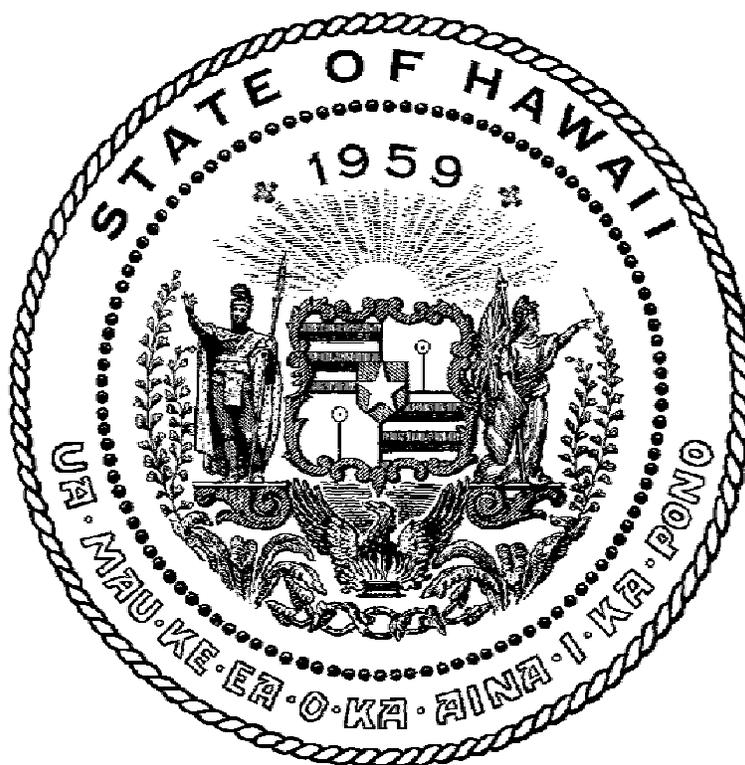


# DEPARTMENT OF TAXATION STATE OF HAWAII



## ANNUAL REPORT 2010–2011

July 6, 2012

NEIL ABERCROMBIE  
GOVERNOR

BRIAN SCHATZ  
LT. GOVERNOR



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June 26, 2012

The Honorable Neil Abercrombie  
Governor, State of Hawaii  
Executive Chambers  
State Capitol, Fifth Floor  
Honolulu, HI 96813

Dear Governor Abercrombie,

This annual report for the Department of Taxation (DOTAX) covers the fiscal year period from July 1, 2010 through June 30, 2011. I succeeded Stanley Shiraki, as Director of Taxation on December 20, 2010, and used the remaining six months of the fiscal year to do a thorough review of the operations and to develop a four-year strategic plan. As is standard business practice when taking over an operation, I reviewed the latest audit report and DOTAX financial statements, and initiated a comprehensive assessment of the strengths and weaknesses of the Department. The review revealed troubling operational issues, which we are working to resolve.

Community and governmental assessments of the Department – issued about the time I took office – preceded my own findings. In December 2010, Hawai'i Business Magazine highlighted the Department's processing delays, stating:

*FOR DECADES, THE STATE has taken weeks on average – even months – to cash taxpayers' checks. Now, with government worker furloughs and restrictions on temporary hires, the check cashing delay has gotten worse.*

To make matters worse, the State Auditor released a scathing report of the Department on December 20, 2010. The report was very critical of DOTAX's overreliance on a computer system vendor who had been continuously on-site since 1999. The report highlighted mismanagement and the formation of communication "silos" within the Department.

Under the circumstances, it was time to develop a transition plan for DOTAX. When Randy Baldemor started as Deputy Director on January 18, 2011, I immediately assigned him to co-chair a Modernization Task Force that would look into modernizing our tax system. After reviewing the Auditor's report and consulting with staff, we determined that the contract with the vendor should not be extended beyond the end of the fiscal year, June 30, 2011. Deputy Director Baldemor's experience as an attorney and software developer has successfully guided the

department through the contractual relationship with the computer vendor, as well as through this transition period towards a modernized tax system.

In February 2011, we began reviewing the financial statements, and we identified several weaknesses in the DOTAX reporting system. We determined that the DOTAX monthly reports contained errors and were somewhat weak in analysis, resulting in misleading calculations and reporting. One report, the Preliminary Comparative Statement, had been based on faulty formulas for calculating and allocating revenue. We immediately took corrective actions.

Another report, the Statement of Tax Operations (STO), did not fully reflect all operations of the Department and, in some cases, was based upon faulty assumptions and data. The STO is an important report that is relied upon by the Department of Budget and Finance and the Department of Accounting and General Services. Immediately, we instituted interim measures to minimize any potential for misreporting.

As our review of the entire document progressed, it became certain that an independent outside audit was needed to confirm our preliminary findings. In order to manage the cost and focus of the audit, a team of DOTAX tax auditors was assigned to preliminarily identify the weaknesses in the STO. Based on their preliminary findings, an outside auditor was hired in July 2011. We tasked the outside auditor to examine and confirm our preliminary findings, and to make recommendations for improvements necessary to have the reports truly reflect the Department's operations.

The February review of DOTAX's financial reporting disclosed significant balances in accounts receivable and accounts payable. The accounts receivable, which broadly consists of delinquent tax accounts, showed a balance of \$1.4 billion, having grown almost \$1 billion in the last decade. Immediately, we began identifying and planning several ways to address this outstanding balance, realizing that the collection staff of 40 was insufficient to handle the on-going workload.

Similarly, we found that the State's potential accounts payable had grown to a balance of \$1.3 billion. The balance appears to be explained by faulty revenue accounting calculations caused by our troubled computer system and/or managerial decisions by the past administration not to automatically release refunds under certain conditions. We have worked to address the issue; however, modernizing our computer system will take many years.

As briefly discussed earlier, an area that required immediate attention was the processing of check payments. Many taxpayers were complaining about the length of time it took the department to process their tax payments. There were letters to the editor, testimony before legislators and the December 2010 Hawai'i Business Magazine article, describing a processing time of up to eight weeks for the Department to deposit a check. In some cases, delinquent taxpayers who were on an installment payment plan learned that their payment agreement had to be renegotiated because of the delay in processing their check that was timely submitted. After a careful review, in April 2011, we changed the processing to what a smart business would do, by prioritizing cash payments followed by billing account receivables. Due to this change and other processing improvements, we received positive feedback from stakeholders, including taxpayers,

tax practitioners, CPAs and legislators. On October 5, 2011, David Shapiro of the Star-Advertiser acknowledged that the "new administration has shown impressive progress" in processing checks. We continue to work on improvements, and the results will be reflected in our Fiscal Year 2012 report.

Quality productivity is achieved through a well-trained workforce, and DOTAX employees are our major assets. While reviewing the audit report, financial statements and manual processes, I reviewed the authorized staffing level, as well as employee development programs and the resources available to them for carrying out their responsibility for collecting the State's revenue. DOTAX is comprised of a dedicated workforce that has gone through very difficult years where the increasing workload has not been matched with adequate staffing. The FY2009 reduction-in-force (RIF) resulted in an 11% decrease in staffing, and each time a position became vacant it could not be filled. The furloughs in FY2010 and FY2011 have also negatively impacted our ability to match available staffing with increasing workload. The frozen positions resulted in a vacancy rate of 20%, which is being addressed as a result of your lifting the prior administration's restrictions.

An additional consequence of insufficient staffing in past years is that taxpayers have encountered delays in receiving replies to their inquiries. For example, the call answer rate for telephone callers attempting to reach a DOTAX employee decreased from 80% in FY2009 to 61% in FY2010 and to 40% in FY2011. This reflects unfavorably on the department and does not help in assuring compliance.

Another grave consequence of insufficient staffing and training is that our compliance programs have experienced a significant decrease in collecting revenue. Our office audit productivity has decreased 38% from 11 thousand completions in FY2010 to 7 thousand in FY2011, and tax assessments have decreased 31% from \$42 thousand in FY2010 to \$23 thousand in FY2011. Similarly, field audit closures has decreased 31% from 332 completions in FY2010 to 229 in FY2011, and tax assessments have decreased from \$118 million in FY2010 to \$95 million in FY2011. Delinquent tax collections decreased 9.3% from \$239 million in FY2010 to \$218 million in FY2011. All of these compliance program decreases translate into a significant loss of revenue to the State of Hawaii.

DOTAX's challenges are not simply limited to internal issues. While reviewing our current electronic filing system, we uncovered a large number of electronically filed returns claiming fraudulent refunds. These were filed by individuals showing mainland addresses and mainland bank accounts, and the activity was similar to schemes that other State tax administrations have uncovered. We immediately revised DOTAX procedures, and now all electronic refunds are reviewed prior to release.

The 2011 fiscal year brought with it a New Day for Hawaii. To correspond with your vision, I developed a four year strategic plan, and I began communicating the plan in March 2011 to all employees and to the public. The strategic plan focuses the department on where it needs to be in order to be truly effective, how it will operate in getting there and what it needs to accomplish. The strategic plan was presented to tax practitioners during meetings with their associations and at the DOTAX tax workshops on all islands.

The four-year strategic plan covers the following vision statement, mission statement and three broad goals. All program managers have developed objectives and performances to support the goals. All employees have been briefed on the strategic plan, in general, and are familiar with the following:

- *Vision:* DOTAX plays a key role in public finance. We will efficiently and effectively collect the revenue required for funding the programs and services rendered to the residents of Hawaii.
- *Mission:* DOTAX will administer the State tax laws in a fair, uniform and consistent manner. We will achieve this mission through education, assistance, compliance checks and enforcement.
- *Goal I: DOTAX will Increase Voluntary Compliance*  
We will employ a market approach by identifying the various segments of the taxpayer population, determining the underlying reasons for non-compliance and developing the most effective approach to each market segment.
- *Goal II: DOTAX will Modernize Processes*  
We will expand electronic filing of tax returns and facilitate the electronic payment of tax liabilities. Each program manager in the department will identify areas which may be now improved through business process re-engineering and other areas which should be automated in a modernized computer tax system.
- *Goal III: DOTAX will Foster Quality Driven Productivity*  
We will develop each employee to his/her full potential through annual training programs to maintain and enhance skills in an ever changing tax environment. The department will provide the resources that are needed to improve productivity; these will include computer analytics, case management systems, and partnering with Federal, State and County agencies.

Your administration recognized the Department as a key player in public finance, and that our Department could not absorb further reductions in revenue producing positions. We are beginning to fill the previously frozen vacant positions and are embarking on a comprehensive training plan to develop employees to their full potential, so that they can help their fellow residents, carry out their work in an informed and competent manner, and develop a strong sense of purpose.

We are also working closely with various state agencies to coordinate our modernization effort to ensure proper integration of the State's financial management systems. Based on information provided by DOTAX, your administration, led by Sanjeev Bhagowalia, the State's Chief Information Officer, identified the design of a new tax system and an Enterprise Resource Planning (ERP) system as two of the State's top IT priorities. We are working closely with the

Office of Information Management & Technology as well as the Department of Accounting & General Services and the Department of Budget & Finance to support your IT plan and help to transform government.

I am convinced that the combination of process improvements, additional, well trained staffing and tax system modernization, as expressed in our strategic plan, will enable us to collect more revenue rightfully owed to the State of Hawai'i, so that it may be used for the betterment of all the residents in our beautiful State.

Sincerely,

A handwritten signature in black ink, reading "Frederick D. Pablo". The signature is written in a cursive style with a large, prominent initial "F".

FREDERICK D. PABLO  
Director of Taxation



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## **THE YEAR IN REVIEW**

The Department of Taxation (“Department”) consists of two divisions, five staff offices, a public information officer, and a taxpayer advocate. The two divisions are the Tax Services and Processing Division and Compliance Division. The five staff offices are the Administrative Services Office, the Rules Office, the Tax Research and Planning Office, the Information Technology Office, and the System Administration Office.

### **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.

During the second half of fiscal year 2011, the TSP Division began a transition from using its historical Legislative performance measures (in Act 100, Session Laws of Hawaii 1999) to using performance measures that support the Department's "*A New Day in Hawaii*" strategic plan. Although the Division's strategic plan, objectives and performance measures were still fluid at the end of FY 2011, they are intended to represent a starting point for future discussion and research.

#### **Document Processing Branch**

The major function of the Document Processing (“DP”) Branch 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.

During FY 2011, the DP Branch processed 3,747,232 returns and payments, 1,276,021 (34%) of which were electronically transmitted. The DP Branch processed approximately 1.8 million payments totaling more than \$5.22 billion during the year.

The Joint Electronic Filing Program (“JELF”) with the Internal Revenue Service (“IRS”) is in its eleventh year, but it is being phased out by the IRS and replaced with their Modernized e-Filing (“MeF”) application. The JELF Legacy program allows certain individual taxpayers who file either the Form N-11 or the Form N-15 to file those returns electronically utilizing State-approved software vendors. The number of Hawaii returns filed through JELF increased by 20.5% from 317,984 returns last year to 383,360 returns this year.

Taxpayers may also electronically file Form N-13, an individual income tax return (short form), as well as certain business income tax returns and payments for corporation, partnership, fiduciary, individual, and other business taxes through the Department's website. In FY 2011, taxpayers filed 559,643 returns for various taxes through our website, a 17.5% increase from last year. Filing electronically allows tax return data to be processed with a minimal amount of manual contact, which enhances efficiency. The N-13 returns filed electronically through the Department website also increased by 12.68% in FY 2011, with 5,111 returns filed in FY 2011 versus 4,536 returns filed in FY 2010.

In total, the DP Branch processed an average of 42.4% of all returns and payments within six calendar days in FY 2011, and 14.4% of all remittances were cashiered within four calendar days from the postmark date.

### **Revenue Accounting Branch**

The main function of the Revenue Accounting (“RA”) Branch is to maintain revenue control and subsidiary ledgers. As such, the RA Branch controls, and is responsible for, all adjustment, error resolution, accounting, and reconciliation functions for all State tax revenues. Specific tasks include the preparation of the Preliminary Report, the Statement of Tax Operations (STO), and related reports.

The Preliminary Report is a monthly, statewide summary of all revenues received by the Department, less the amount of tax refunds, which is prepared by the fifth working day of each month. The STO is a formal, detailed report of State revenues that is based on the Preliminary Report and that is prepared by the tenth working day of each month.

Secondary functions of this branch include statewide processing and manual accounting activities for all miscellaneous taxes except the estate and transfer tax; controlling and accounting for all State tax refunds resulting from either overpayments or adjustments; maintaining the statewide accounting records and preparing journal entries associated with the Special Enforcement Section's administratively established trust account; maintaining the manual accounting system for all protested payments and tax appeals; and handling all State refund exception activities (such as returned checks, tracers, or forgeries).

### **Taxpayer Services Branch**

The major functions of the Taxpayer Services (“TPS”) 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).

In FY 2011, Customer Inquiry was faced with the task of properly servicing more than 300,000 taxpayer requests for assistance through the Call Center, at the counters, and via paper and electronic mail. The following are the production statistics for Customer Inquiry:

Total number of taxpayers serviced at the counter:	46,640
Total number of taxpayers serviced through the Call Center:	205,383
Total number of tax clearances issued:	33,851
Total number of paper and electronic mail (email) responses:	<u>30,900</u>
Total number of taxpayers serviced	316,774

With the delayed issuance of tax refunds<sup>1</sup> and the mailing of thousands of non-filer letters, the call pickup rate for FY 2011 was only 40%. The call statistics for fiscal years ending 2011, 2010, and 2009 are reported as follows:

<u>FY</u>	<u>Total Incoming Calls</u>	<u>Total Calls Answered</u>	<u>Overall Call Answer Rate</u>
2011	513,503	205,383	40%
2010	380,142	232,471	61%
2009	364,804	291,228	80%

Despite the challenges posed by such factors as reduced staffing, an increase in contractor's license renewals, and ongoing initiatives, TPS continued to strive to improve its response to requests made by telephone, by correspondence, and in person.

Account Management faced challenges in accomplishing its task from the delayed refunds, and from processing delays caused by technical problems in implementing the new tax laws and the Department's initiatives. Also, more than half of its staff was assigned to the Miscellaneous Tax Project, which caused the worklist inventory to increase to unprecedented levels.

Licensing processed 20,267 cancellations in FY2011, a significant decline from FY 2010, during which 62,058 cancellations were processed. The surge in cancellations in FY 2010 came as a result of the non-filer project, which caused thousands of taxpayers to cancel their dormant accounts. The total number of license applications processed in FY 2011 was 27,630, a decline from 32,497 applications processed in FY 2010.

## **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. Three programs are established in the Division to meet the objectives of the voluntary compliance, self assessment system: (1) auditing/examination, (2) collection, and (3) taxpayer services (information dissemination).

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<sup>1</sup> In tax year 2009, individual and corporate income tax refunds that should have been paid in FY 2010 were not paid until FY 2011, causing many inquiries from taxpayers regarding the status of their refunds.

## **Auditing/Examination**

To support the voluntary compliance, self-assessment system of taxation, 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	3,927	\$ 7,532,103	123	\$90,376,898
Maui	1,078	9,986,620	27	1,106,267
Hawaii	1,549	4,887,045	30	1,317,129
Kauai	<u>648</u>	<u>1,276,870</u>	<u>49</u>	<u>3,111,776</u>
Total FY 2011	7,202	\$23,682,638	229	\$95,912,070
Total FY 2010	<u>11,620</u>	<u>42,102,963</u>	<u>332</u>	<u>118,908,502</u>
Difference	(4,418)	(\$18,420,325)	(103)	(\$ 22,996,432)

The number of audits completed by Office Audit Branch decreased by 38.0% in FY 2011 compared to FY 2010, and the total dollars assessed decreased by 43.8%. The number of audits completed by Field Audit Branch decreased by 31.0% in FY 2011 compared to FY 2010, and the total dollars assessed decreased by 19.3%. The dollar amount collected at the time the audits were closed and prior to the mailing of any billing notices decreased from \$48.0 million in FY 2010 to \$32.4 million in FY 2011.

The decline in the output of the Audit units was caused by budget restrictions and cuts, employee furloughs, and the assignment of staff to special projects.

Act 74, SLH 2010, amended Hawaii's Estate and Transfer Tax effective for individuals dying on or after May 1, 2010 and taxable estates are hereafter determined under federal estate law as of December 31, 2009. For this fiscal year, the Office Audit section handled the processing of the Estate and Transfer Tax returns and collected \$6.9 million in FY 2011.

## **Criminal Tax Unit**

Criminal Tax Unit investigations resulted in a number of referrals to the Criminal Justice Section of the Department of the Attorney General, which in FY 2011 filed indictments and complaints against 35 taxpayers. A total of \$128,000 in judicial fines and \$2.3 million in tax assessments were imposed. In addition, the collector assigned to criminal cases collected \$1.3 million in taxes, penalty and interest charges, and fines. Additional information about criminal tax cases prosecuted is provided on Page 36.

## **Special Enforcement Section**

Act 134, SLH 2009, provided resources for the creation of a unique initiative to increase compliance by businesses conducting a significant number of difficult to trace cash transactions in what has been called the "cash economy." The newly created unit was formed and began conducting high-risk and complex civil tax investigations in FY 2010 with the following results in FY 2011:

	<u>FY 2011</u>
Complaints Filed	178
Site Visitations (Statewide)	1,058
Verbal Warnings Issued	35
Citations Issued	30
Fines Levied	\$22,230
Fines Paid	\$6,690
Total Dollars Assessed	\$1,903,835
Total Dollars Secured Returns	\$867,839
Total Dollars Assessed Collected	\$930,190

## **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, 9 audits were completed and resulted in \$3.8 million in assessments.
- **Referral Cases from Criminal Investigation Unit:** During this fiscal year, 24 cases that were either originally considered for possible criminal prosecution or arose pursuant to a criminal investigation were completed, resulting in \$3.4 million in assessments.
- **Research Tax Credit:** During this fiscal year, 3 audit cases involving the research tax credit were completed resulting in \$12.8 million in assessments.
- **Special Project to Expedite Audit Process:** From May 2010 through January 2011 of FY 2011, a special project was undertaken to explore ways to expedite the audit process. The project resulted in \$5.6 million in assessments and \$1.6 million in collections. The project was discontinued.
- **Online Travel Companies:** The Field Audit Branch assisted the Attorney General's office and issued assessments to 15 on-line travel companies. The assessments totaled \$392 million. The cases have been appealed and are being handled by outside counsel. (These figures are not included in the Field Audit data reported above.)

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

- Schedule E (Rental Income) and Schedule X (Renter's Credit): Office Audit conducted two projects that targeted rental income and the renter's credit during the fiscal year and which resulted in \$172,813 in assessments and \$34,332 in collections.
- Sports Tournament Participants: During the fiscal year, letters were sent to the participants of a particular sports tournament to inform them that tournament winnings were subject to general excise taxes. The project, which initially covered the 2010 year, resulted in general tax collections of \$74,046. The project is ongoing and may be expanded to other sporting events.

### **Delinquent Tax Collections**

The operations of the Compliance Division's Tax Enforcement Program are conducted by the Oahu Collection Branch and the Collections Sections in the Maui, Hawaii, and Kauai District Tax Offices.

Combined tax collections for FY 2011 increased by \$20.4 million, from \$218.6 million in FY 2010 to \$239.0 million in FY 2011, an increase of 9.3%.

A table of major performance measures for FY 2011 is presented below:

<u>Measure</u>	<u>FY 2011</u>	<u>FY 2010</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Total Delinquent Tax Balance (\$ Millions)	\$ 437.1	\$ 382.4	\$ 54.7	14.3
Total New Delinquent Referrals (\$ Millions)	\$ 306.6	\$ 213.1	\$ 93.5	43.9
Total Cash Collected (\$ Millions)	\$ 239.0	\$ 218.6	\$ 20.4	9.3
Uncollectible Tax Write-Offs (\$ Millions)	\$ 12.9	\$ 10.4	\$ 2.5	24.0
Payment Plans Initiated	31,753	31,171	582	1.9
Tax Liens Filed	6,896	8,088	(1,192)	(14.7)
Levies Served	12,862	12,679	183	1.4

### **Taxpayer Assistance Provided**

During FY 2011, the neighbor island district tax office personnel helped taxpayers 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 to the Oahu TPS Branch when requested.

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

	<u>FY 2011</u>	<u>FY 2010</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Counter	80,155	78,586	1,569	2.0
Phone Services	52,471	48,260	4,211	8.7
Tax Clearances	6,449	4,696	1,753	37.3
Correspondence	16,668	16,939	(271)	(1.6)

The taxpayer services sections were able to maintain telephone services despite the centralization of customer services within the Oahu TSP Division. The district offices continue to receive a steady flow of telephone inquiries, although greater processing efficiency has resulted from the scanning of returns and from improvements to electronic filing, forms design, and mail processes.

The taxpayer services section has also been able to maintain counter services and correspondence despite the challenges from cost cutting measures, from employee furloughs, from unfilled vacant positions, from changes in the tax law, and from an increase in the number of tax clearances caused by the biennial renewal for contractor's licenses.

The assistance provided to taxpayers is part of the Compliance Division's continuing emphasis on taxpayer education and problem resolution in its contacts with taxpayers. The Compliance Division continues to believe that it is important to maintain taxpayers' willingness to accurately and voluntarily comply with the State's 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 to the 2011 Legislature the biennium budget for FY 2011-2013. The Legislature appropriated \$23.4 million for FY 2012 and \$23.1 million for FY 2013. This represents a \$2.6 million increase in General Fund appropriations for FY 2012 and a \$2.3 million increase in General Fund appropriations for FY 2013.

The increases in General Fund appropriations were primarily due to furlough restoration of \$1.7 million and additional funds for the Information Technology Services Office of \$0.6 million.

In discharging its duties and responsibilities, the Department of Taxation incurred operating expenses of \$18.3 million for FY 2011.

Personnel Management

The Department had 364.0 authorized permanent positions for FY 2011, which was a decrease of 27.5 positions from FY 2010. Employees were geographically distributed as follows: Oahu, 301; Hawaii, 27; Maui/Molokai, 21; and Kauai, 15. For FY 2012, the Department has 373.0 authorized permanent positions distributed as follows: Oahu, 310; Hawaii, 27; Maui/Molokai, 21; and Kauai, 15.

Personnel actions included 7 new exempt hires, 4 civil service new hires, 3 appointed new hires, 102 temporary hires, 17 promotions, 1 transfer, 14 retirements, and 13 resignations. Other personnel actions included temporary assignments of employees to higher levels.

STAFFING PATTERN  
(Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Headquarters Administration	71.0	62.0	66.0	66.0	74.0
Tax Services and Processing Division	123.0	123.0	138.0	138.0	138.0
Compliance Division	<u>179.0</u>	<u>179.0</u>	<u>187.5</u>	<u>187.5</u>	<u>195.5</u>
TOTAL	373.0	364.0	391.5	391.5	407.5

**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, and appeared on behalf of the Department before the Boards of Taxation Review. Assistance was also provided to the Tax Division Deputy Attorneys General in support of the Department's tax cases being litigated.

For the 2011 legislative session, the Rules staff drafted and submitted five bills sponsored by the administration, which were submitted to both the House of Representatives and the Senate. 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 3,224 bills introduced to the 2011 Legislature, 1,665 House Bills and 1,559 Senate bills, the Rules staff determined that almost 280 measures proposed tax law changes and analyzed them in depth. These measures were also tracked throughout the legislative session. The Rules staff prepared approximately 280 written testimonies for measures scheduled for public hearings by legislative committees, 170 for the House and 110 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 14 bills passed by the Legislature with possible impact on the Department. Provisions of two of the Department's administration-sponsored bills became law in some form.

During the fiscal year, the Rules staff prepared letters for the Governor and the Director, announcements, tax information releases, letter rulings, directives, and other publications. During the fiscal year, the Rules Office issued eight official Department of Taxation Tax Information Releases and fifteen Department of Taxation Announcements. In 2009, the Department issued a policy of publicly releasing taxpayer letter rulings in redacted form. Letter rulings provide a legal analysis of the tax law as applied to a taxpayer's particular set of facts. Since 2009, the Rules Office has released 52 redacted letter rulings. The Rules Office issued two temporary administrative rules and two Tax Audit Guidelines for use by the Department's compliance personnel. The Rules Office also assisted in the Department's implementation of new legislation.

The Rules and Technical Section staff reviewed and certified 2,108 requests for the high technology business investment tax credit and 1,156 requests for the credit for research activities in accordance with Act 215, Session Laws of Hawaii (SLH) 2004. The Rules staff also responded to 15 requests for ruling on qualified high technology business activities.

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

The Rules Office provided technical support to the 2010-2012 Tax Review Commission, which has a late start and held its first meeting on July 15, 2011.

### Technical Section

The Technical Section answers questions received by telephone, e-mail, and correspondence, and reviews applications for certain tax exemptions. In FY 2011, 285 applications for an exemption from the general excise tax were filed by nonprofit organizations. Staff members approved 230, returned 54 and have 43 pending further action. The staff members also reviewed 3,614 requests for conveyance tax exemption.

A major responsibility of this section is to develop and revise tax forms and instructions, both to make improvements and to incorporate changes needed to conform to changes in Hawaii and federal tax law. During FY 2011, the Technical Section reviewed 444 tax forms and 56 instructions, developed 38 new tax forms and 4 new sets of instructions, and terminated 28 forms and 3 instructions that were determined to be obsolete.

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. Staff also provided training for Department employees and spoke at several workshops for practitioners and new entrepreneurs.

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

The following are the main functions of the Tax Research and Planning (“TRP”) Office: (1) prepare reports on data collected by the Department, including reports on statewide tax collections, on the income patterns of individual and business taxpayers, and on tax credits claimed by taxpayers; (2) provide administrative and technical support to help the Council on Revenues to prepare its forecasts of General Fund tax revenues and total personal income (which are used to plan the State's budget); (3) provide economic and statistical analyses to help the Department execute its policies and programs; (4) prepare reports on the revenue consequences of proposed tax legislation for the Governor, the Legislature, and other agencies in the Administration; and (5) provide administrative and technical support for the Tax Review Commission when it is in session.

In fiscal year 2011, the TRP Office worked on the Department of Taxation's *Annual Report: 2009–2010*, which was completed and published in November of 2011. In addition, the TRP Office compiled statistics on individual income tax liabilities as reported by taxpayers, and on tax credits claimed by taxpayers. The statistics were used to estimate the revenue consequences of legislative proposals. However, due to staff shortages, for the past several years, the Office has been unable to produce the reports to make these data available to the public.

The TRP Office also prepared the following reports on a monthly, fiscal year, and calendar year basis: (1) *State Tax Collections and Distributions*; (2) *General Excise and Use Tax Collections*; (3) *Liquid Fuel Tax Base and Collections*; (4) *Liquid Fuel Tax Allocation by Fund*; (5) *Liquor Tax Collections and Permits*; (6) *Tobacco Tax Collections and Licenses*, and (7) *Preliminary Comparative Statement of General Fund Revenues*.

For the 2011 Legislative session, TRP staff reviewed and tracked tax related legislative bills and resolutions, and prepared more than 250 revenue estimates for various drafts of the bills. Revenue estimates were also prepared for various proposals as requested by the Administration, by legislators and by others.

Because Hawaii's economy remains fragile, the administrative and technical support that the TRP Office provides to help the Council on Revenues produce its forecasts of tax revenues was again of great importance this fiscal year. The seven members of the Council are responsible for

forecasting State General Fund revenues and the State's total personal income. The Council provides forecasts of State revenue for the current and six subsequent fiscal years. The forecasts are due on September 10, January 10, March 15, and June 1 of each year. The forecasts are used by the Governor and by the Legislature to develop and administer the State's budget. The Council forecasts total personal income for the current and immediately following calendar years. The forecasts are due on August 5 and November 5 of each year. The growth in Hawaii total personal income is used to set the ceiling for expenditures from the State's General Fund.

TRP staff used advanced econometric modeling techniques, data on State tax collections, and other economic data to prepare materials to help the Council produce its forecasts. The Council's last General Fund forecast for fiscal year 2011 was produced on May 26, 2011 and called for growth of negative 1.6% over fiscal year 2010. The actual growth rate was negative 0.8%, from \$4,365 million in fiscal year 2010 to \$4,329 million in fiscal year 2011. The growth rate for fiscal year 2011 was strongly influenced by the refunds that were withheld in the last part of fiscal year 2010 and paid out in the first month of fiscal year 2011. Without the withheld refunds, General Fund collections would have grown by 3.5% in fiscal year 2011. The Council's last forecast for total personal income for calendar year 2010 was produced in November of 2010 and called for growth of 2.0% over calendar year 2009. The actual growth was 3.7%, from \$54,786 million in 2009 to \$56,811 million in 2010. (In June of 2011, the U.S. Department of Commerce estimated that total personal income growth for 2010 was 2.1%, but revised its estimate to 3.7% in September of 2011.)

The TRP Office continued to use the econometric model that was developed under a contract with UCLA Anderson Forecast to predict General Fund collections. The Office also continued to provide results based on its own model, but the model was altered to use functional forms similar to those used in the model developed by UCLA Anderson Forecast. At the request of the Council on Revenues, the TRP Office also experimented with a new single-equation regression to predict General Fund tax revenues.

### **Information Technology Services Office**

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

During FY 2011 the ITS Office focused on processing improvements, tax law changes and the change in management of the Integrated Tax Information Management System ("ITIMS"), which had been co-managed with CGI, an outside vendor, but is now managed entirely by the Department. Key projects for this period included: (1) ITIMS knowledge transfer and documentations review; (2) developing a key-from-image data input stream for ITIMS Miscellaneous Tax project; (3) a non filer initiative for tax year 2009 general excise taxes; (4) annual ITIMS updates and ITIMS modifications to accommodate new tax laws; (5) performing an Audit Data Warehouse Federal/State comparison (to derive potential audit leads); (6) implementing more cost effective computerized address correction software; and (7) transitioning to a maintenance support mode for the ITIMS Miscellaneous Tax processing initiative.

Other major technical initiatives completed during FY 2011 included installing and testing a new version of scanned document storage software (FileNet). In addition, there were significant infrastructure upgrade improvements for hardware and software, such as: (1) upgrading all ITIMS application and database servers as well as application and database software; (2) upgrading neighbor island file servers; (3) upgrading desktops and laptops to replace equipment five years old or older; (4) upgrading hardware and software for network switches, firewall and routers; and (5) upgrading the backup/restore hardware and software.

A number of projects that the ITS Office is actively involved with will continue into the next reporting period. They include upgrading the Bulk Filing website, continuing the joint Federal-State electronic filing program migration from JELF to the new MeF electronic filing program, continuing the non filer initiative for general excise taxes, developing a department-wide Intranet, and reviewing systems to modernize the tax processing system.

### **System Administration Office**

The System Administration Office provides technical support to implement computer changes made necessary by changes in the ITIMS and changes in tax law.

The Office provides coordinated operational liaison and support services for the ITIMS across DOTAX, including ITPS (ITIMS Tax Processing System), IAMS (ITIMS Audit Modeling System), ICS (ITIMS Collection System) and other electronic processing systems.

The office acts as a liaison between the users of the computer system and management. It also acts as a liaison between the various units in the Department of Taxation and the Information Technology Services Office. The System Administration Office facilitates and coordinates operational business changes by (1) defining the user's requirements; (2) coordinating the programming changes with the Data Processing Systems Manager; (3) testing the system after changes have been made; and (4) rolling out the changes.

The System Administration Office staff is also responsible for conducting studies and analyses to do an internal audit of the computer system, and for writing reports of findings and recommendations for review by the Director, as appropriate.

### **Taxpayer Advocacy Program**

The Taxpayer Advocacy Program is administered by the Department's Taxpayer Advocate under the direction of the Director of Taxation to assist taxpayers who are unable to resolve their problems through the normal channels. The Taxpayer Advocate also identifies and addresses systemic and procedural problems and recommends corrective changes. This program is a one person operation focusing on the unique needs of each taxpayer requiring assistance while simultaneously identifying issues that impact multiple taxpayers.

During FY 2011, the Taxpayer Advocacy Program helped 441 taxpayers resolve tax matters that included erroneous billings, non receipt of refunds, waivers of penalty and interest charges, verifications of tax liabilities, non-filer letters and non-filed returns, collection issues, difficulty accessing the Call Center, e-filing issues, tax clearance issues, and delays in responses to inquiries. Seventy-five (75) additional cases did not require intervention, but were instead resolved by providing the taxpayers with general tax information, explanations of letters and assessments, or a referral to appropriate management personnel.

The Taxpayer Advocate identified systemic issues or was made aware of systemic issues with tax forms, tax clearance process, office procedures, and tax issues in FY 2011, and recommended a review of these issues.

The Taxpayer Advocacy Program also coordinates a joint outreach project with various partners to provide tax services to communities that do not normally have access to these services. A variety of tax services are provided, including 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 2011 tax season, the Department partnered with the AARP's Tax Aide Program to bring tax assistance to the Liliha community on Oahu. Volunteer Tax Aide Program counselors are trained and certified by the IRS to assist the elderly, those with low incomes, those who speak limited English, or disabled taxpayers in the preparing their federal and State income tax returns. Approximately 10 taxpayers were assisted at this joint outreach one-day event. The Taxpayer Advocate was on hand to assist taxpayers with their questions and with the resolution of their tax concerns. In past years, the Department also partnered with the AARP to provide tax assistance to the Waianae and Molokai community; due to budget constraints, however, the Department was unable to participate this fiscal year.

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 2010–2011)

**OFFICE OF THE DIRECTOR**

Director of Taxation..... Frederick D. Pablo  
Deputy Director of Taxation..... Randolph L.M. Baldemor

**STAFF OFFICES**

Public Information Officer..... Mallory Fujitani  
Rules Officer..... Johnnel Nakamura  
    Technical Section Supervisor..... Denise Inouye  
Acting Tax Research & Planning Officer..... Donald Rousslang  
    Senior Economist..... Yvonne Chow  
Information Technology Services Officer..... Robert Su  
Administrative Services Officer..... Suzanne Efhan  
    Personnel Officer..... Sharon Iwamura  
Taxpayer Advocate..... Fern Elizares

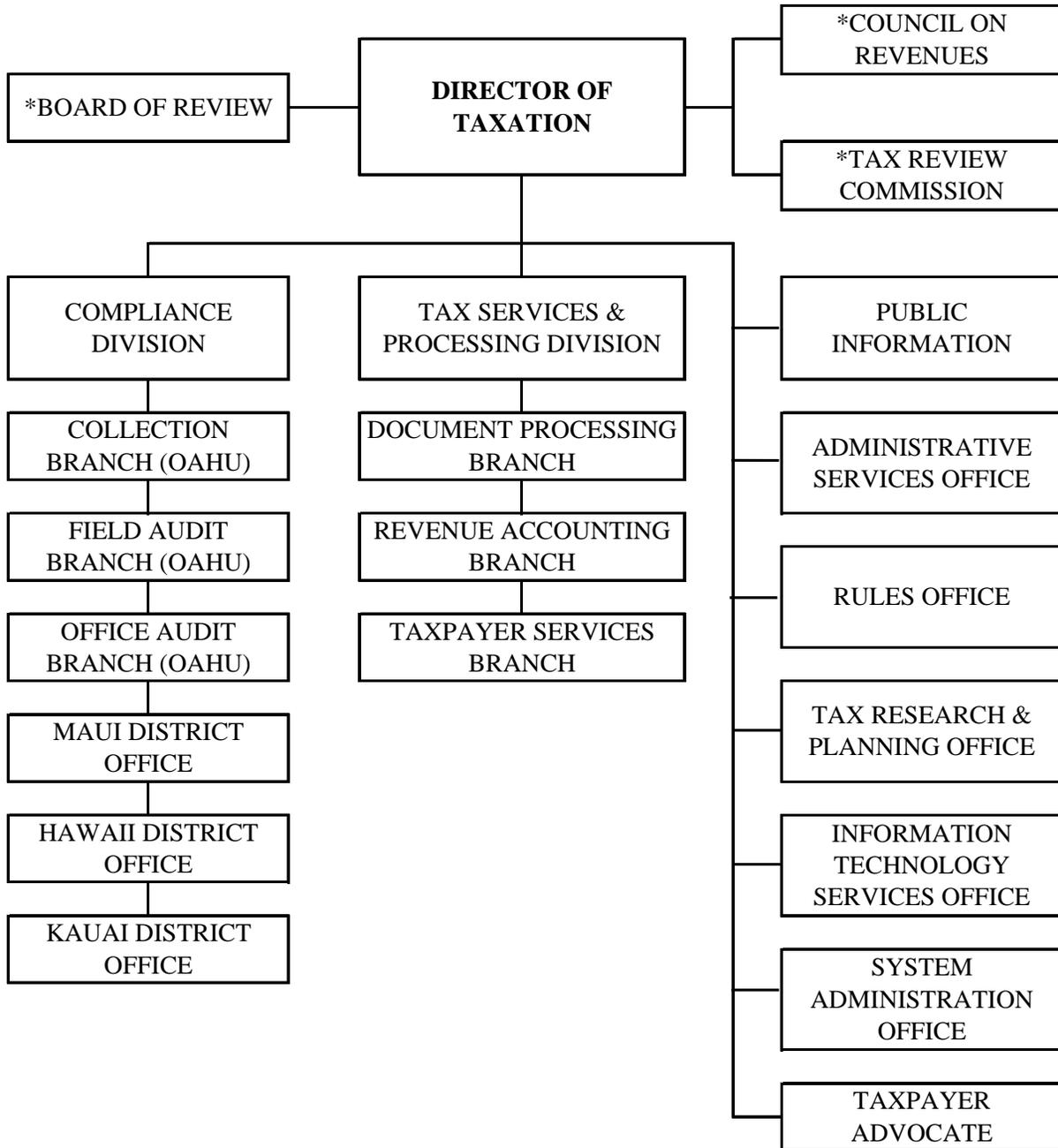
**OPERATIONS STAFF**

Compliance Division Chief..... Vacant  
    Tax Collection Technical Coordinator..... Kathleen Uehara  
    Oahu Field Audit Branch Chief..... Gayle Nakagawa  
    Oahu Office Audit Branch Chief..... Donald Kuriki  
    Oahu Collection Branch Chief..... Lynne Kaneta  
    Maui District Tax Manager..... Wayne Fujita  
    Hawaii District Tax Manager..... Vacant  
    Kauai District Tax Manager..... Dulcie Yano

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

# ORGANIZATION CHART

Department of Taxation  
State of Hawaii

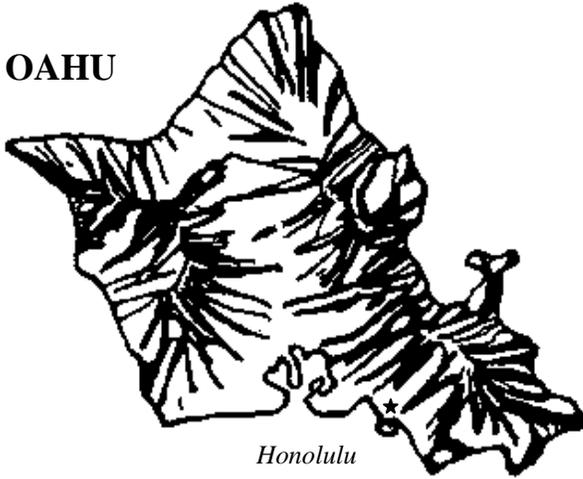


\*For Administrative Purposes

# FIRST TAXATION DISTRICT

City & County of Honolulu

**OAHU**



*Honolulu*

Oahu Office  
830 Punchbowl Street  
Honolulu, Hawaii 96813

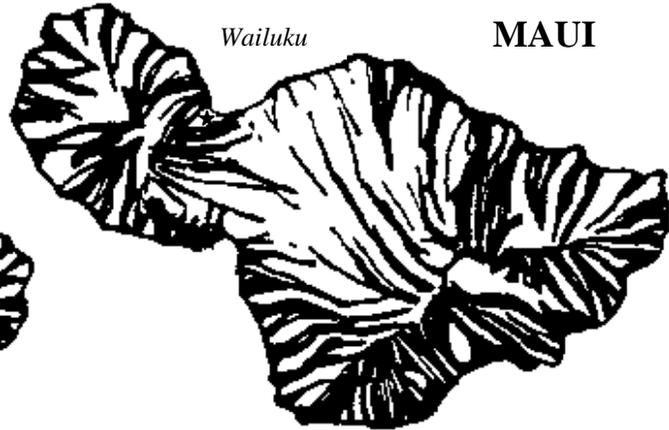
# SECOND TAXATION DISTRICT

Counties of Maui and Kalawao



*Kaunakakai*

**MOLOKAI**



*Wailuku*

**MAUI**

**LANAI**



**KAHOOLAWE**

Maui Office  
54 South High Street  
Wailuku, Hawaii 96793

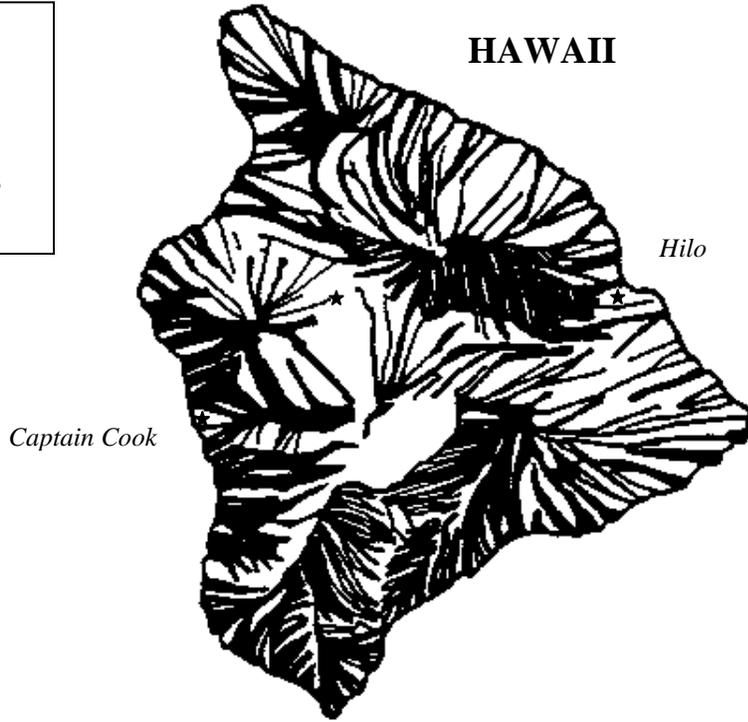
Molokai Office  
35 Ala Malama Street #101  
Kaunakakai, Hawaii 96748

### THIRD TAXATION DISTRICT

County of Hawaii

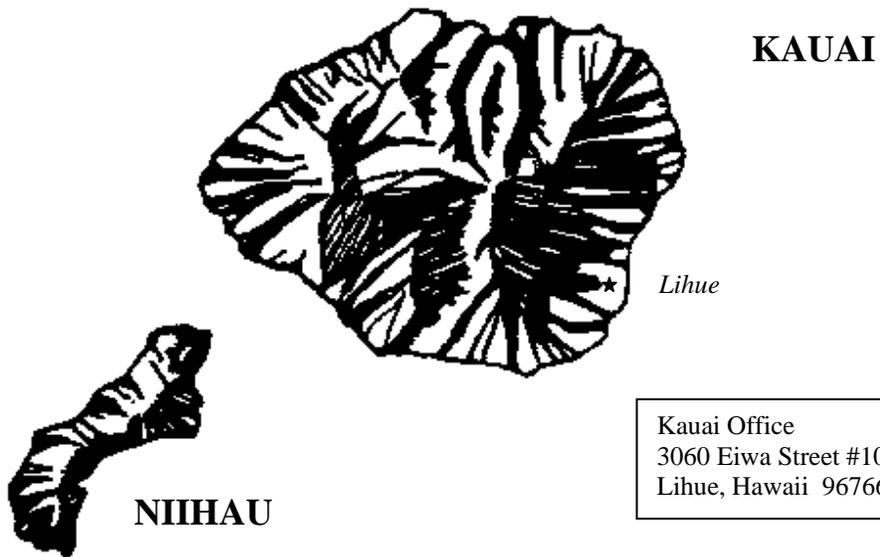
Hilo Office  
75 Aupuni Street  
Hilo, Hawaii 96720

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 a Board of Taxation Review unless the dispute involves the Constitution or laws of the United States. Statewide, the boards began the fiscal year with 121 pending tax appeals. During FY 2011, 58 new appeals were filed, 36 appeals withdrawn, and 29 appeals settled; a total of 114 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 (Field Audit)</u>	<u>First (Office Audit)</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
Appeals Pending (Beginning)	77	12	7	20	5	121
New Appeals	35	8	10	3	2	58
Appeals Withdrawn	20	7	3	5	1	36
Appeals Settled	4	4	11	8	2	29
Appeals Pending (Ending)	88	9	3	10	4	114

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

During the last fiscal year, the Tax Division closed 869 Tax Department related legal matters, not including legislative matters which have not yet been closed in our case management system by the Department's Legislative Division. This report also does not include all of the charitable oversight, charity registration and charitable solicitation-related matters the Division routinely handles.

<u>MATTERS CLOSED</u>	<u>AMOUNTS COLLECTED<sup>2</sup></u>	
Appeals .....	Tax Appeals	\$12,905,500
Bankruptcies .....	Foreclosures	0
Contracts .....	Bankruptcies	1,162,100
Foreclosures .....	Trusts	0
Legislation.....	Miscellaneous	<u>55,737</u>
Opinions .....	TOTAL	<u>\$14,123,337</u>
Quiet Title .....		
Subpoenas .....		
Miscellaneous .....		

<sup>2</sup> The Tax Division of the Department of the Attorney General also secured the dismissal of several tax appeals that would have potentially resulted in refunds to taxpayers from the General Fund and won cases on appeal that will have fiscal impact on similarly situated taxpayers and result in future tax collections that are impossible to forecast.

## Settled Cases

### Tax Appeal Court

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) 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 dividends it received from a REIT. This case was settled and the appeal dismissed.

In re Tax Appeal of Maui Ocean Club Vacation Owners Association, Case No. 08-0075; In re Tax Appeal of Marriott's Kauai Because Club Owners Association, Case No. 08-0077; and In re Tax Appeal of Waiohai Beach Club Vacation Owners Association, Case Nos. 08-0074, 08-0082, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional general excise taxes for amounts they received for condominium maintenance fees that they collected on behalf of their members and paid to the respective association of apartment owners (AOAOs). Taxpayers argued that (1) these fees were not business income for purposes of chapter 237, HRS, (2) the amounts were exempt as either reimbursements under § 237-20, HRS or common area expenses collected by an association under § 237-24.3(3) HRS and (3) these fees were collected as agents of the AOAO. These cases were settled and the appeals dismissed.

In the Matter of the Tax Appeal of Exclusive Resorts, T.A. No. 08-0101, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional transient accommodations tax under § 237D-2(c), HRS. Taxpayer asserted, among other things, that it was not a timeshare and was not subject to tax under chapter 237D, HRS. The case was settled and the appeal dismissed.

In the Matter of the Tax Appeal of Willem Vanderlee, T.A. No. 09-0073; and In the Matter of Van Der Lee Concrete Products, Inc., T.A. No. 09-0074, Tax Appeal Court, State of Hawaii.

Taxpayers, non-filers, appealed from assessments of general excise taxes, claiming that they are wholesalers, not retailers or contractors, who were entitled to the 0.5% rate, rather than the 4% rate. This case was settled.

In the Matter of the Tax Appeal of Darryl M. and Linda M. Kan, Case No. 10-0038, Tax Appeal Court, State of Hawaii.

Taxpayers disputed the penalties and alleged generally that assessments were erroneous. This case was settled.

In the Matter of the Tax Appeal of UXB International, Inc., T.A. Nos. 08-0020, 08-0021, 08-0022, 08-0023, 08-0024, 08-0025, 08-0026, 08-0027, and 08-0028, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes on amounts it received for services provided to a joint venture in which Taxpayer was one of the partners. Taxpayer claimed the amounts it received were partnership distributions and the services were performed outside the state. This case was settled and the appeal dismissed.

In the Matter of the Tax Appeal of Four Seasons, Ltd., T.A. No. 09-0051, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for amounts it received for performing hotel management services in Hawaii. Taxpayer claimed the amounts were not subject to tax because most of the services were performed outside the state. This case was settled and the appeal dismissed.

## **Completed Cases**

### **Hawaii Supreme Court**

In the Matter of the Tax Appeal of CompUSA, S. Ct. No. 29597.

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 claimed that the assessments were incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). The Tax Appeal Court ruled that taxpayer was subject to the use tax on the value of goods it purchased outside Hawaii, imported into Hawaii, and resold to the public. The Intermediate Court of Appeals issued a memorandum opinion on May 28, 2010, ruling in favor of the taxpayer, reversing the Tax Appeal Court's decision, and remanding the case back to the Tax Appeal Court. The ICA determined that Taxpayer was not subject to the use tax on the goods it imported into Hawaii for resale because Taxpayer's factual circumstances were similar to that of the taxpayer in In Re Tax Appeal of Baker and Taylor. The Supreme Court of Hawaii reversed the decision of the ICA and held that Taxpayer was subject to the use tax.

Reel Hooker Sport Fishing, Inc. vs. 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, S. Ct. No. 29598.

The Intermediate Court of Appeals issued a published opinion on May 28, 2010, ruling in favor of the Department and affirming the Tax Appeal Court's decision. The Court determined that Taxpayers were subject to the general excise tax on their gross income from their sport fishing charter businesses because the Supremacy and Tonnage Clauses of the United States Constitution did not apply here. The Supreme Court of Hawaii affirmed the decision of the Intermediate Court of Appeal. The United States Supreme Court denied cert.

## **Intermediate Court of Appeals**

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

After the remand from the Hawaii Supreme Court (S. Ct. No. 27023) holding that the Tax Appeal Court had jurisdiction to review Taxpayer's case, the Tax Appeal Court ruled in favor of the Department. Taxpayer argued that the Department failed to assess the general excise tax for 1989 within the three-year period after he presented his federal income tax return and return information for review to the Department. The Tax Appeal Court determined that the statute of limitations for making an assessment was inapplicable because the Department never issued an assessment and that the alleged assessment was Taxpayer's general excise tax return that he signed and dated.

In the Matter of the Tax Appeal of Daniel Aregger and Susan Rogers Aregger, T.A. No. 08-0110, Tax Appeal Court, State of Hawaii.

The ICA issued a published opinion on November 18, 2010 ruling in favor of the Department and affirmed the Tax Appeal Court's decision. The Court determined that to confer subject matter jurisdiction, Taxpayers needed to timely serve the Director of Taxation pursuant to Hawaii Revised Statute § 232-17, HRS (Supp. 2007). See Aregger v. State, Dept. of Taxation, 124 Haw. 325, 243 P.3d 285 (2010).

## **Tax Appeal Court**

In the Matter of the Tax Appeal of Bobby R. Narmore, T.A. No. 02-0065, Tax Appeal Court, State of Hawaii.

After the remand of his other case from the Hawaii Supreme Court (S. Ct. No. 27023) holding that the Tax Appeal Court had jurisdiction to review Taxpayer's case, Taxpayer filed a motion to reopen this case. The Tax Appeal Court granted Taxpayer's motion and exercised jurisdiction to review the case. Taxpayer argued that the Department failed to assess the general excise tax within a three-year period because he had filed a general excise tax return on April 1, 1993 and that the assessments were issued in September 1996. The Department filed a motion for summary judgment that the Tax Appeal Court denied. The only factual issues were whether Taxpayer filed a general excise tax return on April 1, 1993 and if the Department received this return. Trial was held on August 8, 30, 31, 2011 and September 1, 2011. The Tax Appeal Court ruled in favor of the Department and held that based on the evidence presented, Taxpayer failed to bear his burden of proof in challenging the Department's assessment.

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 claimed that the assessments were incorrect pursuant to In Re Tax Appeal of Baker and

Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

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 for 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 claimed that the assessments were incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Trial is scheduled for January 3, 2011. Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

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 the tax period from 2002 through 2004, inclusive. Taxpayer claimed that the assessments were incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

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

Taxpayer appealed from an assessment of additional general excise taxes for taxable years 2002 through 2005, inclusive. The Department disallowed the subcontractor deductions for amounts paid to other companies in conjunction with work Taxpayer performed for the federal government. This case was dismissed by motion on January 24, 2011.

In re Tax Appeals of Paradise Cruise, Ltd., T.A. Nos. 09-0033, 09-0037, and 09-0054; In re Tax Appeals of Royal Princess Cruises, Inc., T.A. Nos. 09-0048, 09-0052, and 09-0058; and In re Tax Appeals of Seabird Charters, Inc., T.A. Nos. 09-0047 and 09-0053; Tax Appeal Court, State of Hawaii.

Taxpayers filed Notices of Appeal to Tax Appeal Court challenging the Department's denial of their refund claims. Taxpayers claimed that a portion of their income was exempt from the general excise tax pursuant to the Supremacy and Tonnage Clauses of the United States Constitution. Based on the Hawaii Supreme Court's decision in In re Tax Appeal of Reel Hooker Sport Fishing, Inc., the taxpayers stipulated to dismissal of their respective appeals.

In the Matter of the Tax Appeal of Antonio and Carol Tagal, T.A. No. 09-0063, Tax Appeal Court, State of Hawaii.

Taxpayers filed a tax appeal from income tax assessments. The Department moved to dismiss the case for lack of subject matter jurisdiction on the basis that the notice of

appeal was untimely and was not properly served on the Director of Taxation. By order filed July 26, 2010, the court granted the motion to dismiss.

In re Tax Appeal of Radio Shack Corp., T.A. No. 09-0064, 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 1998 through 2004, inclusive. Taxpayer argued that the denial was incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

In the Matter of the Tax Appeal of Maria Q. Galicia, Inc., T.A. No. 09-0070, Tax Appeal Court , State of Hawaii.

Taxpayer appealed from general excise and income tax assessments for the period 2005 through 2008, inclusive. On January 10, 2011, the Tax Appeal Court granted the Department's motion for summary judgment.

In the Matter of the Tax Appeal of Lowell Rego, T.A. No. 09-0096, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from income tax assessments for years 2001 through 2004, inclusive. The Director of Taxation moved to dismiss the appeal for lack of subject matter jurisdiction on the basis that the appeal was not timely filed. The court granted the Director's motion.

In the Matter of the Tax Appeal of Maria Q. Galicia., T.A. No. 09-0205, Tax Appeal Court , State of Hawaii.

Taxpayer appealed from general excise and income tax assessments for the period 2005 through 2008, inclusive. On January 10, 2011, the Tax Appeal Court granted the Department's motion for summary judgment.

In the Matter of the Tax Appeal of Angela Correale, Case No. 10-0026, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax assessments for tax years 2003 through 2006, inclusive. Taxpayer argued that the penalties and interest were excessively punitive and that she did not understand general excise tax law. The court granted the Director's motion to dismiss on August 23, 2010.

In the Matter of the Tax Appeals of Global Horizons, Inc., T.A. Nos. 10-0032 and 10-0033, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes and income taxes for taxable years 2003 through 2007, inclusive. This case was dismissed by motion on March 2, 2011.

In the Matter of the Tax Appeal of Gregory R. Patch and Claire L. Patch, Case No. 10-0159, Tax Appeal Court, State of Hawaii.

Taxpayers appealed their income tax assessment for tax year 2006. Taxpayers claimed they appealed to suspend collection actions until they could determine their tax liability themselves. The Court granted the Director's motion to dismiss.

In the Matter of Tax Appeal of Cardinal Health 200, LLC, Case No. 1 TX 11-1-000015, 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 1998 through 2004, inclusive. Taxpayer argued that the denial was incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

In the Matter of Tax Appeal of Foot Locker Retail, Inc., Case No. 1 TX 11-1-000016, Tax Appeal Court, State of Hawaii. (Damien Elefante)

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 1998 through 2004, inclusive. Taxpayer argued that the denial was incorrect pursuant to In Re Tax Appeal of Baker and Taylor, 103 Haw. 359, 82 P.3d 804 (2004). Based on the outcome of In re Tax Appeal of CompUSA, a stipulated dismissal with prejudice was filed.

## **Pending Appeals**

### **Tax Appeal Court**

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. The Tax Appeal Court denied a partial motion for summary judgment regarding whether a nonprofit may claim a refundable income tax credit. Trial is scheduled for November 21, 2011.

In the Matter of the Tax Appeal of Agnes P. Etscheit, 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 claimed 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 taxpayer is subject to the tax. In addition, the Department further maintains that the tax appeal is improper due to the failure to serve the Director. Trial is scheduled for October 31, 2011.

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

Taxpayer appealed from a final assessment of \$262,514 in general excise, use, and withholding taxes. The general excise tax assessment was based on Taxpayer's income tax returns and on 1099-MISC forms issued to Taxpayer. Trial is set for June 4, 2012.

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

Taxpayer appealed from a final assessment of general excise taxes. The Kaanapali Beach Owners Association is an interval owners association. Included in its annual assessment to its members are amounts owed by the owners to the Association of Apartment Owners (AOAO). Taxpayer asserted that the amounts are exempt under the reimbursement exemption and because it acted as a true agent for the AOAO. Trial date was not rescheduled due to settlement.

In the Matter of the Tax Appeals of TEAM TV, T.A. Nos. 08-0107 and 09-0046, Tax Appeal Court, State of Hawaii.

Taxpayer was denied the high technology business investment tax credit provided under § 235-110.9, HRS. The Department argues that taxpayer has, among other things, not made an "investment" as required by § 235-110.9, HRS, to claim this credit. Trial is scheduled for January 9, 2012.

In the Matter of Kahana Falls Interval Owners Association, T.A. No. 09-0014, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax assessments on the bases that maintenance fees are not taxable to a taxpayer acting as an agent and conduit, and that taxpayer relied on the advice of others who did not inform taxpayer that there were taxes due. Trial was taken off the trial ready calendar to allow settlement.

In the Matter of the Tax Appeal of The Centech Group, Inc., T.A. No. 09-0017, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from assessments of general excise tax and the county surcharge. In the Notice of Appeal, taxpayer claimed: (a) its income was exempt under § 237-26, HRS; (b) its income was for out-of-state activities; (c) its income was exempt under the federal immunity doctrine; (d) the assessments were unconstitutional; (e) the assessments were excessive; (f) its income was exempt under § 237-25, HRS; and (g) Taxpayer should not be subject to penalties and interest. Trial is scheduled for December 12, 2012.

In re Tax Appeal of Kahana Villa Vacation Club, Case Nos. 09-0019, 09-0020; In re Tax Appeal of Kona Islander Vacation Club, Case Nos. 09-0021, 09-0022; In re Tax Appeal of Maui Beach Vacation Club, Case Nos. 09-0023, 09-0024; In re Tax Appeal of Sands of Kahana Vacation Club, Case Nos. 09-0025, 09-0026; In re Tax Appeals of Kahana Beach Vacation Club, Case Nos. 09-0027, 09-0028; In re Tax Appeal of Gardens at West Maui Vacation Club, Case Nos. 09-0029, 09-0030; In re Tax Appeal of Maui Banyan Vacation Club, Case Nos. 09-0031, 09-0032; In re Tax Appeal of Hono Koa Vacation Club, Case Nos. 09-0202, 09-0223, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional general excise and transient accommodations taxes for income received from their operations of timeshare properties in the state. Specifically, Taxpayers were assessed additional general excise taxes for amounts they received as maintenance fees that they collected on behalf of their members. Taxpayers argued that (1) these fees were not business income for purposes of chapter 237, HRS, (2) the amounts were exempt as either reimbursements under § 237-20, HRS or common area expenses collected by an association under § 237-24.3(3), HRS and (3) that Taxpayers were agents of the respective timeshare members and that the fees collected were used to pay the expenses of their respective members.

In the Matter of the Tax Appeal of John M. Dimitrion, T.A. No. 09-0038, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes on income related to the business activity of Total Advantagedge, LLC. The Department made jeopardy assessments against Taxpayer based on the best available information. Taxpayer denied the income should be attributable to him and that any income should be subject to the franchise tax, not the general excise tax. Trial is scheduled for November 7, 2011.

In the Matter of the Tax Appeal of Total Advantagedge, LLC, T.A. No. 09-0039, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on its business activities. The Department made jeopardy assessments against Taxpayer based on the best available information. Taxpayer argued that any income should be subject to the franchise tax, not the general excise tax, and that Taxpayer was not allowed to take certain deductions allowed under chapter 241, HRS. Trial is scheduled for November 7, 2011.

In the Matter of the Tax Appeal of One Napili Way Interval Owners Association, T.A. No. 09-0069, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for amounts it received for condominium maintenance fees that it collected on behalf of its members and paid to the One Napili Way AOA. Taxpayer asserted the fees it collected were not income for purposes of chapter 237, HRS, and, alternatively, that the amounts were exempt reimbursements under § 237-20, HRS. Trial is scheduled for October 1, 2012.

In the Matter of the Tax Appeals of TMI Management, Inc., T.A. Nos. 09-0071 and 09-0072, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on amounts received for performing work for the federal government. Taxpayer argued, among other things, that the disputed income was exempt because Taxpayer was an employee leasing company and the disputed income was for salaries and expenses of leased employees. Trial is scheduled for February 6, 2012.

In the Matter of the Tax Appeals of Bernard & Ellen Fuller and South Pacific Builders, Ltd., T.A. Nos. 09-0087, 09-0088 and 09-89, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional general excise and net income taxes on amounts received for performing work within the state. Taxpayers argued, among other things, that the disputed income was exempt because Taxpayers paid certain amounts to other contractors. Trial is scheduled for July 9, 2012.

In re Tax Appeal of CCHH Maui LLC, Case No. 09-0084 and In re Tax Appeal of CCFH Maui LLC, Case No. 09-0090, Tax Appeal Court, State of Hawaii.

Taxpayers appealed general excise tax assessments that disallowed the sublease deduction pursuant to § 237-16.5, HRS and the imposition and adjustment of use and general excise taxes. Trial is scheduled for January 16, 2012.

In the Matter of the Tax Appeal of CBIP, Inc., Case No. 09-0203, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax assessments. Taxpayer argued that (i) the assessment erroneously included general excise tax on amounts that were not gross income but, rather, were rebates of expenses; (ii) penalties were erroneous because nonfiling and/or underpayment was not due to negligence or intentional disregard of rules; and (iii) the assessments violated the due process, commerce and/or equal protection clauses of the United States Constitution. Trial is scheduled for August 6, 2012.

In the Matter of the Tax Appeal of Passport Resorts, LLC, Case No. 10-0031; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes related to gross receipts for hotel management services performed for a hotel located within the state. Taxpayer claimed the services were performed out-of-state and were therefore, not taxable. The local hotel was also assessed use taxes on these same services. Trial is set for August 13, 2012.

In re Tax Appeal of Peter K. and Sharwayne Kim, Case No. 10-0039, Tax Appeal Court State of Hawaii.

Taxpayers appealed an income tax assessment arguing that the calculations were incorrect, specifically the applicability of the 3% limitation and the one-half self-employment tax adjustment. Taxpayers also challenged the applicability of the negligence penalty that was assessed. Trial is not set.

In re Tax Appeal of Maui Schooner Resort Owners Association, Case No. 10-0158, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's assessment for additional general excise taxes for amounts Taxpayer received for condominium maintenance fees that it collected on behalf of its members and paid to the association of apartment owners (AOAOs). Taxpayer argued that (1) these fees were not business income for purposes of chapter 237, HRS, and (2) the amounts were exempt as either reimbursements under § 237-20, HRS or common area expenses collected by an association under § 237-24.3(3) HRS. Taxpayer also challenged the calculation of the general excise tax on consignment sales, the use tax on imports for resale and transient accommodation tax. Trial is set for February 13, 2012.

In the Matter of the Tax Appeal of Hualalai Investors, LLC, Case No. 10-0178; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional use taxes for the importation of hotel management services. Taxpayer hired a hotel management company based on the mainland to run its hotel located in the State. Taxpayer denied that it was liable for use taxes and claimed the mainland service provider should pay general excise tax on these same amounts. Trial is set for April 16, 2012.

In the Matter of the Tax Appeal of 3900 WA Associates, LLC, Case No. 10-0179; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional use taxes for the importation of hotel management services. Taxpayer hired a hotel management company based on the mainland to run its hotel located in the State. Taxpayer denied that it was liable for use taxes and claims the mainland service provider should pay GET on these same amounts. Trial is set for April 16, 2012.

In the Matter of the Tax Appeals of CP Hotels Inc. & Subsidiaries, Case No. 10-0716; Tax Appeal Court, State of Hawaii.

Taxpayer was denied a request for refund of income taxes because it missed the statute of limitations to make the refund claim. Taxpayer filed for an extension of time to file its original return and claimed the due date for the amended return was also extended; the Department disagreed and denied the refund claim as untimely. Trial is set for May 7, 2012.

In the Matter of the Tax Appeal of Patrick T. Brent, Case No. 10-0717, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from general excise tax and transient accommodations tax assessments for tax years 2003 through 2008, inclusive. Taxpayer argued that he did not owe the taxes because he employed a property management company, who paid the taxes. Trial is set for September 3, 2012.

In the Matter of the Tax Appeal of Robert's Hawaii Cruises, Inc., Case No. 10-1-1235, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax for tax years 2006 and 2007. Taxpayer argued, in part, that (i) it qualified for the general excise tax exemption as a tour packager under sec. 237-18(f), HRS; (ii) the assessment conflicted with and is preempted by the Maritime Transportation Security Act of 2002; (iii) the United States Constitution prohibited Hawaii from laying a “duty of tonnage” without the consent of Congress; (iv) the assessments improperly apportioned and sourced Taxpayer’s income; (v) the assessments violated the United States and Hawaii Constitutions and are otherwise illegal; and (vi) Taxpayer timely filed a refund claim. Trial is set for June 18, 2012.

In the Matter of the Tax Appeal of WEBE Corporation, Ltd., Case 10-1-1236, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax (and county surcharge when applicable) assessments for tax years 2006 through 2008, inclusive. Taxpayer argued, in part, that (i) it qualified for the general excise tax exemption as a tour packager under sec. 237-18(f), HRS; (ii) the assessment conflicted with and was preempted by the Maritime Transportation Security Act of 2002; (iii) the United States Constitution prohibited Hawaii from laying a “duty of tonnage” without the consent of Congress; (iv) the assessments improperly apportioned and sourced taxpayer’s income; (v) the assessments violated the United States and Hawaii Constitutions and was otherwise illegal; and (vi) Taxpayer timely filed a refund claim. Trial is set for July 9, 2012.

In the Matter of the Tax Appeal of Augustine Salbosa, T.A. No. 10-1-1245, Tax Appeal Court, State of Hawaii.

Taxpayer, a non-filer, appealed from assessments of general excise and net income taxes because he claimed that the Department did not take into account applicable deductions and credits. Trial is set for February 6, 2012.

In the Matter of the Tax Appeal of Leslie-Ann Yokouchi, Case No. 10-1-1802; Tax Appeal Court, State of Hawaii.

Taxpayer was disallowed certain deductions and was assessed additional income taxes as a result. Taxpayer failed to, or was unable to provide proper documentation to substantiate deductions for business expenses under audit. Trial is set for May 28, 2012.

In the Matter of the Tax Appeal of Prudential Aina Maui, LLC, Case No. 10-1-1803; Tax Appeal Court, State of Hawaii.

Taxpayer was disallowed certain deductions and was assessed additional income taxes as a result. Taxpayer claimed deductions for improper business expenses and was unable to provide proper documentation to substantiate deductions for other business expenses under audit. Trial is set for May 28, 2012.

In the Matter of the Tax Appeal of MSY Corp., Case No. 10-1-1804; Tax Appeal Court, State of Hawaii.

Taxpayer was disallowed certain deductions and was assessed additional income taxes as a result. Taxpayer failed to, or was unable to provide proper documentation to substantiate deductions for business expenses under audit. Trial is set for May 28, 2012.

In the Matter of Tax Appeal of James J. Richard & Rachael D. Richard, Case No. 1 TX 10-1-1805, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional income and general excise taxes. Taxpayers challenged the Department's reclassification and recalculation of its liability that was based on Taxpayers' IRC Section 338 (g) election on a sale of a business. The basis of Taxpayers' claim was that they made an election error on the Form 8023 and the parties to the sale intended a Section 338(h)(10) election instead of the 338(g) election. Taxpayers also challenged the Department's reclassification of income that changed the amount received as personal loans and/or advances from their business to wages. Trial date has not been set.

In the Matter of Tax Appeal of James & Associates CPAS, Inc., Case No. 1 TX 10-1-001806, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's reclassification and recalculation of its tax liability that was based on Taxpayer's IRC Section 338 (g) election of a sale of a business. The basis of Taxpayer's claim was that it made an election error on the Form 8023 and the parties to the sale intended a Section 338(h)(10) election instead of the 338(g) election. Trial date has not been set.

In the Matter of Tax Appeal of James Professional Services, Inc., Case No. 1 TX 10-1-001807, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's reclassification and recalculation of its liability that was based on Taxpayer's IRC Section 338 (g) election on a sale of a business. The basis of Taxpayer's claim was that it made an election error on the Form 8023 and the parties to the sale intended a Section 338(h)(10) election instead of the 338(g) election. Taxpayer also challenged the use tax assessments on property it purchased. Trial has not been set.

In the Matter of the Tax Appeal of JN Group, Inc., Case No. 10-1808, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise assessments for tax years ending March 31, 1998 through March 31, 2006, inclusive. Taxpayer claimed that the amounts assessed constituted reimbursements that were exempt under sec. 237-20, HRS; the assessments of penalties were erroneous because any nonfiling or underpayment was not due to negligence or intentional disregard of rules; the assessments violated the due process, commerce, and/or equal protection clauses of the United States Constitution and the Constitution of the State of Hawaii. Trial is set for October 8, 2012.

In the Matter of the Tax Appeal of Maui County Association, Case No. 10-1-1810, Tax Appeal Court, State of Hawaii

Taxpayer appealed jeopardy general excise tax assessments for tax years 1996 through 2009, inclusive. Taxpayer claimed that the assessments were based on erroneous information using total revenues for such assessments instead of net income from operations. Trial is set for November 5, 2012.

In the Matter of the Tax Appeal of SRS-Parsons, Case No.10-1-1818; Tax Appeal Court, State of Hawaii.

The Taxpayer filed an appeal challenging the Department's general excise assessment on the basis that the Department incorrectly apportioned its service income between in-state and out-of-state activities. Trial date has not been set.

In the Matter of the Tax Appeal of Patrick O' Brien, Case No. 11-1-0013, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income taxes for unreported schedule C income from a single member LLC owned by Taxpayer. Taxpayer denied the income is taxable to him. Trial is set for June 18, 2012.

In the Matter of the Tax Appeal of Security Resources, LLC, Case No. 11-1-0014; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for underreporting the amount of gross receipts it received. Taxpayer claims the assessments are overstated and that it is entitled to be taxed at the wholesale rate of .5 percent. Taxpayer also claims some of its sales are exempt because they were sales of tangible personal property to the federal government. Trial is set for June 18, 2012.

In the Matter of the Tax Appeal of Helicopter Consultants of Maui, LLC, Case No. 11-1-0018; Tax Appeal Court, State of Hawaii.

The Taxpayer filed an amended general excise/use tax return for taxable year 2006 claiming a refund for use taxes paid for the importation and use of materials, parts, or tools imported for aircraft service and maintenance. The Director denied the claim for refund because Taxpayer is subject to the use tax on its imported goods and does not qualify for any of the applicable exemptions, including the exemption provided in Haw. Rev. Stat. § 238-1 (Supp. 2010) for "the use of materials, parts, or tools imported or purchased by a person licensed under chapter 237 which are used for aircraft service and maintenance, or the construction of an aircraft service and maintenance facility as those terms are defined in section 237-24.9." Trial date has not been set.

In the Matter of the Travelocity.Com, LLC, Case No. 11-1-020, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$11.8 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Travelocity.Com, LLP, Case No. 11-1-0021, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$11.8 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the

retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Site59.Com, LLC, Case No. 11-1-0022, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$11.8 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In re the Matter of the Tax Appeal of Expedia, Inc., Case No. 11-1-0023, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$49.5 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Hotels.Com GP, LP, Case No. 11-1-0024, Tax Appeal Court, State of Hawaii

Taxpayer appeals general excise tax and transient accommodations tax assessments totaling \$58.5 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Travelnow.Com, Case No. 11-1-0025, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$58.5 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Hotwire, Inc., Case No. 11-1-0026, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$14.5 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Hotels.Com LP, Case No. 11-1-0027, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$58.5 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set

In the Matter of the Tax Appeal of Orbitz, Inc., Case No. 11-1-0028, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$10 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Orbitz, LLC, Case No. 11-1-0029, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$10 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set

In the Matter of the Tax Appeal of Lodging.Com, Case No. 11-1-0030, Tax Appeal Court State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$10 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of TripNetwork.Com (Cheaptickets), Case No. 11-1-0031, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$10 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Priceline.Com, Case No. 11-1-0032, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$9.7 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise taxes and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Travelweb LLC, Case No. 11-1-0033, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$9.7 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of the Tax Appeal of Lowesfare.Com, LLC, Case No. 11-1-0034, Tax Appeal Court, State of Hawaii

Taxpayer appealed general excise tax and transient accommodations tax assessments totaling \$9.7 million for tax years 1999 through 2010, inclusive. Taxpayer is an Online Travel Company that collects general excise and transient accommodations taxes on the retail price of hotel rooms it provides over the Internet but only remits the tax on the wholesale price of hotel rooms. Trial is not set.

In the Matter of Taxpayer Appeal of Stephen A. Cipres, Case No. 11-1-0084, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's general excise tax assessments on the basis that the Department incorrectly increased his commissions for certain years and misinterpreted and misapplied the penalty provisions in the HRS. Trial is not set.

In the Matter of the Tax Appeal of Wall Investment Associates, Case No. 11-1-0091; Tax Appeal Court, State of Hawaii.

Taxpayer filed an appeal based on the denial of its request for an exemption on the conveyance tax for property conveyed in the Third Taxation District. The amount in controversy is \$78,626.90. Trial has not been set.

In the Matter of the Tax Appeal of Jesse Spencer and Joyce Spencer, 1 T.X. Case No. 11-1-0098, Tax Appeal Court, State of Hawaii.

Taxpayers appealed income tax assessments for tax years 2005, 2006, and 2007. Taxpayers claimed that the assessments improperly denied their carryover residential construction and remodeling tax credit under sec. 235-110.45, HRS, and their pass-through capital goods excise tax credit. Taxpayers also claimed that they were not required under sec. 235-110.45, HRS, to attach Form N-332 to their 2005 and 2006 Form N-11s to claim properly and timely the tax credit for those years. They further claimed that the assessments and the decision of the board of review violated Hawaii law, due process, the commerce and/or equal protection clauses of the United States constitution and the Constitutions of the State of Hawaii and the State of Hawaii and the Department of Taxation Taxpayer's Bill of Rights. Trial is not set.

In the Matter of Tax Appeal of Craig A. Chambers, Case No 11-1-0123, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's assessments that reclassified and recalculated his general tax liability for services from wholesaling to contracting. Taxpayer also

challenged the assessment as being untimely based on the statute of limitations. Trial has not been set.

## CRIMINAL CASES

During the fiscal year 2011 the Criminal Justice section of the Department of the Attorney General filed complaints or indictments against 35 taxpayers<sup>3</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 35 taxpayers accounted for over \$2.3 million dollars in unpaid taxes (excluding civil assessments, penalties, and interest.) To date, the courts have imposed criminal fines of \$128,000 based on these complaints and indictments<sup>4</sup>.

Ms. Bernie Yamada, Criminal Tax Collector, collected \$1,329,176 in unpaid taxes, penalties and interest during this fiscal year ending June 30, 2011.

The 35 cases in fiscal year 2011 accounted for a total of \$59.9 million dollars in unreported income. Seven of the 35 cases involved taxpayers and their business where unreported income totaled over \$34.5 million dollars. These seven cases involved taxpayers in the business activity of a bridal emporium, a used car dealership, a company that cleaned grease traps from businesses, a company that provided valet and parking for a hotel in Waikiki, a food catering service and a general contractor.

Geographic coverage of these cases was statewide with cases on Oahu and Maui. The 35 taxpayers who were charged had a myriad of occupations which included a landscaper, an auto restorer, a bridal emporium, a hostess bar, a company that provided valet and parking, a home care provider, two used car dealerships, a mortgage solicitor, a dry cleaning business, an engineer, a food service company, a hair salon, an attorney, a general contractor, a dentist, a bus service driver and a lighting consultant.

### Cases worthy of note:

A general contractor and his spouse pled guilty to multiple felony and misdemeanor tax violations and sentencing is scheduled to occur on August 24, 2011. A plea agreement was agreed upon where the taxpayer will pay a fine of \$41,000 and restitution in the amount of \$354,984. At time of sentencing, \$150,000 is to be paid as well as a yearly payment of \$41,000 for five years for the restitution. The tax violations included filing false individual income tax returns, failure to file the corporation's annual general excise and withholding tax returns, failing to file the corporation's income tax return and theft. Both husband and wife also pled guilty to tampering with a government document, i.e., tax clearance.

The owner of a dry cleaning service pled guilty to failing to file the annual general excise tax returns for multiple years. A payment of \$80,000 was made and a free standing order for

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<sup>3</sup> Of these 35 cases, 28 taxpayers have pled guilty or no contest, and 7 taxpayers are awaiting trial.

<sup>4</sup> Criminal fines are imposed at sentencing.

\$40,077 was imposed for the payment of the restitution. No fines were imposed and the owner was ordered to perform 60 hours of community service. The total gross receipts for the business was over \$3.0 million dollars for a period of five years.

A criminal complaint was filed against the responsible officer of two used car dealerships for failure to file annual general excise and corporation income tax returns for the years 2003 through 2006. The used car dealerships operated at locations in Honolulu and earned over \$10 million dollars with a general excise tax liability of over \$400,000 which was not reported. This is a first criminal tax case against a car dealership in the State of Hawaii.

A bridal shop owner was charged with six counts of willful failure to file tax returns for the years 2003 through 2008. The business earned gross income in excess of \$3.6 million dollars and failed to file the annual general excise tax returns having a liability of over \$137,000. The bridal shop provided sales, fitting and alteration of gowns and tuxedos for weddings.

A catering company and its owner were sentenced and ordered to pay fines of \$20,000 for willfully failing to file its annual general excise tax returns. The owner was the responsible party who failed to file the returns. During the five year investigation period the restaurant earned over \$2.4 Million in gross receipts.

An owner of a valet company plead guilty to ten counts of failing to file withholding and general excise tax returns for 2003 through 2007. The taxpayer provided valet and parking services to various Waikiki hotels and restaurants. The taxpayer was ordered to pay restitution of \$391,001 of which \$119,000 was due to unpaid withholding taxes and a fine of \$20,000. The gross income earned was over \$5.0 million dollars.

An owner of a grease cleaning business plead guilty to twelve counts of failing to file tax returns for 2003 through 2008. The business operated in the counties of Oahu and Maui and generated \$3.2 Million in gross receipts during the six year investigation period. During the investigation, the business owner made numerous false claims to investigators, including the type of work performed, number of employees and gross income earned. The taxpayer was ordered to pay a fine of \$12,000 and paid restitution of \$134,074.

The presence of the criminal unit becomes even more important to the State Department of Tax in these critical economic times. Taxpayers must be made aware of the criminal consequences of non-compliance.

## LEGISLATION

The Twenty Sixth Legislature passed the following major tax related measures during the 2011 Regular Session that were subsequently enacted:

### REGULAR SESSION 2011

<u>Act</u>	<u>Brief Description</u>
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|------------|--|
| <b>001</b> | <b>Relating to Civil Unions.</b> Extends the same rights, benefits, protections, and responsibilities of spouses in a marriage to partners in a civil union. All provisions of the Internal Revenue Code that apply to a husband and wife, spouses, or person in a legal marital relationship apply to partners in a civil union. <i>Effective January 1, 2012.</i>  |
| <b>032</b> | <b>Relating to Use Tax.</b> Clarifies the current application of the use tax exemption for certain interstate commerce activities by repealing overbroad and redundant language in the use tax law. <i>Effective April 29, 2011.</i>   |
| <b>086</b> | <b>Relating to Motor Vehicle Weight Tax.</b> Increases the annual state motor vehicle weight tax as follows: <ul style="list-style-type: none"><li>• For vehicles up to and including four thousand pounds net weight, the tax rate increases from 0.75 cents per pound to 1.75 cents per pound;</li><li>• For vehicles over four thousand pounds and up to and including seven thousand pounds net weight, the tax rate increases from 1.00 cents per pound to 2.00 cents per pound;</li><li>• For vehicles over seven thousand pounds and up to and including ten thousand pounds, the tax rate increases from 1.25 cents per pound to 2.25 cents per pound; and</li><li>• For vehicles over ten thousand pounds net weight, the flat tax rate increases from \$150 to \$300.</li></ul> <i>Effective July 1, 2011.</i> |
| <b>091</b> | <b>Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code.</b> Amends Hawaii's income tax law to conform with changes to the IRC, with exceptions. <i>Effective June 9, 2011, provided that the amendments made to section 235-2.4, Hawaii Revised Statutes, by section 4 of this Act shall not be repealed when section 235-2.4(a), Hawaii Revised Statutes, is repealed and reenacted on December 31, 2015, pursuant to section 6 of Act 60, Session Laws of Hawaii 2009.</i>  |
| <b>097</b> | <b>Relating to Taxation.</b> Eliminates the deduction for state taxes paid for taxpayers with income above specified thresholds as follows: <ul style="list-style-type: none"><li>• \$100,000 for single or married filing separately;</li><li>• \$150,000 for head of household;</li><li>• \$200,000 for joint returns or surviving spouse.</li></ul>   |

Places temporary limitations on claims for itemized tax deductions by the lesser of the limitation provided in section 68 of the Internal Revenue Code or the limitation as follows:

- \$50,000 in the case of a joint return with an adjusted gross income of over \$200,000;
- \$37,500 in the case of a head of household with adjusted gross income of over \$150,000; and
- \$25,000 in the case of an individual with an adjusted gross income of over \$100,000.

Delays the standard deduction and personal exemption increases approved under Act 60, SLH 2009, while also making those increases permanent. *Effective July 1, 2011, applicable to tax years beginning after December 31, 2010.*

- 100 Relating to Conveyance Tax.** Repeals conveyance tax exemption for low-income housing projects certified by the Hawaii Housing Finance and Development Corporation. *Effective July 1, 2011.*
- 101 Relating to Taxation.** Clarifies the Department of Taxation's subpoena authority for civil and criminal tax investigations. *Effective July 1, 2011.*
- 102 Relating to Taxation.** Clarifies violations of record and receipt requirements. Limits fines for violation if person is otherwise in compliance with tax laws to a level commensurate with the violation, as determined by the Department of Taxation in accordance with rules adopted under chapter 91, Hawaii Revised Statutes. *Effective July 1, 2011.*
- 103 Relating to the Transient Accommodations Tax.** Applies a \$10.00 daily transient accommodations tax to each transient accommodation furnished on a complimentary or gratuitous basis, or otherwise at no charge. Imposes a ceiling on the amount of transient accommodation tax funds transferred to the tourism special fund (\$69 million/year) and to the counties (\$93 million/year) from July 1, 2011 through June 30, 2015. *Effective July 1, 2011.*
- 104 Relating to Transportation.** Provides rent relief to airport concessionaires that do not have a self-adjusting rent formula. Extends sunset date of Act 33, First Special Session Laws of Hawaii 2009, until July 1, 2013. Increases the rental motor vehicle surcharge tax under section 251-2(a), Hawaii Revised Statutes, to \$7.50 per day for the period of July 1, 2011 to June 30, 2012, and deposits \$4.50 per day of the tax into the general fund for that period. Suspends the rental motor vehicle customer facility charges under section 261-7(h), HRS, for the period of July 1, 2011 to June 30, 2012. *Effective June 30, 2011, provided that part II of this Act shall take effect on July 1, 2011; provided further that on June 30, 2012, sections 4 and 5 of this Act shall be repealed and sections 251-5 and 261-7, Hawaii Revised Statutes, shall be reenacted in the form in which they read on the day before the effective date of this Act.*
- 105 Relating to Taxation.** Suspends temporarily the exemptions for certain persons and certain amounts of gross income or proceeds from the general excise and use tax and requires the payment of both taxes at a four per cent rate. Applies to the following:

- Subcontractors' deduction;
- Federal cost-plus contractors' exemption for materials, plant, and equipment;
- Home service providers acting as service carriers providing mobile telecommunications services;
- Sublease deduction;
- Certain convention, conference, and trade show fees paid to non-profit organizations;
- Amounts received by a producer of sugarcane from the manufacturer;
- Amounts received for loading, transportation, and unloading agricultural commodities shipped for a producer on one island of this State to another island in this State;
- Sales of liquor, cigarettes, tobacco products, and food to common carriers engaged in interstate or foreign commerce, whether by air or sea;
- Amounts received from loading or unloading ships, tugboat services;
- Amounts received by a labor organization for real property leases to a labor organization;
- Rental or leasing of aircraft or aircraft engines used for interstate transport;
- Amounts received by stock or commodities exchange, including transaction fees, membership dues, service fees, and listing fees;
- Amounts received as grants under section 206M-15 (high technology loans and grants from the State or federal government);
- Aircraft service and maintenance or for construction of an aircraft maintenance facility;
- Sales of liquor, tobacco, and other TPP to the federal government;
- Sales by a petroleum refiner to another refiner;
- Construction of, or income from the operation of, an air pollution control facility
- Gross receipts from shipbuilding and ship repair business;
- Gross receipts from operating a call center by a telecommunications business;
- Enterprise Zone sales and construction, unless business qualified before July 1, 2011;
- Exemption from Use Tax for leasing and renting of aircraft used in interstate air transportation; for use of oceangoing vessels for transportation within the State as a public utility; use of a vessel constructed under section 189-25, HRS, prior to July 1, 1969;
- Exemption from Use Tax for use or sale of liquor, cigarettes or tobacco products imported for resale to a common carrier;

Not subject to the suspension:

- Gross income or gross proceeds from stevedoring and related services furnished to a company by its wholly owned subsidiary;
- If property, services, or contracting is imported or purchased under binding written contracts that were:
  - Entered into prior to July 1, 2011, and
  - Do not permit the passing on of increased tax rates.

*Effective July 1, 2011, and sunsets on June 30, 2013.*

- 158 Relating to Low-Income Housing.** Establishes a program for granting low-income housing tax credit loans in lieu of low-income housing tax credits administered by the Hawaii Housing Finance and Development Corporation. *Effective July 1, 2011, and shall apply to qualified low-income buildings placed in service after December 31, 2011.*
- 161 Relating to the Permitted Transfer in Trust Act.** Amends provisions of the Permitted Transfers in Trust Act governing transfers of property from a transferor to a trustee by means of an irrevocable trust instrument. *Effective July 1, 2011.*
- 167 Relating to Tax Appeals.** Allows discovery with court approval, limits the award of costs in controversies involving small claim tax appeals, and requires notice to the Director of Taxation and the county real property assessment division. *Effective July 1, 2011.*

## COLLECTION AND DISTRIBUTION OF TAXES

### INDIVIDUAL INCOME TAX

Individual income tax collections declined by 18.4% from FY 2010 to FY 2011. Tax refunds of \$186.1 million were delayed from FY 2010 and paid in the first month of FY 2011. Otherwise, the net individual income tax collected would have been \$1.4 billion in FY 2011 and \$1.3 billion in FY 2010, or an increase of \$91.2 million (or 6.8%) in FY 2011 over FY 2010.

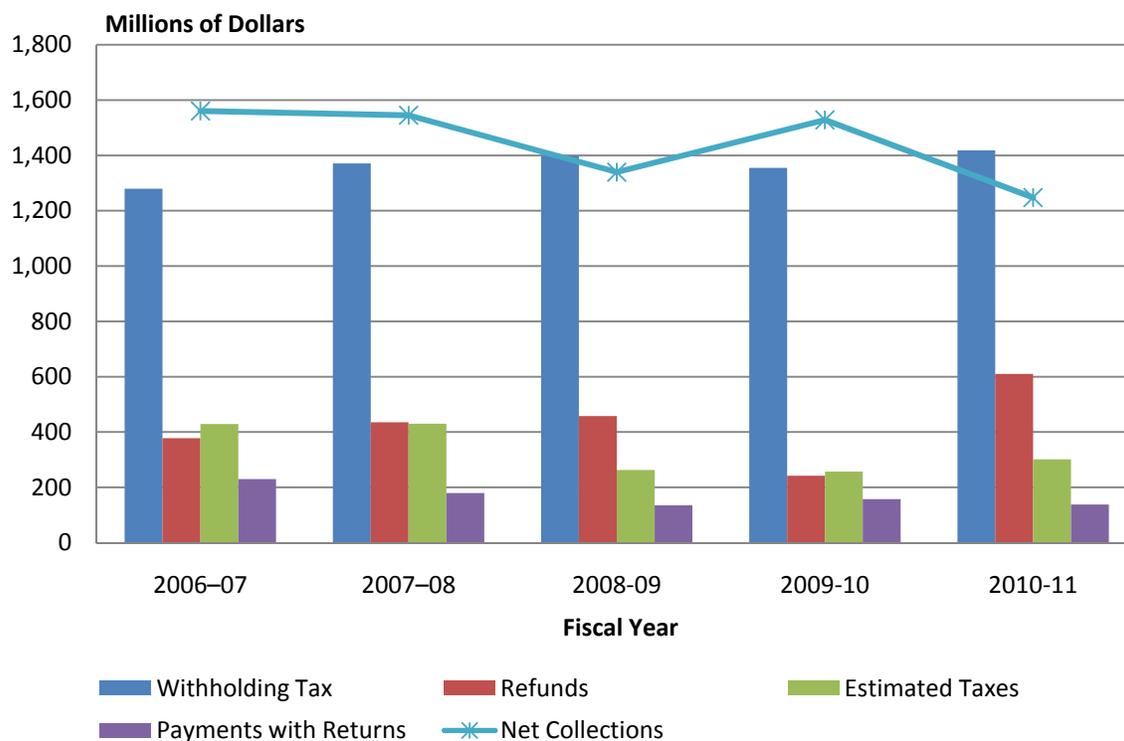
TABLE 1—TAXES PAID BY INDIVIDUALS  
(In thousands of dollars)

	FY 2011	FY 2010	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 301,476	\$ 257,329	\$ 44,147	17.2
Payment with Return	137,754	157,827	(20,073)	(12.7)
Withholding Tax on Wages	1,418,157	1,355,036	63,120	4.7
Subtotal	\$ 1,857,386	\$ 1,770,192	87,194	4.9
Refunds 1/	610,234	242,083	368,151	152.1
NET	\$ 1,247,153	\$ 1,528,110	(280,957)	(18.4)

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

1/ Delay of paying out tax year 2009 income tax refund (\$186.1 million) from FY 2010 into FY 2011.

Chart 1  
Components of the Individual Income Tax



## CORPORATE INCOME TAX

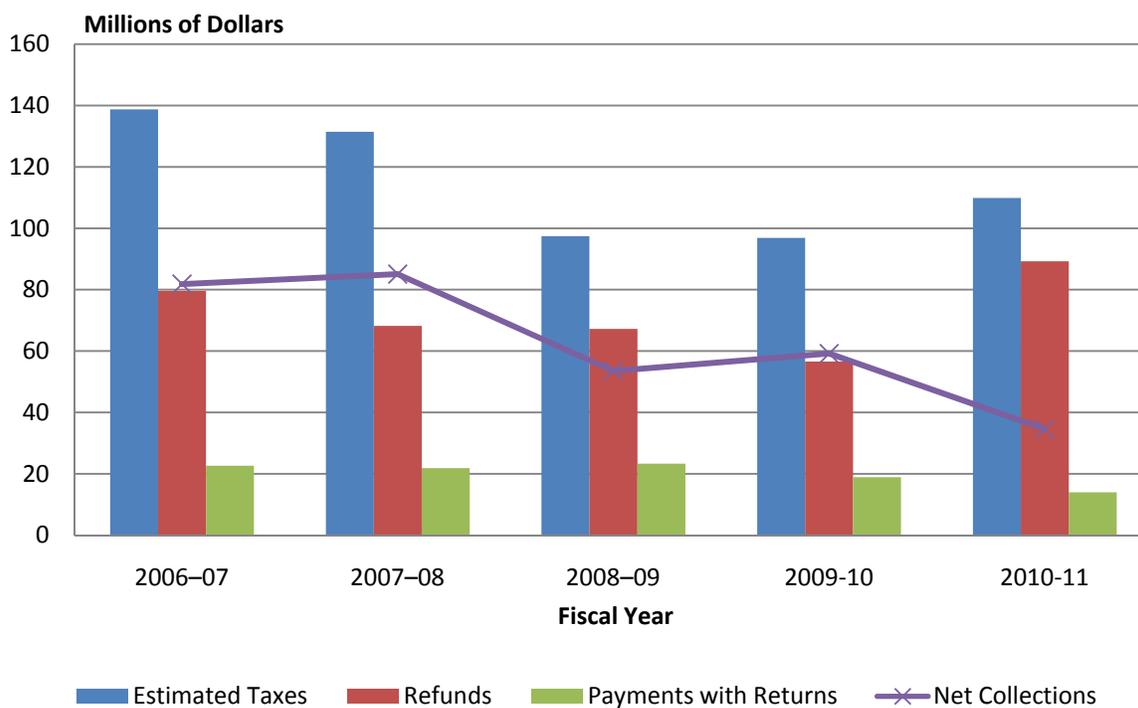
Net corporate income tax collections totaled \$34.6 million in FY 2011, a decrease of 41.6% over the previous year's total of \$59.2 million.

TABLE 2—TAXES PAID BY CORPORATIONS  
(In thousands of dollars)

	FY 2011	FY 2010	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 109,860	\$ 96,855	\$ 13,006	13.4
Payment with Return	13,982	18,911	(4,929)	(26.1)
Subtotal	\$ 123,842	\$ 115,765	\$ 8,077	7.0
Refunds	89,269	56,580	32,689	57.8
NET	\$ 34,573	\$ 59,186	\$ (24,612)	(41.6)

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

Chart 2  
Components of the Corporate Income Tax



## GENERAL EXCISE AND USE TAXES

General excise and use taxes, which made up 47.1% of total tax collections in FY 2011, increased by 7.7% from FY 2010 to a total of \$2.5 billion in FY 2011. All components, except contracting, manufacturing, and insurance commission, were higher in FY 2011 than in FY 2010. Retailing revenues showed much improvement, increasing by \$78.7 million or 8.2% from FY 2010. Services revenues were higher by \$31.6 million or 7.1% from FY 2010. Transient accommodation rentals revenues increased by \$16.7 million or 16.0% compared to the previous year. Rental revenue from all rentals other than from the furnishing of transient accommodations was up by \$8.8 million or 3.8%. Contracting revenues were lower by \$7.0 million or 3.0% from FY 2010.

**Chart 3**  
**General Excise and Use Tax Trends**

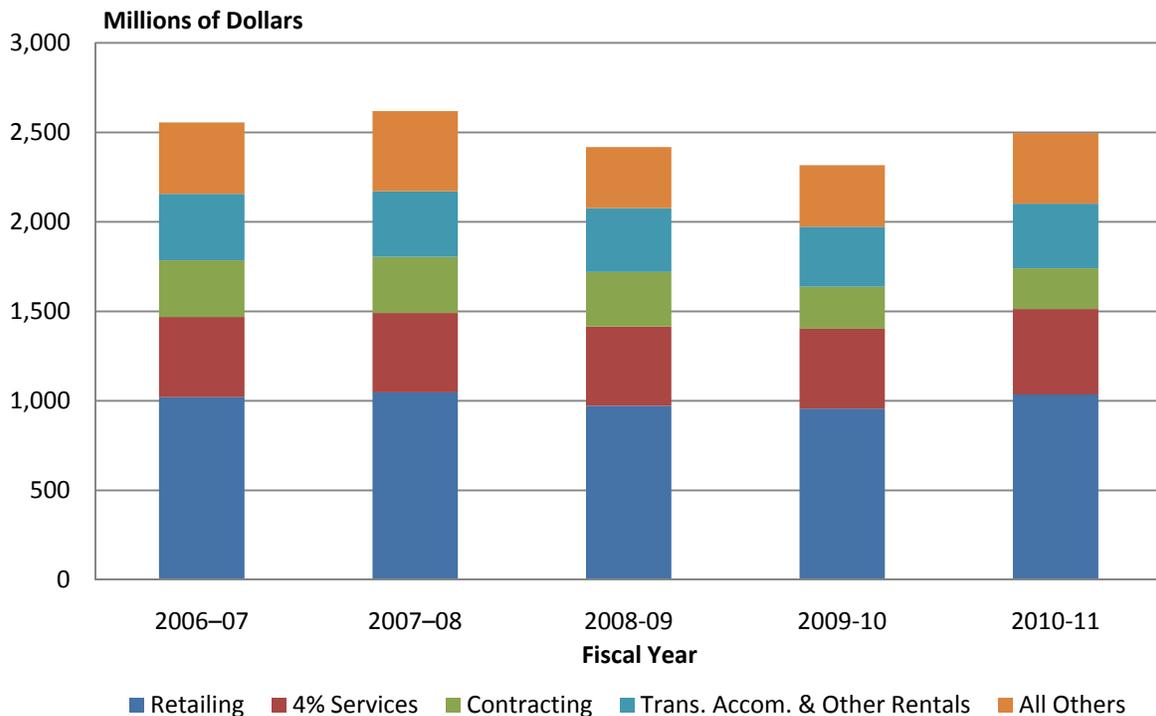


TABLE 3—GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 2011 & 2010  
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2011	FY 2010	Difference	
				Amount	%
<b>TAX BASE</b>					
Retailing		\$ 25,886,624	\$ 23,919,023	\$ 1,967,601	8.2
Services		11,943,830	11,153,552	790,278	7.1
Contracting		5,687,433	5,864,048	(176,615)	(3.0)
Transient Accommod. Rentals		3,023,850	2,606,510	417,340	16.0
All Other Rentals		5,998,588	5,778,068	220,520	3.8
All Others (4%)		4,824,575	4,360,092	464,483	10.7
Subtotal		<u>\$ 57,364,900</u>	<u>\$ 53,681,293</u>	<u>\$ 3,683,607</u>	<u>6.9</u>
Producing		\$ 369,986	\$ 339,417	\$ 30,569	9.0
Manufacturing		697,675	703,483	(5,807)	(0.8)
Wholesaling		13,121,508	12,207,146	914,363	7.5
Use (1/2%)		6,669,355	6,430,375	238,979	3.7
Wholesale Services		577,177	572,402	4,774	0.8
Insurance Commissions		480,437	502,071	(21,634)	(4.3)
Subtotal		<u>\$ 21,916,139</u>	<u>\$ 20,754,894</u>	<u>\$ 1,161,245</u>	<u>5.6</u>
<b>TOTAL-ALL ACTIVITIES</b>		<u><u>\$ 79,281,039</u></u>	<u><u>\$ 74,436,188</u></u>	<u><u>\$ 4,844,851</u></u>	<u><u>6.5</u></u>
<b>TAX</b>					
Retailing	4.00%	\$ 1,035,465	\$ 956,761	\$ 78,704	8.2
Services	4.00%	477,753	446,142	31,611	7.1
Contracting	4.00%	227,497	234,562	(7,065)	(3.0)
Transient Accommod. Rentals	4.00%	120,954	104,260	16,694	16.0
All Other Rentals	4.00%	239,944	231,123	8,821	3.8
All Others	4.00%	192,984	174,404	18,580	10.7
Subtotal		<u>\$ 2,294,597</u>	<u>\$ 2,147,252</u>	<u>\$ 147,345</u>	<u>6.9</u>
Producing	0.50%	\$ 1,850	\$ 1,697	\$ 153	9.0
Manufacturing	0.50%	3,488	3,517	(29)	(0.8)
Wholesaling	0.50%	65,608	61,036	4,572	7.5
Use (1/2%)	0.50%	33,347	32,152	1,195	3.7
Wholesale Services	0.50%	2,886	2,862	24	0.8
Insurance Commissions	0.15%	721	753	(32)	(4.3)
Subtotal		<u>\$ 107,899</u>	<u>\$ 102,017</u>	<u>\$ 5,882</u>	<u>5.8</u>
Unallocated 1/		\$ 93,312	\$ 67,165	\$ 26,147	38.9
<b>TOTAL-ALL ACTIVITIES</b>		<u><u>\$ 2,495,808</u></u>	<u><u>\$ 2,316,434</u></u>	<u><u>\$ 179,375</u></u>	<u><u>7.7</u></u>

NOTE: Due to rounding detail may not add to totals.

1/ Includes collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements, and business activities of disabled persons.

## TRANSIENT ACCOMMODATIONS TAX

Transient accommodations tax collections totaled \$284.5 million for FY 2011, an increase of \$60.2 million or 26.9% from last fiscal year. Transient accommodations tax funds were 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. In FY 2011, an additional 2% TAT was levied and all proceeds from the increase were allocated to the General Fund except in FY 2011, 12.5% of the additional 2% was allocated to the tourism special fund. In FY 2011, \$59.8 million was deposited into the General Fund; an increase of \$28.1 million over FY 2010.

TABLE 4—TRANSIENT ACCOMMODATIONS TAX  
(In thousands of dollars)

	FY 2011	FY 2010	Difference	
			Amount	%
<b>COLLECTION</b>				
Transient Accommodations Tax	\$ 271,755	\$ 214,219	\$ 57,536	26.9
Time Share Occupancy Tax	12,708	10,023	2,684	26.8
Trans. Accom./Time Share Occup. Fees	9	9	1	10.0
<b>TOTAL</b>	<b>\$ 284,472</b>	<b>\$ 224,251</b>	<b>\$ 60,221</b>	<b>26.9</b>
<b>DISTRIBUTION *</b>				
Counties Share	\$ 102,931	\$ 90,568	\$ 12,363	13.7
Convention Center Fund	36,795	32,838	3,957	12.1
Tourism Special Fund	84,981	69,139	15,842	22.9
General Fund	59,766	31,705	28,061	88.5
<b>TOTAL</b>	<b>\$ 284,472</b>	<b>\$ 224,250</b>	<b>\$ 60,221</b>	<b>26.9</b>

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

\* For detailed percentages of distribution see HRS, 237D-6.5.

## **FUEL AND MOTOR VEHICLE TAXES**

Total taxable fuel consumption increased by 4.7% to 884.0 million gallons in FY 2011. The environmental response tax was modified to be called the environmental response, energy, and food security tax, and the rate was increased from \$0.05 to \$1.05 on each barrel of petroleum product sold by a distributor to any retail dealer or end user. A total of 28.1 million barrels of petroleum was subjected to the environmental response tax in FY 2011, a decline of 1.3% from the previous year.

The revenues from fuel taxes are distributed to several special funds. One percent of the fuel taxes paid on liquid fuel are deposited into the Boating Special Fund. Fuel taxes paid on sales of aviation fuel are deposited into the Airport Revenue Fund.

Environmental response, energy, and food security tax collections are deposited into the Environmental Response Revolving Fund, Energy Security Special Fund, Energy Systems Development Special Fund, and Agricultural Development and Food Security Special Fund. The Environmental Response Revolving Fund is administered by the Department of Health for oil spill prevention and remediation programs. The Energy Security and Energy Systems Development Special Funds are administered by the Department of Business Economic Development and Tourism to support the Hawaii clean energy initiative program. The Food Security Special Fund is administered by the Department of Agriculture to fund activities intended to increase agricultural production or processing that may lead to reduced importation of food, fodder, or feed from outside the state.

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.

TABLE 5—GALLONS OF FUEL CONSUMED  
(In Thousands of Gallons)

	FY 2011	FY 2010	Difference	
			Amount	%
Gasoline	445,756	411,419	34,337	8.3
Diesel Oil - Nonhighway	144,815	152,118	(7,303)	(4.8)
Diesel Oil - Highway	51,246	47,606	3,640	7.6
Liq. Pet. Gas - Highway	53	65	(12)	(18.6)
Small Boats - Gasoline	964	1,390	(426)	(30.7)
Small Boats - Diesel Oil	4,161	1,001	3,160	315.7
Aviation Fuel	202,269	179,609	22,660	12.6
Other Fuel 1/	34,770	51,353	(16,583)	(32.3)
<b>TOTAL-GALLONS</b>	<b>884,033</b>	<b>844,560</b>	<b>39,473</b>	<b>4.7</b>
Environmental Tax (Barrel)	28,057	28,427	(370)	(1.3)

NOTE: Due to rounding detail may not add to totals.

1/ Starting September 2007, includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

Chart 4  
Trends in Fuel Consumption

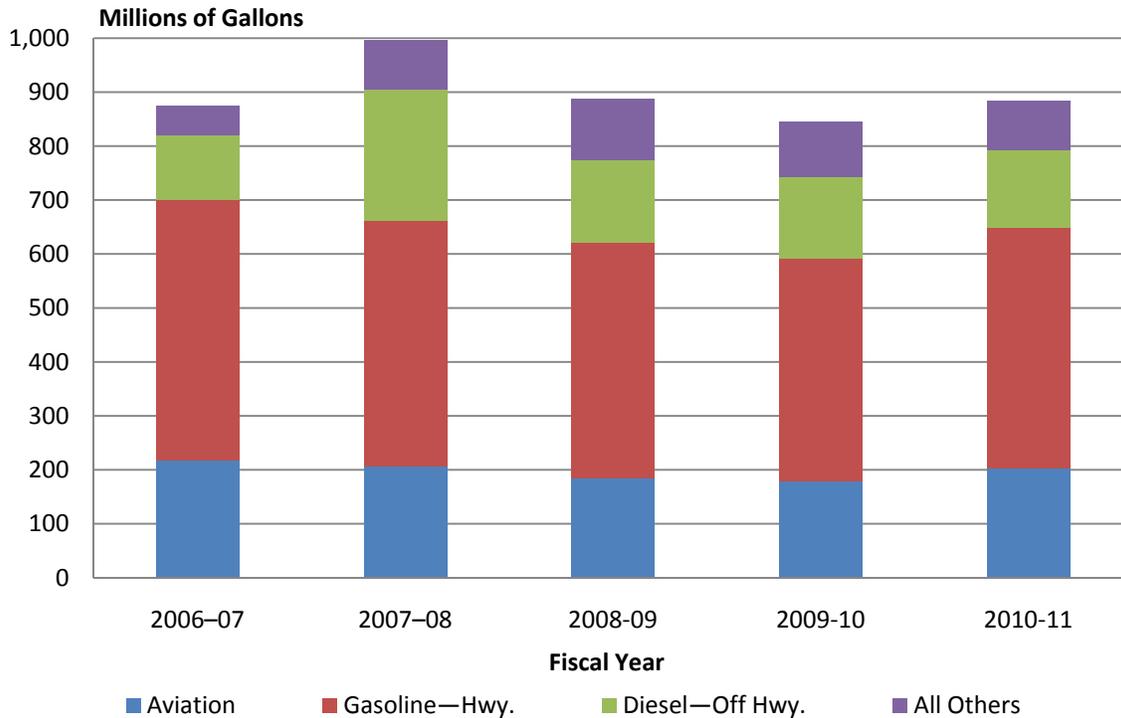


TABLE 6—ALLOCATION OF FUEL TAXES  
(In thousands of dollars)

	FY 2011	FY 2010	Difference	
			Amount	%
<b>STATE HIGHWAY FUND</b>				
Fuel	\$ 89,599	\$ 81,271	\$ 8,328	10.2
Motor Vehicle Tax/Fees	106,166	102,319	3,846	3.8
TOTAL	\$ 195,765	\$ 183,590	\$ 12,174	6.6
<b>COUNTY HIGHWAY FUNDS</b>				
City & County of Honolulu	\$ 52,298	\$ 47,639	\$ 4,659	9.8
County of Maui	11,085	9,679	1,406	14.5
County of Hawaii	7,753	6,997	756	10.8
County of Kauai	4,163	3,596	567	15.8
TOTAL	\$ 75,299	\$ 67,911	\$ 7,388	10.9
BOATING SPECIAL FUND	\$ 1,666	\$ 1,507	\$ 159	10.5
<b>STATE AIRPORT FUND</b>				
Aviation Fuel	\$ 4,045	\$ 3,592	\$ 453	12.6
<b>ENVIRONMENTAL RESPONSE REVOLVING FUND</b>				
	\$ 1,403	\$ 1,421	\$ (18)	(1.3)
ENERGY SECURITY FUND	\$ 3,499	\$ -		
<b>ENERGY SYSTEMS DEVELOPMENT FUND</b>				
	\$ 2,332	\$ -		
<b>AGRICULTURAL DEVELOPMENT &amp; FOOD SECURITY FUND</b>				
	\$ 3,499	\$ -		
<b>GENERAL FUND</b>	\$ 13,995	\$ -		

NOTE: Due to rounding detail 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 2011 are shown below:

FUEL TAX RATES PER GALLON\*

TYPE OF FUEL	State	County	Total
<b>Gasoline &amp; Diesel Oil (Highway Use)</b>			
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¢
<b>Liquid Petroleum Gas (Highway Use)</b>			
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¢
<b>Ethanol (Highway Use)</b>			
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¢
<b>Methanol (Highway Use)</b>			
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¢
<b>Biodiesel (Highway Use)</b>			
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¢
<b>Compressed Natural Gas (Highway Use)</b>			
City & County of Honolulu	0.8¢	1.3¢	2.1¢
County of Maui	0.8¢	1.2¢	2.0¢
County of Hawaii	0.8¢	0.7¢	1.5¢
County of Kauai	0.8¢	1.0¢	1.8¢
<b>Liquefied Natural Gas (Highway Use)</b>			
City & County of Honolulu	2.4¢	4.7¢	7.1¢
County of Maui	2.4¢	4.5¢	6.9¢
County of Hawaii	2.4¢	2.5¢	4.9¢
County of Kauai	2.4¢	3.7¢	6.1¢
<b>Environmental Response Tax (Per Barrel)</b>			
All Counties	105.0¢	0.0¢	105.0¢

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

## **PUBLIC SERVICE COMPANY TAXES**

Public utilities paid \$117.9 million in public service company tax, penalty, and interest in FY 2011, compared to \$157.7 million in FY 2010.

## **ESTATE AND TRANSFER TAXES**

During FY 2011, estate tax collections totaled \$6.9 million, compared to less than \$1,000 in FY 2010.

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

Act 74, Session Laws of Hawaii 2010, reenacts Hawaii's Estate and Transfer Tax for decedents dying after April 30, 2010. The new tax makes the Internal Revenue Code ("IRC") operative for purposes of the estate and transfer tax as of December 31, 2009. However, IRC section 2011 (federal estate tax credit for state death taxes paid) and IRC section 2604 (federal credit for state generation-skipping transfer taxes paid), which are used to define the Hawaii estate tax base, are made operative as of December 31, 2000. An applicable exclusion amount of up to \$3.5 million per decedent is provided. The tax also is imposed on transfers made by nonresidents who are not United States citizens.

## **OTHER TAXES**

Total revenues from other miscellaneous taxes amounted to \$803.5 million in FY 2011, \$212.4 million more than the previous fiscal year. Employment security contributions increased by \$108.5 million in FY 2011. Insurance premium tax collections were higher by \$35.7 million in FY 2011. Tobacco tax collections rose by \$19.8 million.

Act 316, SLH 2006, and Act 56, SLH 2009 contributed to the increase in tobacco tax collections. Act 316 increased the excise tax per cigarette by one cent per year over a six year period that began on September 30, 2006. Act 56 increased the tax on cigarettes to \$0.13 each effective July 1, 2009, \$0.14 each effective July 1, 2010, and \$0.15 each effective July 1, 2011. Act 316 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 Trauma System Special Fund and the Emergency Medical Services Special Fund began a year later, and allocations to the Community Health Centers Special Fund began on October 1, 2008.

The Bureau of Conveyances under the Department of Land and Natural Resources collected \$47.9 million in conveyance taxes in FY 2011, up from \$40.6 million collected in FY 2010. Of the total, \$21.5 million was allocated to the General Fund, the remainder going to the Rental Housing Fund, Natural Area Reserve Fund, and Land Conservation Fund.

Liquor tax collections increased to \$48.1 million in FY 2011, up from \$44.1 million in the previous fiscal year. Franchise taxes collected from banks and other financial corporations increased to \$33.7 million from \$20.7 million in the previous fiscal year.

Act 247, SLH 2005, granted counties the authority to pass an ordinance imposing a county surcharge of no more than 0.5% on gross income subjected to the State's 4% general excise tax to fund county public transportation systems. The Act specified that the county surcharge tax be levied no earlier than January 1, 2007, and that the ordinance be automatically 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 to adopt an ordinance levying a 0.5% county surcharge tax. The Honolulu county surcharge tax took effect on January 1, 2007. In FY 2011, \$199.0 million in county surcharge tax was collected on behalf of the City and County of Honolulu, an increase from the \$175.1 million collected in FY 2010.

TABLE 7—MISCELLANEOUS TAXES <sup>1/</sup>  
(In thousands of dollars)

	FY 2011	FY 2010	Difference	
			Amount	%
Banks & Other Financial Corp.	\$ 33,677	\$ 20,666	\$ 13,011	63.0
Conveyance	47,906	40,634	7,272	17.9
Empl. Security Contributions	190,511	82,017	108,494	132.3
Insurance Premiums	140,456	104,721	35,735	34.1
Insurance Fees	4,869	293 <sup>2/</sup>	4,576	1,561.8
Liquor & Permits	48,054	44,074	3,980	9.0
Tobacco & Licenses	143,293	123,489	19,804	16.0
General Excise Licenses & Fees	479	449	30	6.6
Honolulu County Surcharge	199,010	175,062	23,948	13.7
<b>TOTAL</b>	<b>\$ 808,254</b>	<b>\$ 591,405</b>	<b>\$ 216,849</b>	<b>36.7</b>

NOTE: Due to rounding detail may not add to totals.

1/ Before allocation to special funds or other funds.

2/ One month collection.

## TOTAL TAX COLLECTIONS

Total tax collections in FY 2011 amounted to \$5.3 billion, or about 3.2% more than the \$5.1 billion collected in the previous fiscal year. While the Department of Taxation collected the majority of the total taxes, the counties collected \$62.3 million in State motor vehicle weight taxes and registration fees, the Department of Commerce and Consumer Affairs collected \$145.3 million in insurance premium taxes, the Department of Land and Natural Resources collected \$47.9 million in conveyance taxes, and the Department of Labor and Industrial Relations collected \$190.5 million in employment security contributions.

TABLE 8—TAX COLLECTIONS  
(In thousands of dollars)

SOURCE OF REVENUE	FY 2011		FY 2010	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 33,677	0.64	\$ 20,666	0.40
Conveyance	47,906	0.90	40,634	0.79
Employment Security Contributions	190,511	3.60	82,017	1.60
Fuel	195,336	3.69	155,703	3.03
General Excise & Use	2,495,807	47.12	2,316,434	45.11
Honolulu County Surcharge	199,010	3.76	175,061	3.41
Income - Corporations	34,573	0.65	59,186	1.15
Income - Individuals	1,247,153	23.54	1,528,110	29.76
Inheritance and Estate	6,899	0.13	0	0.00
Insurance Premiums & Fees	145,325	2.74	105,014	2.05
Liquor & Permits	48,054	0.91	44,074	0.86
Motor Vehicle Tax 1/	106,166	2.00	102,319	1.99
Public Service Companies	117,940	2.23	157,661	3.07
Tobacco & Licenses	143,293	2.71	123,489	2.40
Trans. Accom. Fees	9	0.00	9	0.00
Trans. Accom. Tax	284,463	5.37	224,243	4.37
All Others 2/	939	0.02	482	0.01
<b>TOTAL</b>	<b>\$ 5,297,062</b>	<b>100.00</b>	<b>\$ 5,135,100</b>	<b>100.00</b>

1/ Includes Motor Vehicle Weight Tax, Registration Fees, Commercial Driver's License, Periodic Mtr. Vehicle Inspection, Rental Vehicle Registration Fees, and Rental Vehicle Surcharge Tax.

2/ Includes fuel retail dealers permits, penalty and interest, Permitted Transfers Tax, and General Excise Fees.

## DISTRIBUTION OF TAXES

Of the total \$5.3 billion in tax revenues collected in FY 2011, \$4.3 billion or 81.7% was deposited into the State's General Fund. The four counties received \$178.2 million or 3.3% of the tax collections, which came from county fuel taxes and the transient accommodations tax. In

addition, \$199.0 million was collected and credited to the City and County of Honolulu county surcharge tax.

The remaining \$590.5 million of tax revenue not deposited into the General Fund or transferred to the counties was distributed among several State special funds. The State Highway Fund received the largest portion, \$195.8 million. All \$190.5 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: \$85.0 million to the Tourism Special Fund and \$36.8 million to the Convention Center Fund.

For FY 2011, 10% of the conveyance tax was allocated to the Land Conservation Fund, 25% was allocated to the Rental Housing Trust Fund and 25% was allocated to the Natural Area Reserve Fund. The balance of the conveyance tax collections (40%) was allocated to the General Fund.

Effective July 1, 2010, 2.0 cents of the 14 cents tax per cigarette was allocated to the Hawaii Cancer Research Special Fund (which received a total of \$17.5 million), 0.75 cents of the cigarette tax was allocated to the Trauma Systems Special Fund (which received a total of \$6.5 million), 0.75 cents of the cigarette tax was allocated to the Community Health Centers Special Fund (which received a total of \$6.5 million), and 0.50 cents of the cigarette tax was allocated to the Emergency Medical Services Special Fund (which received a total of \$4.3 million)

Distributions of State tax revenue into the General Fund are shown in Table 9. Distributions of all tax collections are shown in Table 10.

TABLE 9—STATE GENERAL FUND  
(In thousands of dollars)

SOURCE OF REVENUE	FY 2011		FY 2010	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 31,677	0.73	\$ 18,666	0.43
Conveyance	21,527	0.50	18,216	0.42
General Excise & Use	2,495,807	57.65	2,316,434	53.07
Income - Corporations	34,573	0.80	59,186	1.36
Income - Individuals	1,246,672	28.80	1,527,619	35.00
Inheritance & Estate	6,899	0.16	0	0.00
Insurance Premiums	140,456	3.24	104,721	2.40
Liquor & Licenses	48,054	1.11	44,074	1.01
Public Service Companies	117,940	2.72	157,661	3.61
Tobacco & Licenses	106,137	2.45	85,503	1.96
Trans. Accom. Tax	59,757	1.38	31,696	0.73
All Others 1/	19,812	0.46	783	0.02
<b>TOTAL</b>	<b>\$ 4,329,311</b>	<b>100.00</b>	<b>\$ 4,364,559</b>	<b>100.00</b>

NOTE: Due to rounding detail may not add to totals.

1/ Includes fuel retail dealer permits, fuel penalty and interest, Permitted Transfers Tax, General Excise Fees, Transient Accommodations Fees, Environmental Tax, and Insurance Fees.

TABLE 10—DISTRIBUTION OF COLLECTIONS  
(In thousands of dollars)

	FY 2011		FY 2010	
	Amount Distributed	% of Total	Amount Distributed	% of Total
<b>STATE FUNDS:</b>				
State General	\$ 4,329,311	81.73	\$ 4,364,559	84.99
State Highway	195,765	3.70	183,590	3.58
State Airport	4,045	0.08	3,592	0.07
Boating Special Fund	1,666	0.03	1,507	0.03
Environmental Fund	1,403	0.03	1,421	0.03
Cigarette Stamp Admin/Enf. Fund	2,231	0.04	1,988	0.04
Compliance Resolution Fund	2,000	0.04	2,000	0.04
Unemployment Trust	190,511	3.60	82,017	1.60
Election Campaign Fund	223	0.00	217	0.00
Tourism Special Fund	84,981	1.60	69,139	1.35
Rental Housing Fund	11,990	0.23	10,190	0.20
Land Conservation Fund	4,796	0.09	4,076	0.08
Natural Area Reserve Fund	9,592	0.18	8,152	0.16
Convention Center Fund	36,795	0.69	32,838	0.64
Public Libraries Fund	62	0.00	68	0.00
Domestic Violence/Child Abuse	129	0.00	134	0.00
School Repair & Maintenance Fund	66	0.00	72	0.00
Cancer Research Fund	17,496	0.33	17,966	0.35
Trauma System Fund	6,544	0.12	6,754	0.13
Emergency Medical Service Fund	4,341	0.08	4,525	0.09
Community Health Centers Fund	6,544	0.12	6,754	0.13
Energy Security Fund	3,499	0.07	0	0.00
Energy Systems Development Fund	2,332	0.04	0	0.00
Agricultural Dev. & Food Security Fund	3,499	0.07	0	0.00
Subtotal - State	\$ 4,919,822	92.88	\$ 4,801,559	93.50
HONOLULU COUNTY SURCHARGE:	\$ 199,010	3.76	\$ 175,061	3.41
<b>REVENUES TRANSFERRED TO COUNTIES:</b>				
Other County Revenues				
Fuel	\$ 75,299	1.42	\$ 67,911	1.32
Trans. Accom. Tax	102,931	1.94	90,568	1.76
Subtotal - Counties	\$ 178,230	3.36	\$ 158,480	3.09
<b>TOTAL</b>	<b>\$ 5,297,062</b>	<b>100.00</b>	<b>\$ 5,135,100</b>	<b>100.00</b>

NOTE: Due to rounding detail 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 the more common sales tax in some other states and localities, 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 and its complementary 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 either 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. Two refundable non-business income tax credits, the food/excise tax credit and the credit for low-income household renters, specifically provide tax relief to lower-income taxpayers.

The refundable food/excise tax credit is allowed resident individuals, including those with no gross income, in amounts ranging from \$85 to \$25 per qualified exemption for resident individuals who have less than \$50,000 of federal adjusted gross income; those with the lowest incomes are eligible for the highest credit amounts. 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.

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, except the collections from the \$4.50 per day surcharge tax for the period of July 1, 2011 to June 30, 2012 are deposited into the General Fund.

# OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2011

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(1) Net Income Chapter 235 — Section 235-1 to 235-130</p>	<p>For taxable years beginning after December 31, 2008, the tax rates for individuals range from 1.4% to 11% of taxable income. The standard deduction amounts are 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. The tax rates for estates and trusts range from 1.4% to 8.25%. The 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.</p>	<p>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.</p>	<p>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).</p>
<p>(2) Estate and Transfer (for decedents dying after 4/30/10) Chapter 236D — Section 236D-1 to 236D-18</p>	<p>Act 74, SLH 2010, reenacts Hawaii's Estate and Transfer Tax for decedents dying after April 30, 2010. The new definition of "Internal Revenue Code" makes the IRC operative for purposes of the estate and transfer tax as of December 31, 2009. However, IRC section 2011 (federal estate tax credit for state death taxes paid) and IRC section 2604 (federal credit for state generation-skipping transfer taxes paid), which comprise the Hawaii estate tax base, are made operative as of December 31, 2000. An applicable exclusion amount of up to \$3,500,000 per decedent is provided. Also, IRC section 2058 (deduction for state death taxes paid) is not made operative. The tax also is imposed on transfers made by nonresidents who are not United States citizens.</p>	<p>Returns due 9 months from the decedent's date of death. An automatic 6-month extension of time to file may be requested.</p>	<p>At time of filing returns.</p>
<p>(3) General Excise (Gross Income) Chapter 237 — Section 237-1 to 237-49</p>	<p>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.</p>	<p>Monthly returns are due on or before the 20th 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 20th 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 20th day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(4) Transient Accommodations tax</p> <p>Chapter 237D — Section 237D-1 to 237D-16</p>	<p>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.</p> <p>Effective July 1, 2010, the transient accommodations tax rate is 9.25%.</p> <p>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.</p> <p>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.</p> <p>Effective July 1, 2011, Act 103, SLH 2011, imposes a \$10 per day transient accommodations tax on complimentary rooms.</p>	<p>Monthly returns are due on or before the 20th 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 20th 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 20th day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(5) Use</p> <p>Chapter 238 — Section 238-1 to 238-16</p>	<p>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.</p> <p>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.</p> <p>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.</p>	<p>Monthly returns are due on or before the 20th 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 20th 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 20th 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.</p>	<p>At time of filing returns.</p>
<p>(6) Public Service Company</p> <p>Chapter 239 — Section 239-1 to 239-25</p>	<p>Nature of Tax—Public utility business in lieu of general excise tax.</p> <p>(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.</p>	<p>Returns filed on or before the 20th day of the 4th month following the close of the taxable year, passed upon operations of the preceding taxable year.</p>	<p>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.</p>
<p>(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations</p> <p>Chapter 241 — Section 241-1 to 241-7</p>	<p>(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.</p>	<p>Returns filed on or before the 20th day of the 4th month following the close of the taxable year, passed upon operations of the preceding taxable year.</p>	<p>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.</p>

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, 2¢ per gallon on 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-36. 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, Energy, and Food Security Tax of \$1.05 per barrel or a fractional part of a barrel of petroleum product that is not aviation fuel sold by a distributor to a retail dealer or end user is also imposed. 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 20th 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 20th 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 the sale or use of tobacco products and on each cigarette sold, used, or possessed. The tax on cigarettes and little cigars is increased to 16¢ per cigarette or little cigar sold on and after July 1, 2011. The tobacco tax is imposed as follows: (1) Tobacco products (other than large cigars), 70% of the wholesale price, (2) Large cigars, 50% of the wholesale price, (3) Little cigars, 16¢ for each little cigar. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year. Cigarette and tobacco wholesalers and dealers are required to affix stamps to individual cigarette packages as proof of payment of cigarette taxes. 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 20th 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	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. The conveyance tax rate ranges from 10¢ per \$100 for properties with a value of less than \$600,000 to \$1 per \$100 for properties with a value of \$10,000,000, or greater. 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 rate ranges from 15¢ per \$100 for properties with a value of less than \$600,000 to \$.25 per \$100 for properties with a value of \$10,000,000, or greater. (Documents of certain conveyances are exempted.)	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	For the period July 1, 2011, through June 30, 2012, Act 104, SLH 2011, increases the rental motor vehicle surcharge tax from \$3.00 to \$7.50 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee.	Monthly returns are due on or before the 20th 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 20th 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 20th 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	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%. There is also an additional employment and training (E & T) fund assessment on taxable wages paid to an employee. For 2011, the percentage rate for this additional tax is .02%. The E & T assessment is applicable to all employing units with unemployment insurance contribution rates of 0.00% to 5.4%. 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. (For 2011, the tax base is 90% of the state's annual average wages per legislation.) <b>Note:</b> The tax base for calendar year 2011 has been set at \$34,200.	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	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.	Monthly tax statement is due on or before the 20th day of the calendar month following the month in which the taxes accrue. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.	At time of filing statements.

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