.5¢
County of Maui	17.0¢	16.0¢	33.0¢
County of Hawaii	17.0¢	8.8¢	25.8¢
County of Kauai	17.0¢	13.0¢	30.0¢
Liquid Petroleum Gas (Highway 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¢	0.0¢	4.0¢
County of Kauai	4.0¢	0.0¢	4.0¢
Compressed Natural Gas			
City & County of Honolulu	0.8¢	7.6¢	8.4¢
County of Maui	0.8¢	7.6¢	8.4¢
County of Hawaii	0.8¢	7.6¢	8.4¢
County of Kauai	0.8¢	7.6¢	8.4¢
Liquefied Natural Gas			
City & County of Honolulu	2.4¢	28.3¢	30.7¢
County of Maui	2.4¢	28.3¢	30.7¢
County of Hawaii	2.4¢	28.3¢	30.7¢
County of Kauai	2.4¢	28.3¢	30.7¢
Environmental Response Tax (Per Barrel)			
All Counties	5.0¢	0.0¢	5.0¢

\* Diesel oil (off highways) and aviation fuel are taxed by the State at the rate of 2¢ per gallon. Naphtha sold for use in a power-generating facility is taxed by the State at the rate of 1¢ per gallon.

\*\* The County of Hawaii's tax on biodiesel was reduced from 2.2¢ per gallon to 0.0% effective October 1, 2007.

## PUBLIC SERVICE COMPANY TAXES

Public utilities paid public service company taxes totaling \$127.5 million, including penalty and interest.

### PUBLIC SERVICE COMPANY TAXES (In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Public Service Company Taxes	\$ 126,495	\$ 123,788	\$ 2,707	2.2
Penalty & Interest	986	229	786	329.8
TOTAL	\$ 127,481	\$ 124,017	\$ 3,464	2.8

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

## ESTATE AND TRANSFER TAXES

During FY 2008, a total of 696 estates were settled, of which 17 were taxable. Estate tax collections totaled \$164,000, compared to \$595,000 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 deduction fully replaced the federal credit. Under current federal and Hawaii law, Hawaii's estate tax again becomes effective on January 1, 2011.

### ESTATE AND TRANSFER TAXES (In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Estate Tax	\$ 164	\$ 595	\$ (430)	(72.4)
Penalty & Interest	0	0	0	0.0
TOTAL	\$ 164	\$ 595	\$ (430)	(72.4)

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

## OTHER TAXES

Total revenues from other miscellaneous taxes amounted to \$590.3 million, \$103.3 million more than the previous year. Employment security contributions decreased by \$42.3 million in

FY 2008. Insurance premium tax collections exceeded last year's total by \$3.5 million, while tobacco tax collections rose by \$10.2 million.

Contributing to the increase in tobacco tax collections was Act 316, SLH 2006, which increases the excise tax per cigarette by one cent per year over a six-year period that began on September 30, 2006; on September 30, 2007, the tax per cigarette increased from eight cents per cigarette to nine cents per cigarette. This Act also provided for the allocation of a portion of the tobacco tax collections to the following special funds: the Hawaii Cancer Research Special Fund, the Trauma System Special Fund, the Emergency Medical Services Special Fund, and the Community Health Centers Special Fund. Allocations to the Hawaii Cancer Research Special Fund began on October 1, 2006. Allocations to the Hawaii Trauma System Special Fund and the Emergency Medical Services Special Fund began a year later, and allocations to the Community Health Centers Special Fund will begin on October 1, 2008.

Conveyance taxes collected by the Bureau of Conveyances under the Department of Land and Natural Resources decreased by \$3.5 million, a decline of 7.4% from the previous year. The temporary increase in the amount of conveyance tax revenues deposited into the Rental Housing Trust Fund was extended to June 30, 2008, by Act 222, SLH 2007. The amount of conveyance tax allocated to the Natural Area Reserve Fund and to the Land Conservation Fund remained at 25% and 10%, respectively.

Liquor tax collections declined 0.9% to \$45.6 million. Franchise taxes collected from banks and other financial corporations increased 8.7 % to \$20.2 million.

Act 247, SLH 2005, granted counties the authority to impose a county surcharge of no more than 0.5% on gross income subjected to the State's 4% general excise tax. The county surcharge tax could be levied no earlier than January 1, 2007, to fund county public transportation systems, and will be repealed on December 31, 2022. The Department of Taxation is required to levy, assess, collect, and administer the county surcharge tax for the counties. The City and County of Honolulu was the only county that adopted an ordinance to levy a county surcharge tax of 0.5%. The Honolulu surcharge tax took effect on January 1, 2007, and \$53.8 million was collected during the last six months of FY 2007. In FY 2008, its first full fiscal year, \$187.9 million in county surcharge tax was collected on behalf of the City and County of Honolulu.



**MISCELLANEOUS TAXES\***  
(In thousands of dollars)

	FY 2008	FY 2007	Difference	
			Amount	%
Banks & Other Financial Corporations	\$ 20,212	\$ 18,599	\$ 1,613	8.7
Conveyance	43,421	46,887	(3,465)	(7.4)
Employment Security Contributions	92,279	134,612	(42,332)	(31.4)
Insurance Premiums	95,742	92,196	3,547	3.8
Liquor & Permits	45,620	46,034	(414)	(0.9)
Tobacco & Licenses	104,624	94,387	10,237	10.8
General Excise Licenses & Fees	487	484	3	0.5
Honolulu County Surcharge**	187,904	53,805	134,099	249.2
<b>TOTAL</b>	<b>\$ 590,290</b>	<b>\$ 487,004</b>	<b>\$ 103,286</b>	<b>21.2</b>

\* Before allocation to special or other funds.

\*\* The total Honolulu County Surcharge tax collections for FY 2007 reflects only the six-month period of January 1, 2007, through June 30, 2007.

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

## **TOTAL TAX COLLECTIONS**

Total tax collections in FY 2008 amounted to \$5.5 billion, which is 3.0% more than the \$5.3 billion collected in the previous year. While the Department of Taxation collected the majority of the \$5.5 billion total tax collected, the counties collected \$63.3 million in State motor vehicle weight taxes and registration fees, the Department of Commerce and Consumer Affairs collected \$95.7 million in insurance premium taxes, the Department of Land and Natural Resources collected \$43.4 million in conveyance taxes, and the Department of Labor and Industrial Relations collected \$92.3 million in employment security contributions.

**TAX COLLECTIONS**  
(In thousands of dollars)

SOURCE OF REVENUE	FY 2008		FY 2007	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corporations	\$ 20,212	0.37	\$ 18,599	0.35
Conveyance	43,421	0.79	46,887	0.88
Employment Security Contributions	92,279	1.68	134,612	2.53
Fuel	169,927	3.10	169,712	3.19
General Excise & Use Tax	2,618,787	47.80	2,555,762	48.07
Honolulu County Surcharge	187,904	3.43	53,805	0.01
Income – Corporations	85,081	1.55	81,834	1.54
Income – Individuals	1,544,835	28.20	1,560,286	29.35
Inheritance and Estate	164	0.00	595	0.01
Insurance Premiums	95,742	1.75	92,196	1.73
Liquor & Permits	45,620	0.83	46,034	0.87
Motor Vehicle Tax*	112,448	2.05	112,412	2.11
Public Service Companies	127,481	2.33	124,017	2.33
Tobacco & Licenses	104,624	1.91	98,387	1.78
Transient Accommodations Fees	10	0.00	11	0.00
Transient Accommodations Tax	229,378	4.19	224,931	4.23
All Others**	576	0.01	514	0.01
<b>TOTAL</b>	<b>\$ 5,478,491</b>	<b>100.00</b>	<b>\$ 5,316,593</b>	<b>99.00</b>

\* Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental motor vehicle and tour vehicle registration fees, and rental motor vehicle and tour 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 \$5.5 billion in tax revenues collected, \$4.6 billion (84.7%) was deposited into the State's General Fund. The four counties received \$177.0 million (3.2%), which came from county fuel taxes and 44.8% of the transient accommodations tax collections. In addition, \$187.9 million was collected and credited to the City and County of Honolulu county surcharge tax.

The remaining \$471.7 million of tax revenue not deposited into the General Fund was distributed among several State special funds. The State Highway Fund received the largest portion, \$200.6 million. All \$92.3 million of the employment security contributions went into the Unemployment Trust Fund for unemployment benefits. Portions of the transient accommodations tax went to the next two largest special funds: \$78.2 million to the Tourism Special Fund and \$32.5 million to the Convention Center Fund.

The temporary increase in the amount of conveyance tax revenue allocated to the Rental Housing Trust Fund from 30% to 50% (Act 100, SLH 2006) was extended by Act 222, SLH 2007,

through June 30, 2008, such that 15% of the conveyance tax revenue, rather than 35%, was deposited into the General Fund.

On September 30, 2007, the amount of tobacco tax revenues deposited into the Hawaii Cancer Research Special Fund was increased from one cent per cigarette to one and a half cents per cigarette. An additional 0.25 cents per cigarette was deposited into the trauma system special fund, and another 0.25 cents per cigarette was deposited into the emergency medical services special fund.

The distribution of tax collections is shown in the following table.

DISTRIBUTION OF COLLECTIONS  
(In thousands of dollars)

	FY 2008		FY 2007	
	Amount Collected	% of Total	Amount Collected	% of Total
<u>STATE FUNDS</u>				
State General Fund	\$ 4,641,872	84.73	\$ 4,585,580	86.25
State Highway Fund	200,583	3.66	198,280	3.73
State Airport Fund	4,216	0.08	2,174	0.04
Boating Special Fund	1,640	0.03	1,658	0.03
Environmental Fund	1,695	0.03	1,741	0.03
Cigarette Stamp Admin/Enforcement Fund	1,665	0.03	1,532	0.03
Compliance Resolution Fund	2,000	0.04	2,000	0.04
Unemployment Trust Fund	92,279	1.68	134,612	2.53
Election Campaign Fund	107	0.00	220	0.00
Tourism Special Fund	78,229	1.43	73,328	1.38
Rental Housing Fund	21,711	0.40	23,443	0.44
Natural Area Reserve Fund	10,855	0.20	11,722	0.22
Convention Center Fund	32,453	0.59	33,758	0.63
Public Libraries Fund	98	0.00	88	0.00
School Repair & Maintenance Fund	114	0.00	106	0.00
Land Conservation Fund	4,342	0.08	4,689	0.09
Domestic Violence/Child Abuse Fund	209	0.00	182	0.00
Cancer Research Fund	15,359	0.28	8,636	0.16
Trauma System Fund	2,079	0.04	-	-
Emergency Medical Services Fund	2,079	0.04	-	-
Subtotal – State	\$ 5,113,585	93.34	\$ 5,083,749	95.62
<u>HONOLULU COUNTY SURCHARGE</u>	\$ 187,904	3.43	\$ 53,805	1.01
<u>REVENUES TRANSFERRED TO COUNTIES</u>				
Other County Revenues				
Fuel	\$ 74,240	1.36	\$ 78,270	1.47
Transient Accommodations Tax	102,761	1.88	100,769	1.90
Subtotal – Counties	\$ 177,001	3.23	\$ 179,040	3.37
<b>TOTAL</b>	<b>\$ 5,478,491</b>	<b>100.00</b>	<b>\$ 5,316,593</b>	<b>100.00</b>

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

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

Hawaii has 17 separate tax laws, of which 14 are administered by the State. The counties administer the remaining three—the real property tax, motor vehicle weight tax, and public utility franchise tax—although the revenue from the motor vehicle weight taxes accrues to both the State and county highway funds. The number of taxes administered by the State is indicative of the highly centralized nature of the State's governmental structure.

The State's primary revenue source is the general excise tax. Unlike more common sales taxes, the general excise tax is levied on the business receiving the income, rather than the customer, for the privilege of doing business in the State. Despite the relatively low tax rates, substantial revenue is generated in large part due to the broad tax base on which this tax, as well as its complement, the use tax, is levied. Gross income from most business activities, including most sales, services, contracting, and rental activities, are subject to the general excise tax. In general, the general excise tax law levies the tax on all business activities at a 4% retail rate, while allowing a lower rate on some transactions, including many business-to-business transactions, and exempting some other transactions because those transactions are subject to other taxes or because the legislature wished to grant a preference to that economic activity.

Although not a State tax realization, the Department of Taxation is required to administer the county surcharge on the State's general excise tax for the counties. Act 247, SLH 2005, authorized the counties to establish by ordinance a surcharge of up to 0.5% to fund public transportation systems; only the City and County of Honolulu adopted a surcharge. Beginning January 1, 2007, the county surcharge tax adopted pursuant to City and County of Honolulu Ordinance No. 05-027 has been levied at the rate of 0.5% on transactions that are subjected to the State general excise or use taxes at the 4% rate and that are attributable to business conducted in the City and County of Honolulu. Act 247, SLH 2005, and Ordinance No. 05-027 will both be automatically repealed on December 31, 2022.

Second in revenue generation is the State's income tax, the majority of which is from the income tax levied on individual taxpayers. A number of tax credits are available to mitigate the income tax burden. Of the tax credits specifically benefitting businesses, the most commonly claimed is the capital goods excise tax credit. Two nonbusiness income tax credits, the low-income refundable tax credit and the credit for low-income household renters, specifically provide tax relief to lower-income taxpayers.

The low-income refundable tax credit is allowed resident individuals, including those with no gross income, in amounts ranging from \$35 per qualified exemption for resident individuals who have less than \$10,000 of Hawaii adjusted gross income, to \$10 per qualified exemption for resident individuals who have up to \$20,000 of Hawaii adjusted gross income; no credit is allowed taxpayers who have more than \$20,000 of Hawaii adjusted gross income. The credit for low-income household renters is \$50 per qualified exemption, including the extra exemption for taxpayers who are age 65 or older, for resident individuals with less than \$30,000 of Hawaii adjusted gross income.

A one-time general income tax credit for the 2007 tax year was enacted (Act 210, SLH 2007) to satisfy the requirements of Article VII, section 6, of the Constitution of Hawaii. Unlike general income tax credits enacted from time to time in previous years, the 2007 credit was limited to resident individual taxpayers with federal adjusted gross incomes below \$30,000 for single taxpayers and married taxpayers filing separate returns, and below \$60,000 for married taxpayers filing joint returns and heads of households.

Revenues from 11 of the State-administered taxes go into the 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. Employment security tax collections are deposited into the Unemployment Trust Fund and used exclusively to provide benefits to 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 2008		FY 2007	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corporations	\$ 18,212	0.39	\$ 16,599	0.36
Conveyance	6,513	0.14	7,033	0.15
General Excise & Use Tax	2,618,787	56.42	2,555,762	55.73
Income – Corporations	85,081	1.83	81,834	1.78
Income – Individuals	1,544,307	33.27	1,559,690	34.01
Inheritance and Estate	164	0.00	595	0.01
Insurance Premiums	95,742	2.06	92,196	2.01
Liquor & Permits	45,620	0.98	46,034	1.00
Public Service Companies	127,481	2.75	124,017	2.70
Tobacco & Licenses	83,443	1.80	84,219	1.84
Transient Accommodations Tax	15,935	0.34	17,076	0.37
All Others**	586	0.01	525	0.01
<b>TOTAL</b>	<b>\$ 4,641,872</b>	<b>100.00</b>	<b>\$ 4,585,580</b>	<b>100.00</b>

\* Net of transfers to special funds.

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

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

# OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2008

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. For taxable years beginning after December 31, 2006: (1) the individual income tax brackets are expanded, and (2) the standard deduction amounts are increased 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. 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.	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 non-resident 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.  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.		
(3) General Excise (Gross Income)  Chapter 237 — Section 237-1 to 237-49	This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 0.5% on wholesaling and wholesale 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 0.15%. 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.	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.

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: 0.5%, 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, 0.5%. (iii) 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, 0.5%. (iv) All other revenues: 4% of gross 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.
(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: 2¢ per gallon on aviation fuel, an initial 2¢ per gallon on diesel oil, 1¢ per gallon of naphtha fuel sold for use in a power-generating facility, as defined, .25¢ 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 25.8¢ to 33.5¢ per gallon on liquid fuels other than the foregoing, also, pay additional taxes from 23.8¢ to 31.5¢ 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 5¢ 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 9¢ on each cigarette sold, used, or possessed on and after September 30, 2007. Section 245-3 increases the tax on cigarettes to 10¢ per cigarette sold on and after September 30, 2008. 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. Beginning December 1, 2006, every retailer 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>	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.	At time of filing the certificate, but no later than 90 days after the taxable transaction.
(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 lessee. 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, 2011, Act 226, Session Laws of Hawaii 2008, decreases the rental motor vehicle surcharge tax to \$2 a day or any portion of a day that a rental motor vehicle is rented or leased.</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.	At time of filing returns.
(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><b>Note:</b> The tax base for calendar year 2008, 2009, and 2010 has been set at \$13,000, so long as the balance of the unemployment trust fund does not fall below the adequate reserve fund as specified by section 383-63.</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.	At time of filing returns.
(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>	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.	At time of filing statements.

## **ADMINISTRATIVELY ATTACHED ENTITIES**

### **COUNCIL ON REVENUES**

Paul H. Brewbaker, Chair  
Jack P. Suyderhoud, Vice Chair  
Carl S. Bonham  
Dean K. Hirata  
Pearl Imada Iboshi  
Richard F. Kahle, Jr.  
Albert Yamada

### **BOARDS OF TAXATION REVIEW**

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Tracy T. Chiang  
Michael J. Choi  
Maria Joan Lowder  
Manoj P. Samaranayake  
Alan Mun Leong Yee

#### **SECOND TAXATION DISTRICT (MAUI)**

Alan K. Bernaldo  
Carol Ann Burdick  
Patrick L. Ing  
Ronald A. Kawahara  
Randal Taniguchi

#### **THIRD TAXATION DISTRICT (HAWAII)**

Ioana D. Agasa  
Michael Chang  
Dwayne Stephen Lerma  
Carol P. Weir  
Vacant

#### **FOURTH TAXATION DISTRICT (KAUAI)**

Sandra L. Day  
Jose Ricardo da Silva Diogo  
Ronald William Peeren  
Albert W. Stiglmeier  
Matt H. Takata