

DEPARTMENT OF TAXATION STATE OF HAWAII



ANNUAL REPORT 2011–2012

April 18, 2013

DEPARTMENT OF TAXATION

VISION

"The Department of Taxation will efficiently and effectively collect the revenue for funding programs and services for the people of Hawaii."

MISSION

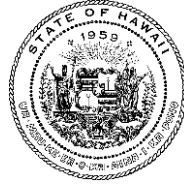
"Our mission is to administer the tax laws for the State of Hawaii in a consistent, fair and uniform manner."

GOALS

1. To *"Increase Voluntary Compliance"*
2. To *"Improve Processing"* which will be accomplished in three ways
 - a. Business Process Re-engineering
 - b. Tax Systems Modernization
 - c. Electronic Processing
3. To *"Enhance Productivity"* covering three areas
 - a. Human Resources
 - b. Resources
 - c. Management Information Reports

NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

April 18, 2013

The Honorable Neil Abercrombie
Governor, State of Hawaii
Executive Chambers, State Capitol

Dear Governor Abercrombie:

I am pleased to present you with the attached Annual Report summarizing the major operations of the Department of Taxation (DOTAX) for the fiscal year ending June 30, 2012.

DOTAX plays a key role in public finance by collecting most of the revenues that fund the services and programs provided by the State of Hawaii. The Department's net total tax collections were \$6.0 billion in fiscal year 2012, which is up by 13.4% over the \$5.3 billion collected in fiscal year 2011. This increase was amplified, however, by the delay in paying income tax refunds by the previous Administration. Refunds of individual and corporate income taxes totaling \$187.4 million were withheld toward the end of fiscal year 2010 and paid out in the first month of fiscal year 2011. If the refunds had been timely released, net total collections would have been \$5.5 billion in fiscal year 2011 and the growth rate for fiscal year 2012 would have been 9.5%.

Beginning with this annual report, we are including multi-years trend analyses in a new section covering Hawaii taxes because the sources of revenue for the State are major factors to consider in public finance. An analysis shows that taxes allocated to the General Fund totaled \$5.0 billion in fiscal year 2012, an increase of 15% from the \$4.3 billion allocated in fiscal year 2011. Collections of Hawaii's largest source of revenue, the General Excise Tax, grew from \$2.5 billion in fiscal year 2011 to \$2.7 billion in fiscal year 2012, or by 8.1%. The next largest source of revenue is the Individual Income Tax which totaled \$1.5 billion in fiscal year 2012, an increase from the \$1.2 billion in fiscal year 2011.

DOTAX's operations continue to suffer from the 2009-2010 reduction in staffing and accompanying budget cuts. Beginning in 2011, DOTAX's new management developed a strategic plan to position the organization for the 21st century and to set goals towards increasing voluntary compliance, improving processing and enhancing productivity.

The staffing reductions in the Taxpayer Services Branch resulted in the call answer rate decreasing from 80% in 2009 to 40% in fiscal year 2011. While the pick-up rate increased to 57% in fiscal year 2012, the improvement can be partly attributed to a decrease in the number of

calls, which had significantly spiked upward in fiscal year 2011 due to the many inquiries on delayed refunds put in place by the previous Administration. The total number of taxpayers serviced at the counter, through correspondence and by telephone increased from about 317 thousand in the previous fiscal year to about 332 thousand in fiscal year 2012.

The Department's compliance programs also continued to operate under challenging conditions after the 2009-2010 staffing reductions. The Office Audit unit increased the number of audits and the total amount assessed from last fiscal year, but assessments remained substantially below the levels in fiscal years 2009 or 2010. Total assessments were \$26.5 million in fiscal year 2012, versus \$87.9 million in fiscal year 2009, \$42.1 million in fiscal year 2010 and \$23.7 million in fiscal year 2011. The Field Audit unit completed fewer audits and also had lower assessments in fiscal year 2012 than in fiscal year 2011. Its total assessments fell from \$158.1 million in fiscal year 2009 to \$118.9 million in fiscal year 2010, to \$95.9 million in fiscal year 2011, and to \$51.2 million in fiscal year 2012. After the hiring freeze was lifted, section heads have been focusing on filling vacant positions which would result in assessments and collections of additional tax revenue. DOTAX presently audits less than 1% of total taxpayer accounts; the strategic plan aims to increase compliance efforts through market segment specialization and an audit plan covering 2% of taxpayer population. This will be accomplished through expanding staffing and using technology for audit selection and data matching.

The strategic plan also covers providing adequate training as well as the resources needed by DOTAX employees. A major part of the strategic plan is Tax Systems Modernization (TSM) which has been in the planning stage for the past two years of this administration. TSM will involve the design and implementation of a new computer system over the next 3 to 4 years. In preparing for TSM, DOTAX section heads have been encouraged to utilize business process re-engineering to identify better ways of doing manual processes and to redesign management information reports to better capture performance measures. These efforts will support TSM which will also look at increasing electronic filing from 30% to 80% of all tax returns filed. In the biennial FY2014-2015 budget, DOTAX has requested funding for the TSM capital improvement project and operations.

In fiscal year 2013, the Department will continue efforts to modernize its operations. Modernization will help reduce the costs of tax administration and will help the Department achieve its goal of increasing voluntary compliance, improving processing and enhancing productivity.

Sincerely,

/s/

FREDERICK D. PABLO
Director of Taxation

TABLE OF CONTENTS

LETTER OF TRANSMITTAL TO THE GOVERNOR

COLLECTION AND DISTRIBUTION OF TAXES.....	1
Overview.....	1
General Excise and Use Taxes.....	3
Individual Income Tax.....	7
Corporate Income Tax	9
Transient Accommodations Tax	11
Fuel Taxes	13
Motor Vehicle Taxes.....	17
Cigarette and Tobacco Tax	19
Public Service Company Taxes	20
Unemployment Insurance Taxes.....	21
Insurance Premium Tax	22
Liquor Tax	23
Conveyance Tax.....	24
Bank and Other Financial Corporations Tax	25
Estate and Transfer Taxes	26
City and County of Honolulu Surcharge Tax	28
Total Tax Collections.....	28
Distribution of Taxes	29
Trends in Tax Collections	32
TAX ADMINISTRATION.....	34
Overall Performance	34
Tax Services and Processing Division.....	36
Compliance Division	39
Staff Offices	47
MANAGEMENT PERSONNEL.....	55
ORGANIZATION CHART.....	56
DISTRICT OFFICES.....	57
TAX APPEALS AND LITIGATION	59
Boards of Taxation Review	59
Civil Decisions, Settlements, and Other Legal Matters	59
ADMINISTRATIVELY ATTACHED ENTITIES	68
Council on Revenues	68
Tax Review Commission.....	68
Boards of Taxation Review	68

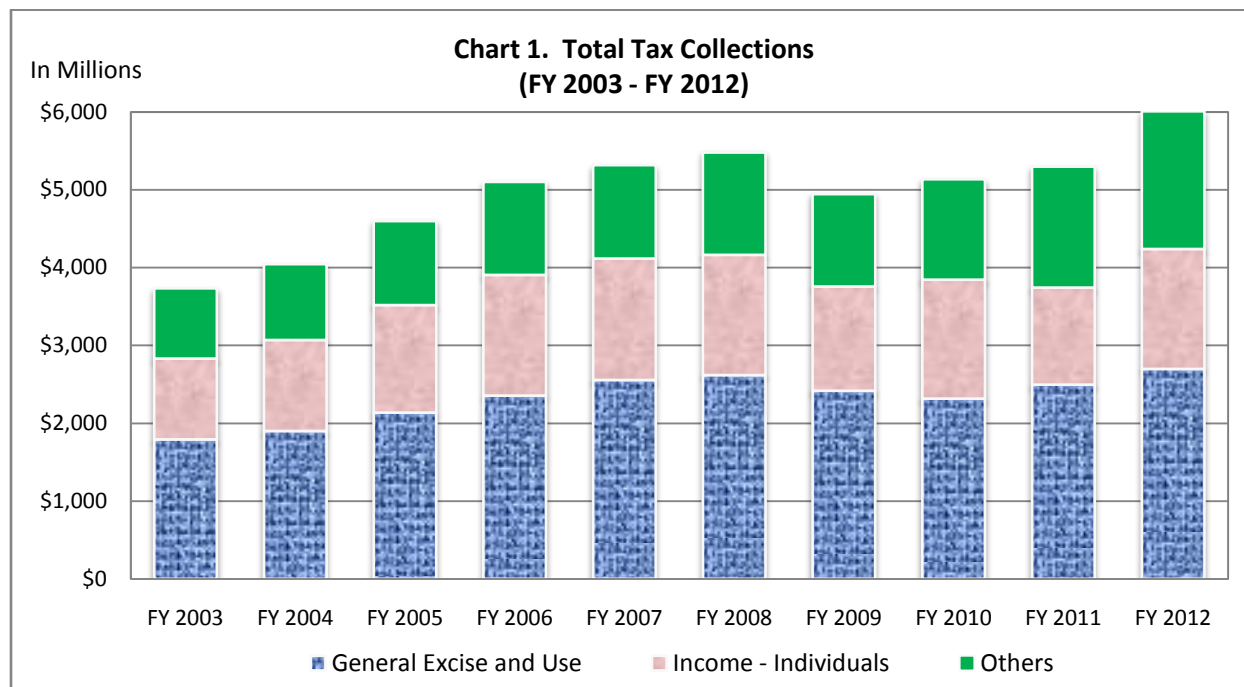
1.0 COLLECTION AND DISTRIBUTION OF TAXES

1.1 OVERVIEW

Hawaii has 17 separate tax laws, of which 14 are administered by the State¹. The counties administer the remaining three: (1) the real property tax, (2) motor vehicle weight tax, and (3) public utility franchise tax.

The Department of Taxation ("Department") plays a key role in public finance, collecting the revenue that provides the funding for services and programs operated by all departments and impacting the quality of life here in Hawaii. The Department has had a very successful year in collecting more revenue while continually improving the operations in assuring that the Department effectively brings in what is due to the State and efficiently processes documents and remittances in doing so.

Total tax collections in fiscal year ("FY") 2012 amounted to \$6.0 billion, or about 13.4% more than the \$5.3 billion collected in FY 2011. Adjusting for the effect of the delayed refunds of \$187.4 million in FY 2011, the growth rate in FY 2012 would be 9.5%.² In FY 2009, like many States, Hawaii also experienced a decrease in tax revenue as the great recession reduced spending by consumers and businesses. Over the past years, tax collections have steadily increased due to temporary tax measures, an improving economy, and better tax administration.

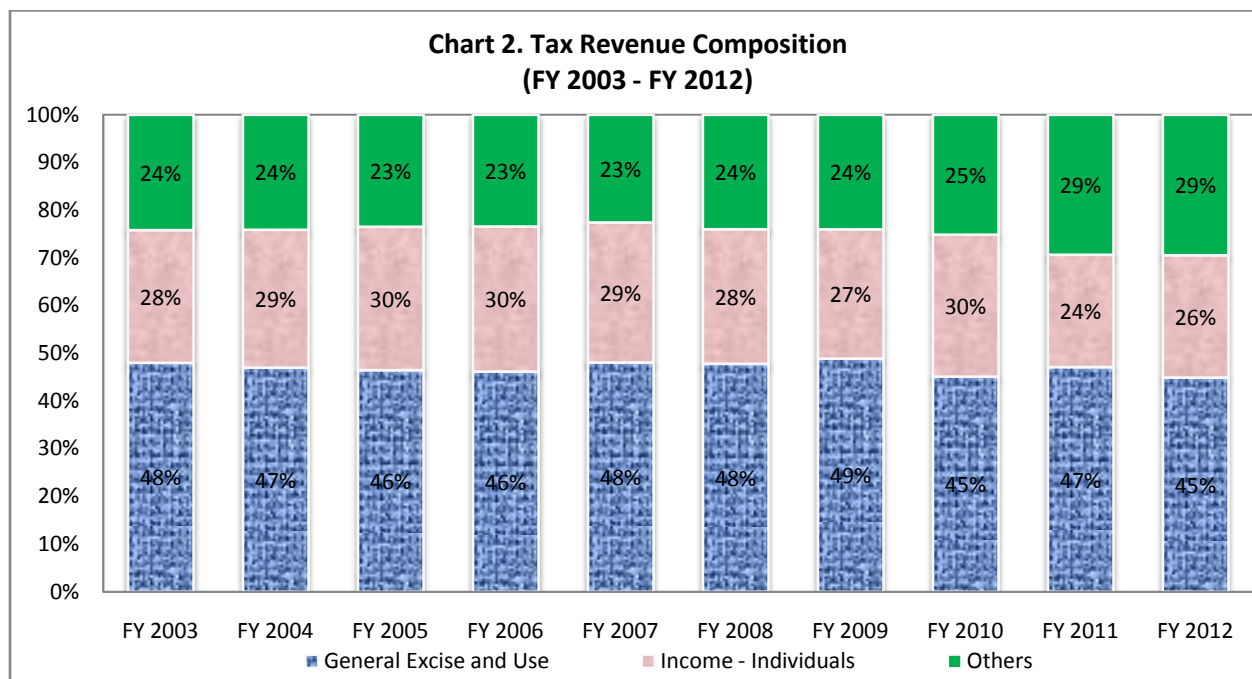


¹ Chapters (1) 235: Income Tax, (2) 236D: Estate and Transfer Tax, (3) 237: General Excise Tax, (4) 237D: Transient Accommodations Tax, (5) 238: Use Tax, (6) 239: Public Service Company Tax, (7) 241: Banks and Other Financial Corporations (Franchise Tax), (8) 243: Fuel Tax, (9) 244D: Liquor Tax, (10) 245: Cigarette and Tobacco Tax, (11) 247: Conveyance Tax, (12) 251: Rental Motor Vehicle and Tour Vehicle Surcharge Tax, (13) 383: Unemployment Insurance, and (14) 431: Insurance Premiums.

² Tax year 2010 income tax refunds that would have been paid out in FY 2010 were paid out in FY 2011.

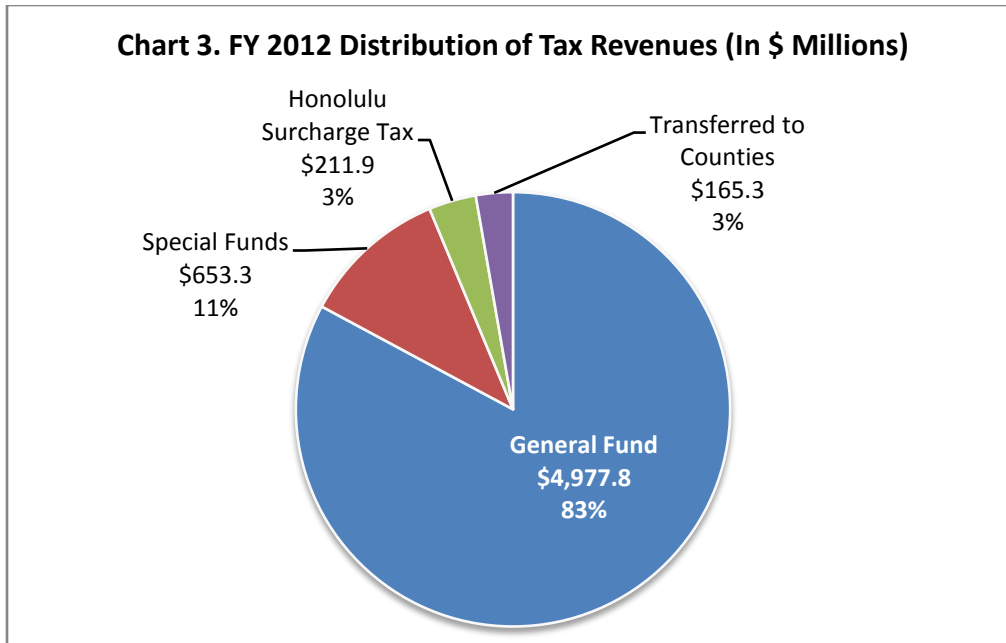
The State's primary revenue source is the general excise tax ("GET")³. In FY 2012, total tax collections were \$6.0 billion, with the GET accounting for \$2.7 billion (44.9%) of the total. The individual income tax ("IIT"), the second largest revenue source, accounted for \$1.5 billion (25.6%). The GET and IIT combined accounted for 71% of total tax revenues. The remaining \$1.8 billion (29.5%) came from other sources (transient accommodations tax, rental motor vehicles tax, fuel tax, public service companies' tax, etc.). As shown below, the GET and IIT have historically been the two biggest sources of tax revenues.

In FY 2012, of the total tax revenue, 44.9% came from the GET and 25.6% came from the IIT. The GET and IIT together accounted for 71% of total tax revenues.



Of the total \$6.0 billion in tax revenue collected in FY 2012, \$5.0 billion (82.9%) was deposited into the general fund, \$653.2 million (10.9%) was deposited into various special funds and other funds, and \$211.9 million (3.5%) was transferred to the City and County of Honolulu in the GET surcharge tax to fund its mass transit project. The rest of the revenue (from fuel taxes and the TAT) or \$165.3 million (2.8%) was transferred to the counties (see Chart 3).

³ The GET includes both the general excise and the use tax, which complements the general excise tax and is levied on imports into the State from an unlicensed seller.



The tax revenue that was deposited into the general fund was used to fund 15 state agencies, including the Department of Education (Charter Schools and Public Libraries), the University of Hawaii, and the Office of the Governor and Lieutenant Governor.

1.2 GENERAL EXCISE AND USE TAXES

1.2.1 Overview

The GET is the State's primary source of tax revenue. Unlike the more common sales tax of many States and localities, the GET is a tax for the privilege of doing business in Hawaii and is measured by gross receipts of sales or gross income and is imposed on the business receiving the income, rather than the customer. Despite the relatively low tax rates, substantial revenue is generated due to the broad tax base on which the tax is levied.

The tax rates are (1) 0.5% on wholesaling and wholesale services, producing, sugar processing and pineapple canning; (2) 4.0% on all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals), and (3) 0.15% on insurance commissions received by general agents, subagents and solicitors. The licensing fee for GET licensees and nonprofit organizations is a one-time fee of \$20.

1.2.2 Revenue

The GET, which made up 44.9% of total tax collections in FY 2012, increased by 8.1% (\$202.1 million) from FY 2011 to a total of \$2.7 billion in FY 2012. All components of the tax except manufacturing and insurance commissions were higher in FY 2012 than in FY 2011: Retailing revenues increased by \$128.3 million (12.4%), services revenues increased by \$30.1 million (6.3%), contracting revenues increased by \$22.6 million (9.9%), revenues from transient accommodation rentals increased by \$16.3 million (13.4%), and revenue from all rentals other than transient accommodations was up by \$6.2 million (2.6%).

Revenue from many GET components increased in FY 2012:
 Retailing by \$128.3M (12.4%),
 Services by \$30.1 M (6.3%),
 Contracting by \$22.6 M (9.9%),
 Transient accommodation rentals by \$16.3 M (13.4%), and
 All other rentals by \$6.2 M (2.6%)

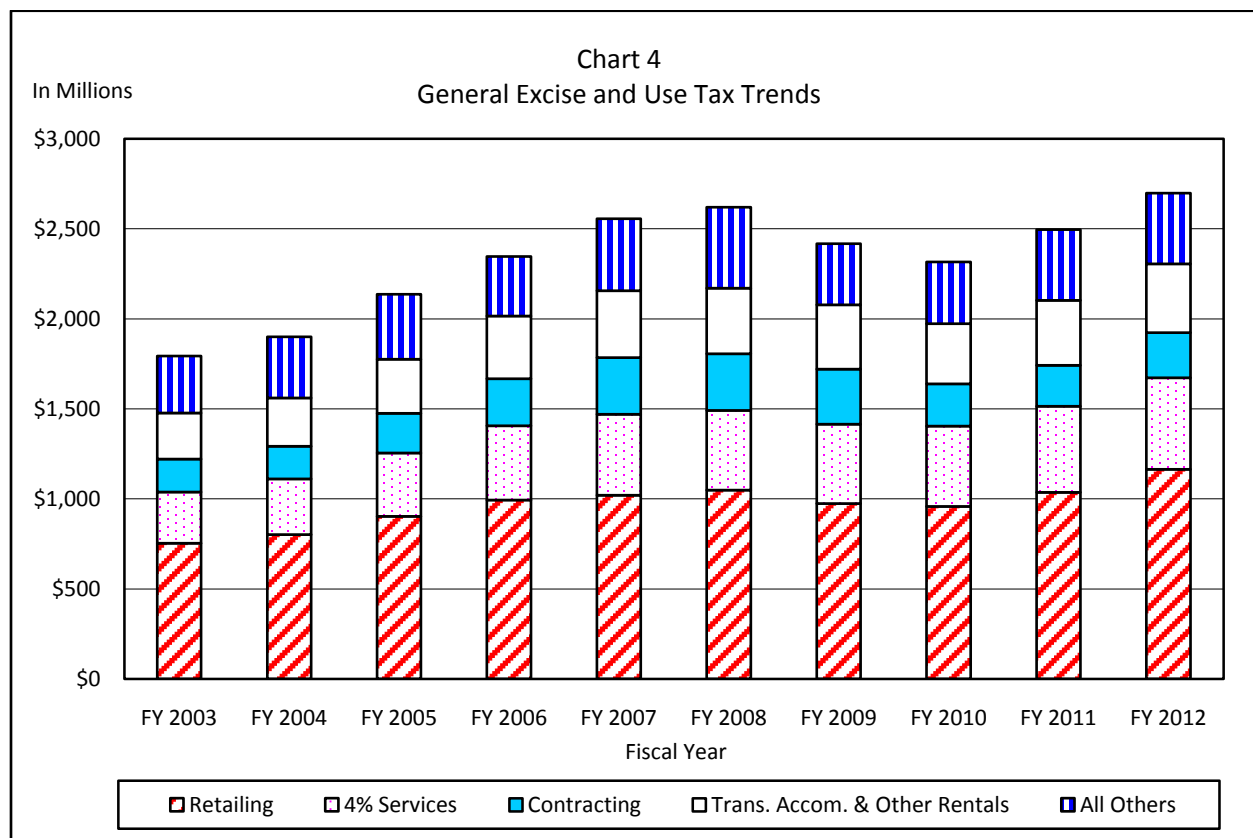


TABLE 1 - GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 2012 & 2011
(In thousands of dollars)

SOURCE OF REVENUE	Rate	FY 2012	FY 2011	Difference	
				Amount	% Change
TAX BASE					
Retailing		\$29,095,118	\$25,886,624	\$3,208,494	12.4
Services		12,696,608	11,943,830	\$752,778	6.3
Contracting		6,253,047	5,687,433	\$565,614	9.9
Transient Accommodations Rentals		3,430,541	3,023,850	\$406,691	13.4
All Other Rentals		6,153,777	5,998,588	\$155,189	2.6
All Others (4%)		5,160,338	4,824,575	\$335,763	7.0
Subtotal		\$62,789,429	\$57,364,900	\$5,424,529	9.5
Producing		400,836	369,986	\$30,850	8.3
Manufacturing		680,454	697,675	(\$17,221)	(2.5)
Wholesaling		14,442,067	13,121,508	\$1,320,559	10.1
Use (1/2%)		8,005,211	6,669,355	\$1,335,856	20.0
Wholesale Services		652,996	577,177	\$75,819	13.1
Insurance Commissions		477,268	480,437	(\$3,169)	(0.7)
Subtotal		\$24,658,831	\$21,916,139	\$2,742,692	12.5
TOTAL-ALL ACTIVITIES		\$87,448,260	\$79,281,039	\$8,167,221	10.3
TAX					
Retailing	4.00%	\$1,163,805	\$1,035,465	\$128,340	12.4
Services	4.00%	507,864	477,753	\$30,111	6.3
Contracting	4.00%	250,123	227,497	\$22,626	9.9
Transient Accommodations Rentals	4.00%	137,222	120,954	\$16,268	13.4
All Other Rentals	4.00%	246,151	239,944	\$6,207	2.6
All Others	4.00%	206,412	192,983	\$13,429	7.0
Subtotal		\$2,511,577	\$2,294,596	\$216,981	9.5
Producing	0.05%	2,004	1,850	154	8.3
Manufacturing	0.05%	3,402	3,488	(86)	(2.5)
Wholesaling	0.05%	72,210	65,608	6,602	10.1
Use (1/2%)	0.05%	40,026	33,347	6,679	20.0
Wholesale Services	0.05%	3,265	2,886	379	13.1
Insurance Commissions	0.15%	716	721	(5)	(0.6)
Subtotal		\$121,623	\$107,899	\$13,724	12.7
Unallocated 1/		64,750	93,312	(28,562)	(30.6)
TOTAL-ALL ACTIVITIES		\$2,697,951	\$2,495,807	\$202,143	8.1

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.

1.2.3 Recent Legislation

Act 105, Session Laws of Hawaii ("SLH") 2011, temporarily suspends the exemptions for certain persons and certain amounts of gross income or proceeds from the GET and requires the payment of both taxes at a four per cent rate effective July 1, 2012. Suspended exemptions include:

- Subcontractors' deduction;
- Federal cost-plus contractors' exemption for materials, plant, and equipment;
- Sublease deduction;
- Certain convention, conference, and trade show fees paid to non-profit organizations;
- 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, HRS, (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 tangible personal property 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; and
- Exemption from Use Tax for use or sale of liquor, cigarettes or tobacco products imported for resale to a common carrier;

Act 105 provides that gross income or gross proceeds from stevedoring and related services furnished to a company by its wholly owned subsidiary are not subject to the suspension, and grandfathering 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. Act 105 sunsets on June 30, 2013.

1.3 INDIVIDUAL INCOME TAX

1.3.1 Overview

The individual income tax ("IIT") is the second largest tax revenue source. It is a progressive tax. Income from all sources (salaries and wages, interest, dividends, business income, annuities, capital gains, rents and royalties, partnership income, state tax refund, alimony, S corporation, estates and trust, State tax refund, and income from other sources) are taxed.

Certain income is exempted from income tax and there are deductions and exemptions allowed to reduce taxable income. The IIT is applied to taxable income (net of deductions and exemptions). The IIT has twelve brackets, with tax rates ranging from 1.4% to 11%.

Rate	Single/MFS*			Joint			Head of Household		
	Taxable Income			Taxable Income			Taxable Income		
1.40%	Not over	\$2,400		Not over	\$4,800		Not over	\$3,600	
3.20%	\$2,401	"	4,800	\$4,801	"	9,600	\$3,601	"	7,200
5.50%	4,801	"	9,600	9,601	"	19,200	7,201	"	14,400
6.40%	9,601	"	14,400	19,201	"	28,800	14,401	"	21,600
6.80%	14,401	"	19,200	28,801	"	38,400	21,601	"	28,800
7.20%	19,201	"	24,000	38,401	"	48,000	28,801	"	36,000
7.60%	24,001	"	36,000	48,001	"	72,000	36,001	"	54,000
7.90%	36,001	"	48,000	72,001	"	96,000	54,001	"	72,000
8.25%	48,001	"	150,000	96,001	"	300,000	72,001	"	225,000
9.00%	150,001	"	175,000	300,001	"	350,000	225,001	"	262,500
10.00%	175,001	"	200,000	350,001	"	400,000	262,501	"	300,000
11.00%	Over	200,000		Over	400,000		Over	300,000	

Note: *MFS - Married filing separately

There are numerous credits allowed to offset the income tax liability.

1.3.2 Revenue

The biggest source of the IIT collections is from taxes withheld from employee wages. In FY 2012, the withholding tax collections were \$1.46 billion, an increase of 2.9% from FY 2011. Total IIT refunds in FY 2012 were \$412.9 million. The net IIT collections in FY 2012 were \$1.54 billion, an increase of 23.6% compared to FY 2011. The growth rate was high, because tax refunds of \$186.1 million were delayed from FY 2010 and paid in the first month of FY 2011. Otherwise, the net IIT collections would have been \$1.43 billion in FY 2011 and the growth from FY 2011 to FY 2012 would have been only 7.5%.

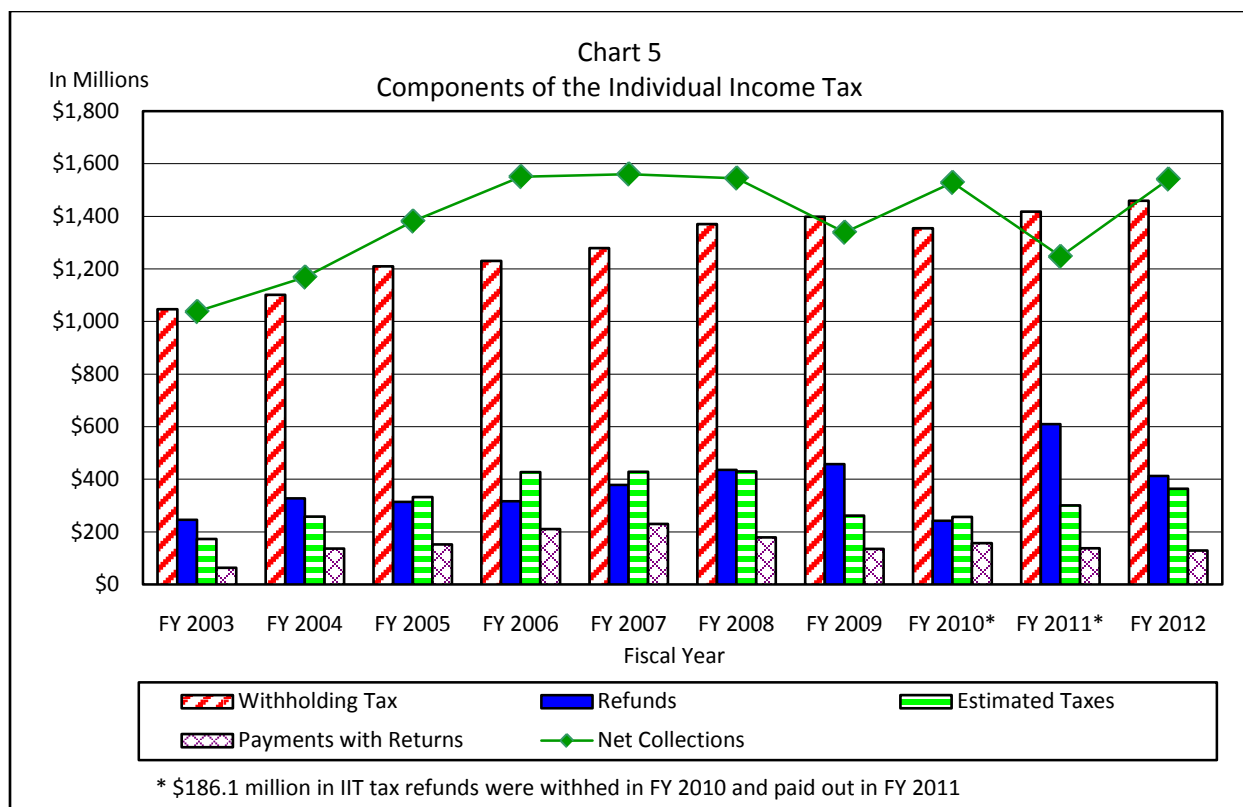


TABLE 2 - TAXES PAID BY INDIVIDUALS
(In Thousands of Dollars)

	FY 2012	FY 2011	Difference	
			Amount	%
Declaration of Estimated Taxes	\$364,470	\$301,476	\$62,994	20.9%
Payment with Return	129,671	137,754	(\$8,083)	-5.9%
Withholding Tax on Wages	1,459,769	1,418,157	\$41,612	2.9%
Subtotal	\$1,953,910	\$1,857,386	\$96,524	5.2%
Refunds 1/	412,859	610,234	(197,375)	-32.3%
NET	\$1,541,051	\$1,247,153	\$293,898	23.6%

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

1/ The total for FY 2011 contained some refunds that were withheld in the last months of FY 2010.

1.3.3 Recent Legislation

Act 60, SLH 2009, increases the income tax for high income brackets for taxable years beginning after December 31, 2008 to December 31, 2015. Act 60 affects individuals with taxable incomes over \$150,000 (single/married filing separately) or \$300,000 (married filing jointly) by adding tiers to their highest marginal tax rates, from 8.25% to 9%, 10%, and 11%.

Act 97, SLH 2011, eliminates the deduction for state income taxes paid for individuals with Federal adjusted gross income above specified thresholds:

- \$100,000 for single or married filing separately;
- \$150,000 for head of household; and
- \$200,000 for joint returns or surviving spouse.

Act 97 also 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 based on Hawaii adjusted gross income as follows:

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

Act 97 delays the standard deduction and personal exemption increases approved under Act 60, SLH 2009, by two years while making those increases permanent.

Effective January 1, 2012, Act 1, SLH 2011, provides that all provisions of the Internal Revenue Code ("IRC") referred to in the IIT that apply to a husband and wife, spouses, or person in a legal marital relationship shall be deemed to apply to partners in a civil union with the same force and effect as if they were "husband and wife", "spouses", or other terms that describe persons in a legal marital relationship.

1.4 CORPORATE INCOME TAX

1.4.1 Overview

Unlike many other states, Hawaii corporate income tax is not among the top three major taxes. The corporate income tax accounted for 1.2% of total tax collections in FY 2012.

There are three corporate income tax brackets and rates. The rates are (1) 4.4% up to \$25,000, (2) 5.4% over \$25,000 but not over \$100,000, and (3) 6.4% over \$100,000 of taxable income. The tax rate for corporate capital gains is 4%.

1.4.2 Revenue

Net corporate income tax collections totaled \$73.0 million in FY 2012, an increase of 111.2% over the previous year's total of \$34.6 million. The declaration of estimated taxes for corporation fluctuated mostly reflecting the business cycle. In FY 2012, the corporate income tax refunds totaled \$100.9 million.

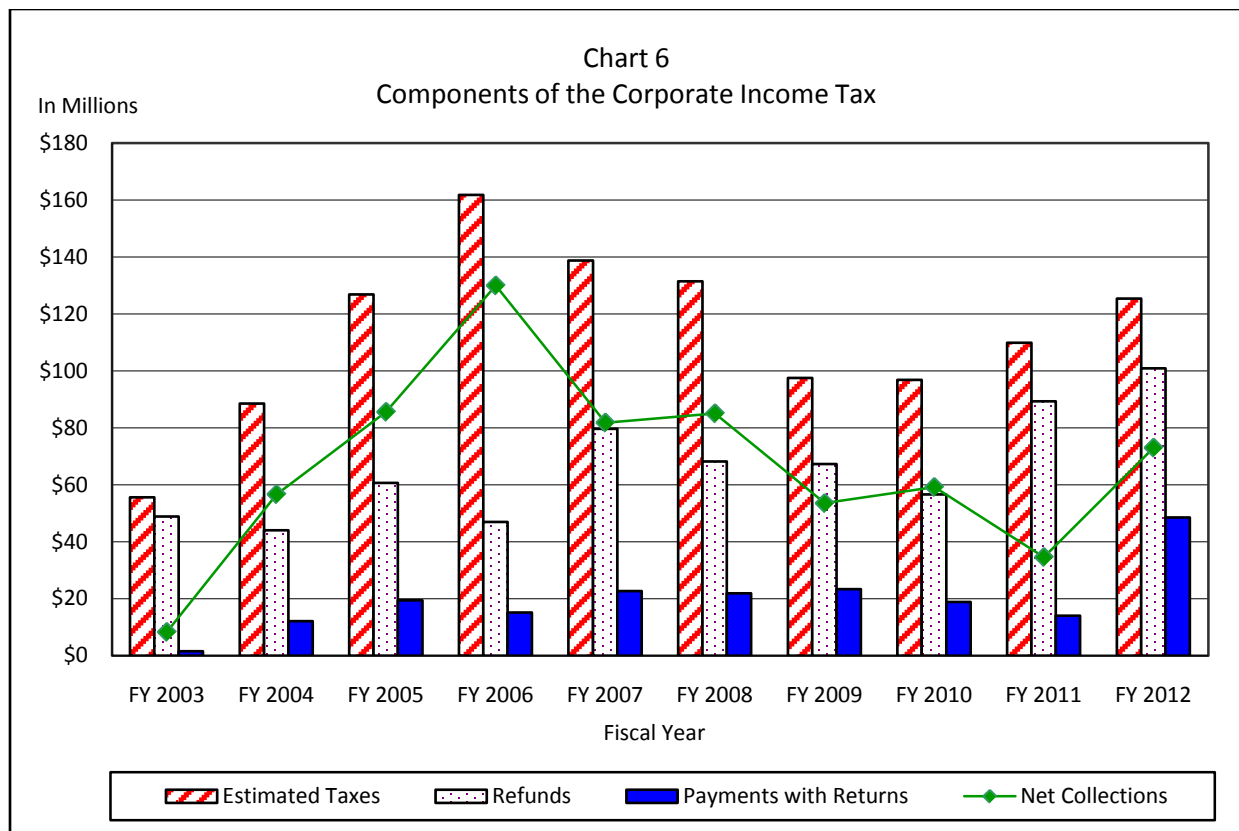


TABLE 3 - TAXES PAID BY CORPORATIONS
(In Thousands of Dollars)

	FY 2012	FY 2011	Difference	
			Amount	%
Declaration of Estimated Taxes	\$125,383	\$109,860	\$15,523	14.1%
Payment with Return	48,494	13,982	34,513	246.8%
Subtotal	\$173,877	\$123,842	\$50,035	40.4%
Refunds	100,851	89,269	11,582	13.0%
NET	\$73,027	\$34,573	\$38,454	111.2%

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

1.5 TRANSIENT ACCOMMODATIONS TAX

1.5.1 Overview

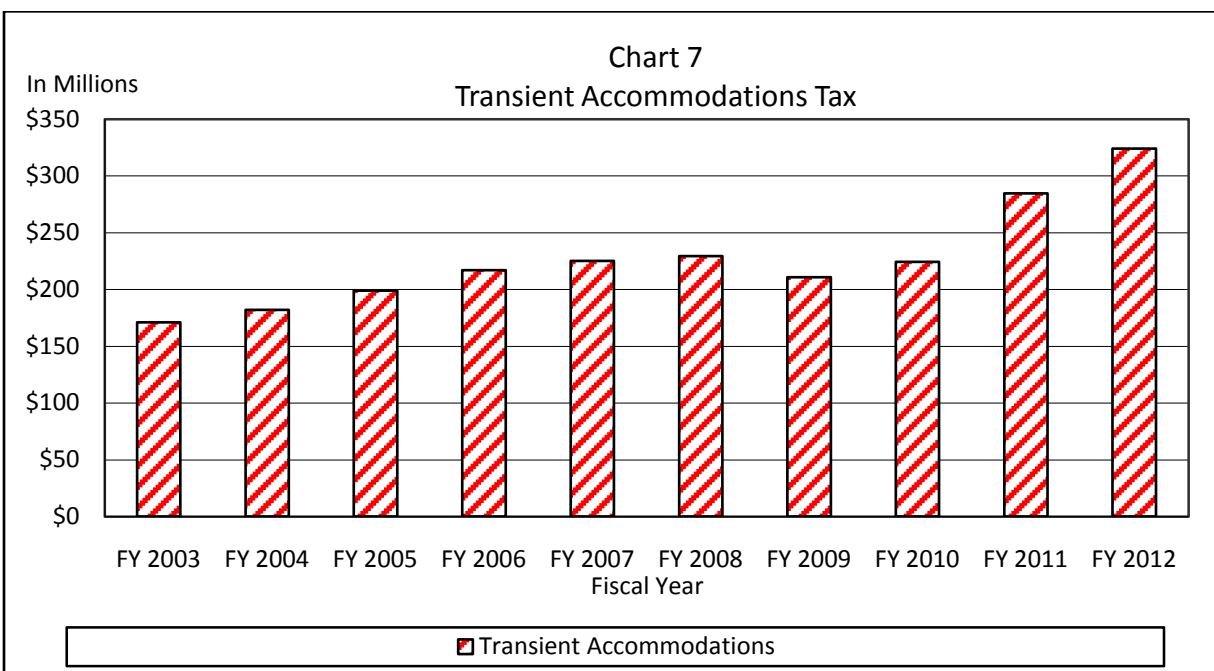
The Transient Accommodations Tax (TAT) is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration.

Effective July 1, 2010, the transient accommodations tax (TAT) rate is 9.25%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units. Plan managers are liable for and pay to the State, the TAT of 7.25% that is imposed on the fair market rental value of time share vacation units.

1.5.2 Revenue

TAT collections totaled \$324.0 million for FY 2012, an increase of 13.9% (\$39.5 million) from FY 2011. In FY 2012, collections from the TAT were distributed as follows: (1) \$93.0 million to the counties; (2) \$35.6 million to the Convention Center Enterprise Special Fund, (3) \$69.0 million to the Tourism Special Fund (TSF), and (4) the remainder, or \$126.3 million, to the General Fund.

Due to Act 103, SLH 2011, which imposed caps on the allocations to the counties and to the TSF, allocations to the counties declined by 9.6% and allocations to the TSF declined by 18.8%, while allocations to the General Fund grew by 111.3%.



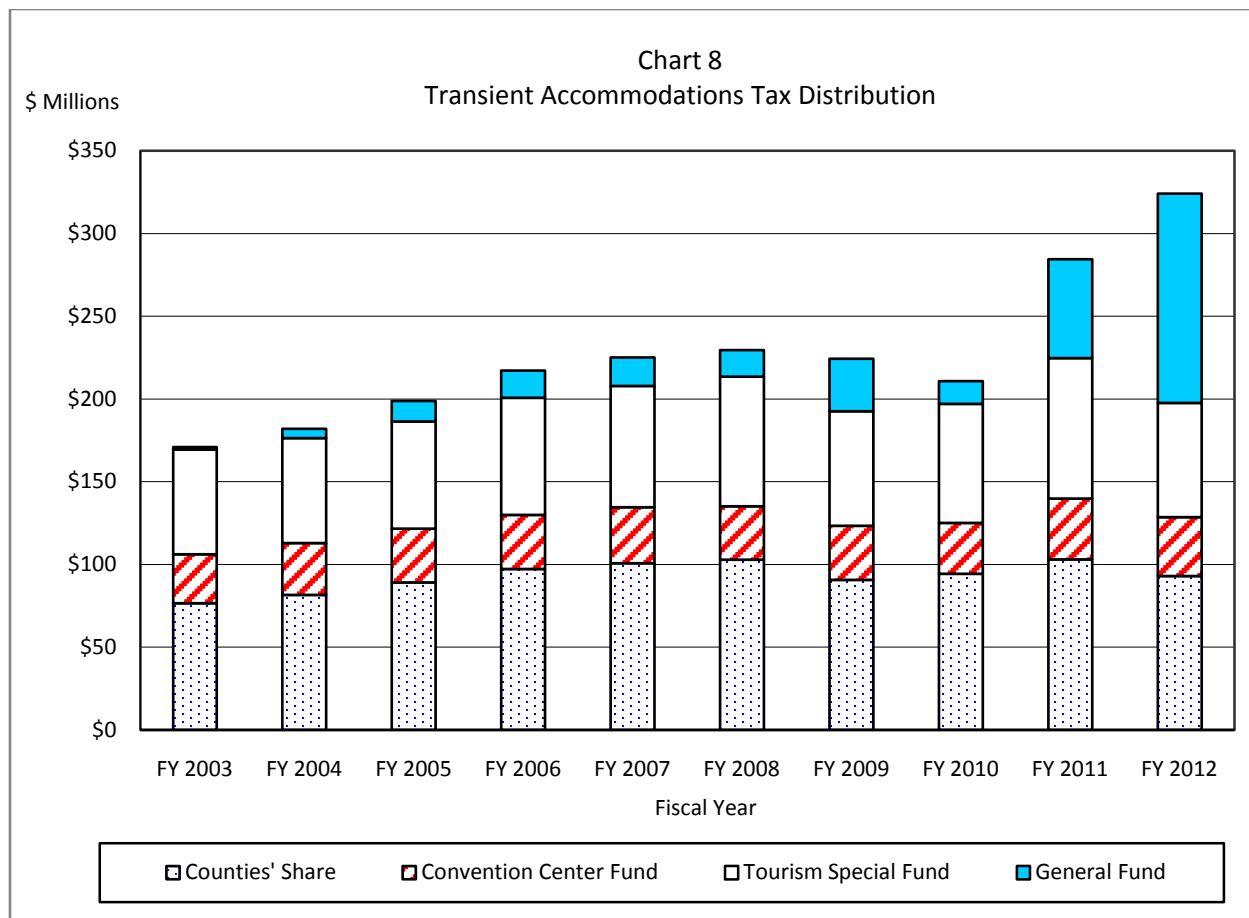


TABLE 4 - TRANSIENT ACCOMMODATIONS TAX
(In Thousands of Dollars)

	FY 2012	FY 2011	Difference	
			Amount	%
COLLECTION				
Transient Accommodations Tax	\$308,974	\$271,755	\$37,219	13.7
Time Share Occupancy Tax	14,965	12,708	2,257	18
Transient Accommodations/Time Share Occup. Fees	11	9	2	17
TOTAL	\$323,950	\$284,472	\$39,478	13.9
DISTRIBUTION *				
Counties' Share	\$93,000	\$102,931	-\$9,931	-9.6
Convention Center Fund	35,637	36,795	(1,158)	-3.1
Tourism Special Fund	69,000	84,981	(15,981)	-18.8
General Fund	126,313	59,766	66,547	111.3
TOTAL	\$323,950	\$284,472	\$39,477	13.9

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

* For details on how revenues from the TAT are distributed, see HRS, 237D-6.5.

1.5.3 Recent Legislation

Act 61, SLH 2009, adds to the 7.25% TAT an additional 1% for the period July 1, 2009, through June 30, 2010, and an additional 2% for the period July 1, 2010, through June 30, 2015. The additional 1% and 2% TAT collections were dedicated to the General Fund. The distribution of the existing 7.25% TAT is unchanged.

Act 103, SLH 2011, applies a \$10 daily TAT to each transient accommodation furnished on a complimentary or gratuitous basis, or otherwise at no charge. Act 103 also imposes a ceiling on the amount of TAT funds transferred to the Tourism Special Fund (\$69 million/year) and to the counties (\$93 million/year) from July 1, 2011 to June 30, 2015.

Act 1717, SLH 2012, increased the allocation to the Tourism Special Fund from \$69 million to \$71 million from July 1, 2012 to June 30, 2015.

1.6 FUEL AND MOTOR VEHICLE TAXES

1.6.1 Overview

Fuel tax is levied on the distributors. The State Legislature sets the State fuel tax rates, while the county councils set the county rates. The effective rates for FY 2012 are shown below:

FUEL TAX RATES PER GALLON*

TYPE OF FUEL	State	County	Total
Gasoline & Diesel Oil (Highway Use)			
City & County of Honolulu	17.0¢	16.5¢	33.5¢
County of Maui	17.0¢	16.0¢	33.0¢
County of Hawaii	17.0¢	8.8¢	25.8¢
County of Kauai	17.0¢	13.0¢	30.0¢
Liquid Petroleum Gas (Highway Use)			
City & County of Honolulu	5.2¢	5.4¢	10.6¢
County of Maui	5.2¢	4.3¢	9.5¢
County of Hawaii	5.2¢	2.9¢	8.1¢
County of Kauai	5.2¢	4.3¢	9.5¢
Ethanol (Highway Use)			
City & County of Honolulu	2.4¢	2.4¢	4.8¢
County of Maui	2.4¢	3.8¢	6.2¢
County of Hawaii	2.4¢	1.3¢	3.7¢
County of Kauai	2.4¢	1.9¢	4.3¢
Methanol (Highway Use)			
City & County of Honolulu	1.9¢	1.8¢	3.7¢
County of Maui	1.9¢	2.9¢	4.8¢
County of Hawaii	1.9¢	1.0¢	2.9¢
County of Kauai	1.9¢	1.4¢	3.3¢
Biodiesel (Highway Use)			
City & County of Honolulu	4.0¢	8.3¢	12.3¢
County of Maui	4.0¢	0.0¢	4.0¢
County of Hawaii	4.0¢	0.0¢	4.0¢
County of Kauai	4.0¢	0.0¢	4.0¢
Compressed Natural Gas (Highway Use)			
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¢
Liquefied Natural Gas (Highway Use)			
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¢
Environmental Response Tax (Per Barrel)			
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.

1.6.2 Revenue

Fuel tax collections amounted to \$193.1 million in FY 2012, a decrease of 1.1% from the previous year (\$195.3 million). Total taxable fuel consumption increased by 1.4% to 896.2 million gallons in FY 2012. The biggest fuel consumption is gasoline (454.6 million gallons, or 50.7% of total taxable fuel consumption in FY 2012). The next biggest is aviation fuel (217.7 million gallons, or 24.3% of total consumption in FY 2012).

The environmental response, energy, and food security tax was imposed at the rate of \$1.05 on each barrel of petroleum product sold by a distributor to any retail dealer or end user. A total of 26.3 million barrels of petroleum was subjected to the environmental response tax in FY 2012, a decline of 6.3% from FY 2011.

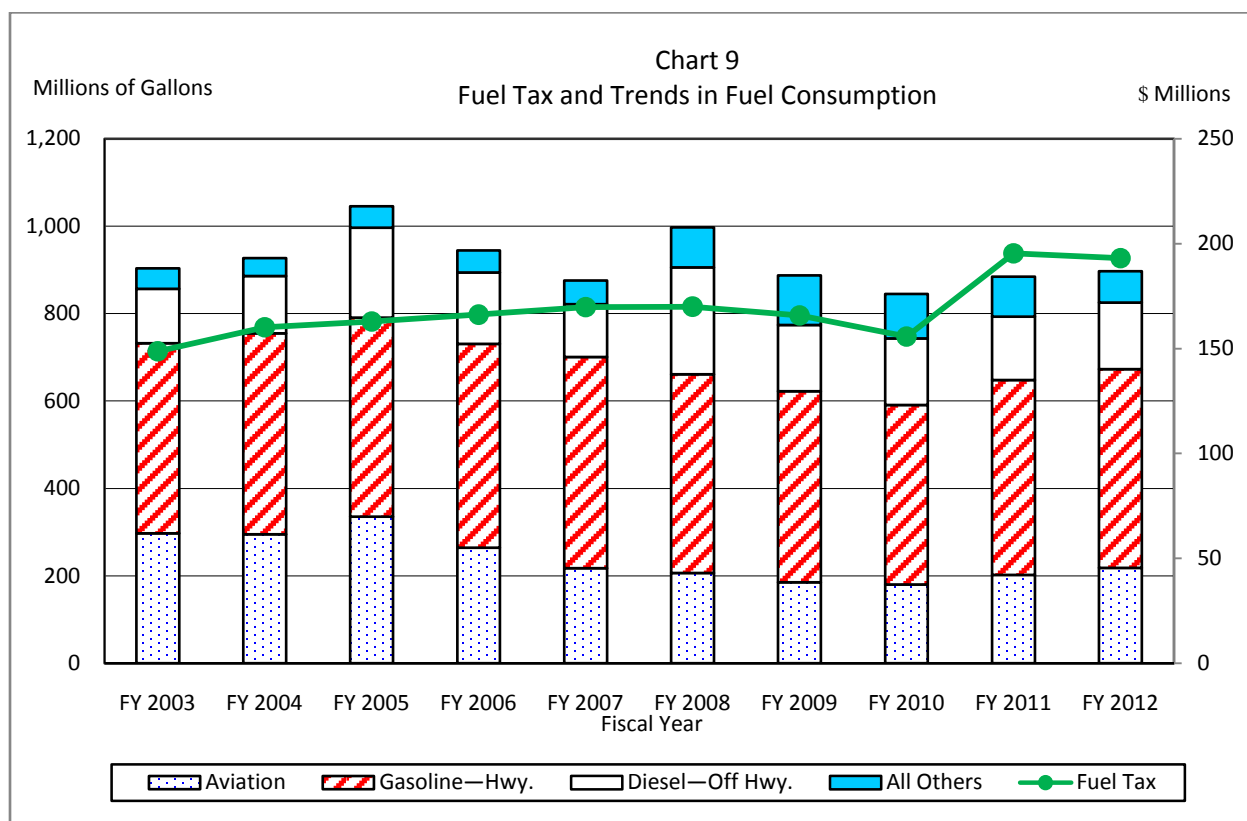


TABLE 5 – GALLONS OF FUEL CONSUMED
(In thousands of gallons or barrels)

	FY2012	FY2011	Difference	
			Amount	%
Gasoline	454,555	445,756	8,800	2.0
Diesel Oil – Non-highway	151,635	144,815	6,820	4.7
Diesel Oil – Highway	41,679	51,246	(9,567)	(18.7)
Liq. Pet. Gas – Highway	44	53	(9)	(16.3)
Small Boats – Gasoline	1,148	964	184	19.1
Small Boats – Diesel Oil	425	4,161	(3,735)	(89.8)
Aviation Fuel	217,656	202,269	15,387	7.6
Other Fuel 1/	29,030	34,770	(5,739)	(16.5)
TOTAL-GALLONS	896,173	884,033	12,139	1.4
Environmental Tax (Barrel)	26,294	28,057	(1,762)	(6.3)

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

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

The revenues from fuel taxes are distributed to several special funds. One percent of the fuel taxes paid on liquid fuel, not including aviation 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, the Energy Security Special Fund, the Energy Systems Development Special Fund, the Agricultural Development and Food Security Special Fund, and the General Fund. Of the \$1.05 collected on each barrel of non-aviation fuel, 5 cents goes into the Environmental Response Revolving Fund administered by the Department of Health for oil spill prevention and remediation programs, 25 cents goes into the Energy Security and Energy Systems Development Special Funds administered by the Department of Business Economic Development and Tourism support the Hawaii clean energy initiative program, and 15 cents goes into the Food Security Special Fund 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 remainder is deposited into the General Fund.

The remaining State fuel tax revenues are deposited into the State Highway Fund, while the remaining county fuel tax revenues are deposited into the counties' highway funds. 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. In FY 2012, part of the rental motor vehicle surcharge went into the General Fund.

TABLE 6 - ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

	FY 2012	FY 2011	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Fuel	\$87,230	\$89,599	(\$2,369)	-2.6%
Motor Vehicle Tax/Fees	150,312	106,166	44,146	41.6%
TOTAL	\$237,542	\$195,765	\$41,777	21.3%
COUNTY HIGHWAY FUNDS:				
City & County of Honolulu	\$49,220	\$52,298	(\$3,078)	-5.9%
County of Maui	10,438	11,085	(\$647)	-5.8%
County of Hawaii	8,691	7,753	\$938	12.1%
County of Kauai	3,949	4,163	(\$215)	-5.2%
TOTAL	\$72,297	\$75,299	(\$3,002)	-4.0%
BOATING SPECIAL FUND	\$1,611	\$1,666	(\$55)	-3.3%
STATE AIRPORT FUND:				
Aviation Fuel	\$4,353	\$4,045	\$308	7.6%
ENVIRONMENTAL TAX FUND	\$1,315	\$1,403	(\$88)	-6.3%
ENERGY SECURITY FUND	\$3,944	\$3,499		
ENERGY SYSTEMS DEVELOPMENT FUND	\$2,629	\$2,332		
AGRICULTURAL DEVELOPMENT & FOOD SECURITY FUND	3,944	3,499		
GENERAL FUND	\$15,777	\$13,995		

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

1.7 MOTOR VEHICLE TAXES AND FEES

1.7.1 Overview

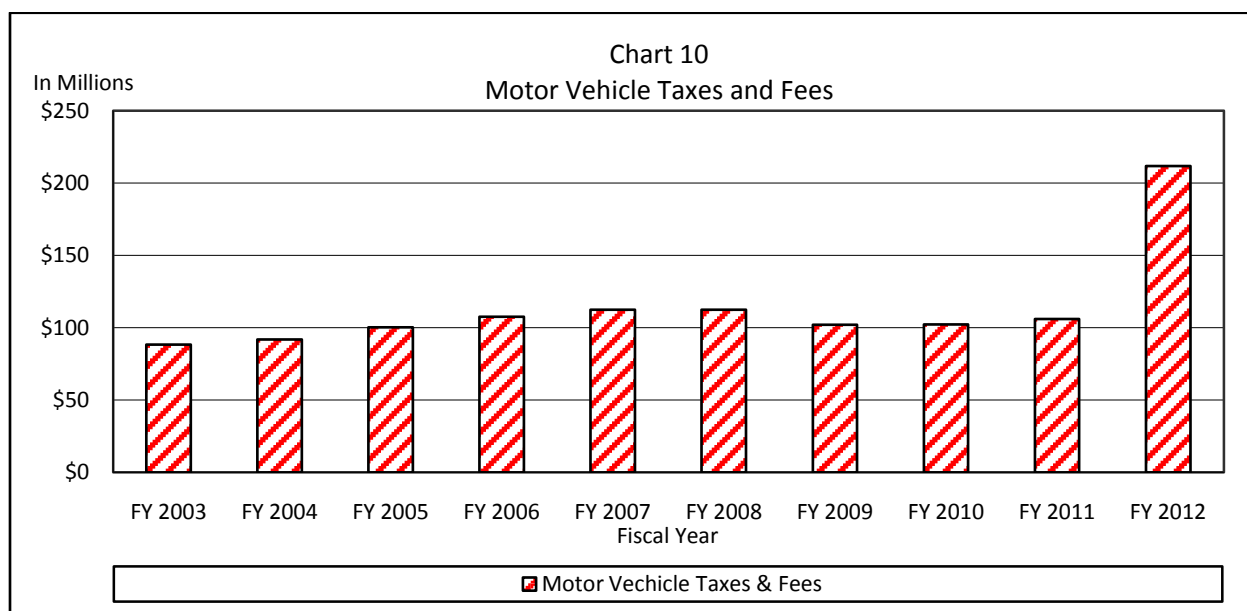
There is an annual registration fee per vehicle, and the counties levy additional fees based on vehicle weight or usage (Vehicle Weight Tax).

The State assesses Rental Motor Vehicle Surcharge tax of \$7.50 per day for the period of July 1, 2011 to June 30, 2012, and \$3.00 a day beginning July 1, 2012 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.

1.7.2 Revenue

During FY 2012, motor vehicle taxes and fees totaled \$211.7 million, compared to \$106.2 million in FY 2011, an increase of 99.3% (\$105.5 million). The increase is mainly due to the increase in the vehicle weight tax and rental motor vehicle surcharge tax enacted in 2011 (Act 86 and Act 104).



1.7.3 Recent Legislation

Effective July 1, 2011, Act 86, SLH 2011, increased the annual state motor vehicle weight tax as follows:

- For vehicles up to and including four thousand pounds net weight, the tax rate increased from 0.75 cents per pound to 1.75 cents per pound;
- For vehicles over four thousand pounds and up to and including seven thousand pounds net weight, the tax rate increased from 1.00 cents per pound to 2.00 cents per pound;
- For vehicles over seven thousand pounds and up to and including ten thousand pounds, the tax rate increased from 1.25 cents per pound to 2.25 cents per pound; and
- For vehicles over ten thousand pounds net weight, the flat tax rate increased from \$150 to \$300.

Act 104, SLH 2011, increased the rental motor vehicle surcharge tax under section 251-2(a), HRS, to \$7.50 per day for the period of July 1, 2011 to June 30, 2012, and deposited \$4.50 per day of the tax into the general fund for that period. Act 104 suspended the rental motor vehicle customer facility charges under section 261-7(h), HRS, for the period of July 1, 2011 to June 30, 2012.

1.8 CIGARETTE AND TOBACCO TAX

1.8.1 Overview

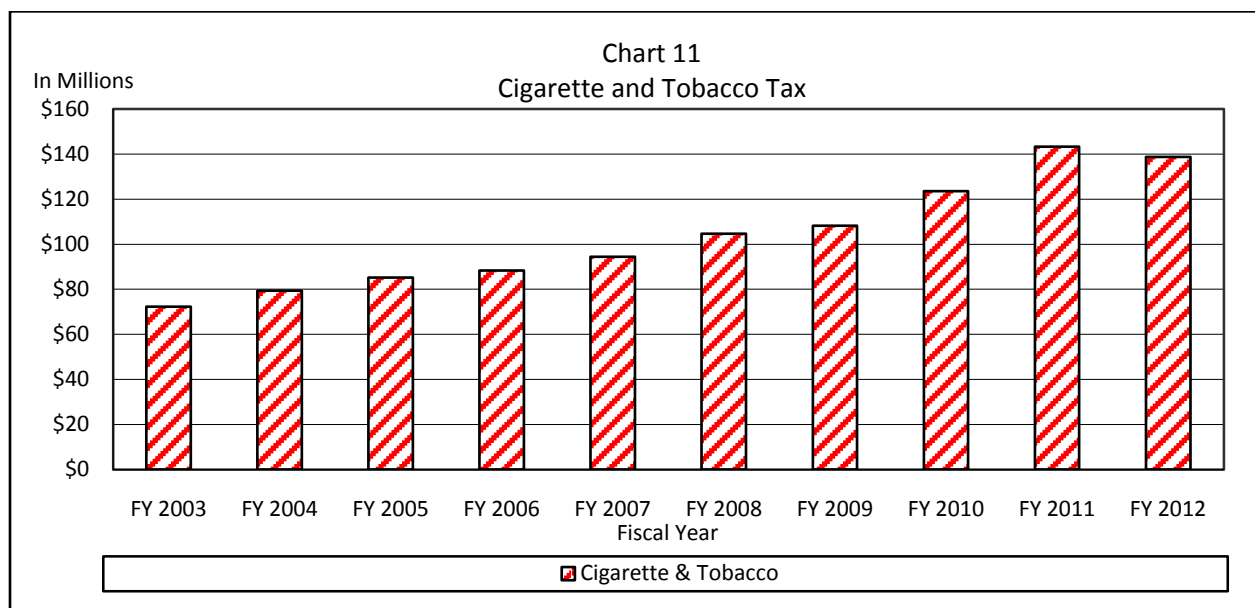
“Wholesalers” and “dealers” as defined in the law must pay an excise tax on the sale or use of tobacco products and on each cigarette sold, used, or possessed. The tax on cigarettes and little cigars was increased to 16 cents per cigarette or little cigar sold on and after July 1, 2011.

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, and (3) Little cigars, 16 cents 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.

1.8.2 Revenue

During FY 2012, cigarette and tobacco tax collections totaled \$138.8 million, compared to \$143.3 million in FY 2011, a decrease of 3.1% (\$4.5 million).



The tobacco tax collections are allocated to the following funds: the Hawaii Cancer Research Special Fund, the Trauma System Special Fund, the Emergency Medical Services Special Fund, the Community Health Centers Special Fund and the General Fund. Of the tax of 16 cents charged for each cigarette in FY 2012, 2.0 cents per cigarette went into the Hawaii Cancer Research Special Fund, 0.5 cents per cigarette went into the Trauma System Special Fund, 0.25

cents per cigarette went into the Community Health Centers Special Fund, and 0.25 cents went into the Emergency Medical Services Special Fund.

TABLE 7 - CIGARETTE AND TOBACCO TAX
(In Thousands of Dollars)

	FY 2012	FY 2011	Difference	
			Amount	%
COLLECTION				
Cigarette and Tobacco Tax	\$138,798	\$143,293	-\$4,495	-3.1
DISTRIBUTION*				
Hawaii Cancer Research Special Fund	16,828	17,496	-\$668	-3.8
Trauma System Special Fund	6,312	6,544	(232)	-3.5
Emergency Medical Service Special Fund	4,203	4,341	(138)	-3.2
Community Health Centers Special Fund	6,312	6,544	(232)	-3.5
General Fund	105,143	108,368	(3,225)	-3.0
TOTAL	\$138,798	\$143,293	-\$4,495	-3.1

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

* For a detailed distribution of the revenues, see HRS, 245-15

1.8.3 Recent Legislation

Act 56, SLH 2009, increased the per cigarette tax to 13 cents beginning July 1, 2009, 14 cents beginning July 1, 2010, and 15 cents beginning July 1, 2011. Act 56 amended the dates on which changes in the amount of cigarette tax collections deposited into various special funds occur to coincide with the dates of the tax increases.

Act 59, SLH 2010, increased the per cigarette tax to 15 cents beginning July 1, 2010, and 16 cents beginning July 1, 2011.

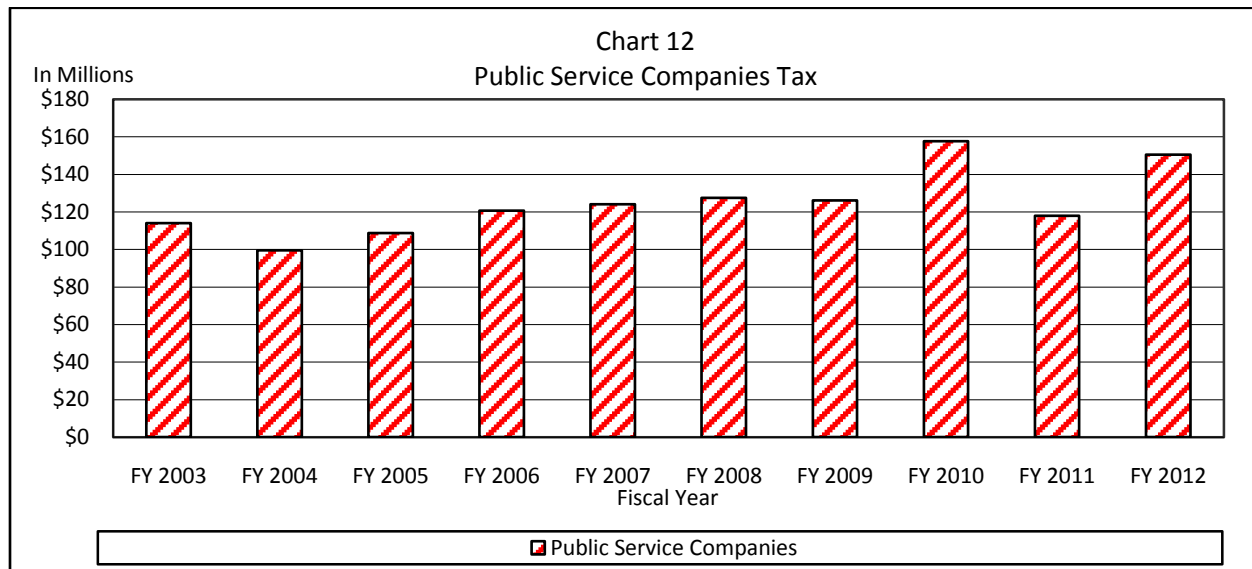
1.9 PUBLIC SERVICE COMPANY TAX

1.9.1 Overview

The Public Service Company (PSC) tax is applicable to public utility business in lieu of the GET. Generally, the tax is applied to gross income from public utility business of public utilities for the preceding calendar year. The rates are as follow: (1) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%, (2) Sale of its products or services to another public utility which resells such products or services, 0.5%, (3) Sale of telecommunications services by a public utility to an interstate or foreign telecommunications services provider that is subject to the GET and that resells the services to retail customers, 0.5%, and (4) All other revenues, 4% of gross income.

1.9.2 Revenue

Public utilities paid \$150.5 million in PSC tax, penalty, and interest in FY 2012, compared to \$117.9 million in FY 2011, an increase of 27.6% (\$32.6 million).



1.10 UNEMPLOYMENT INSURANCE

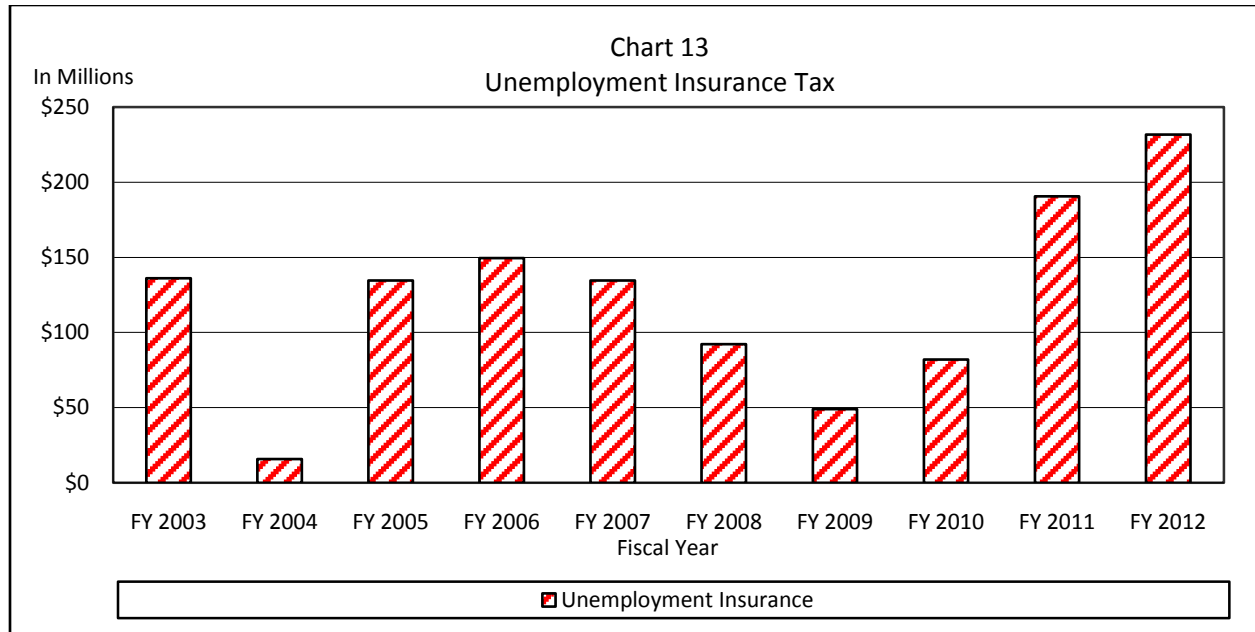
1.10.1 Overview

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 2012, the percentage rate for this additional tax is 0.00%. 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 2012, the tax base was set at \$38,800.

The revenue from the unemployment tax goes to unemployment compensation fund. The Department of Labor and Industrial Relations administers and collects the unemployment insurance tax.

1.10.2 Revenue

During FY 2012, the unemployment insurance tax totaled \$231.7 million, compared to \$190.5 million in FY 2011, an increase of 21.6% (\$41.2 million).



1.11 INSURANCE PREMIUM TAX

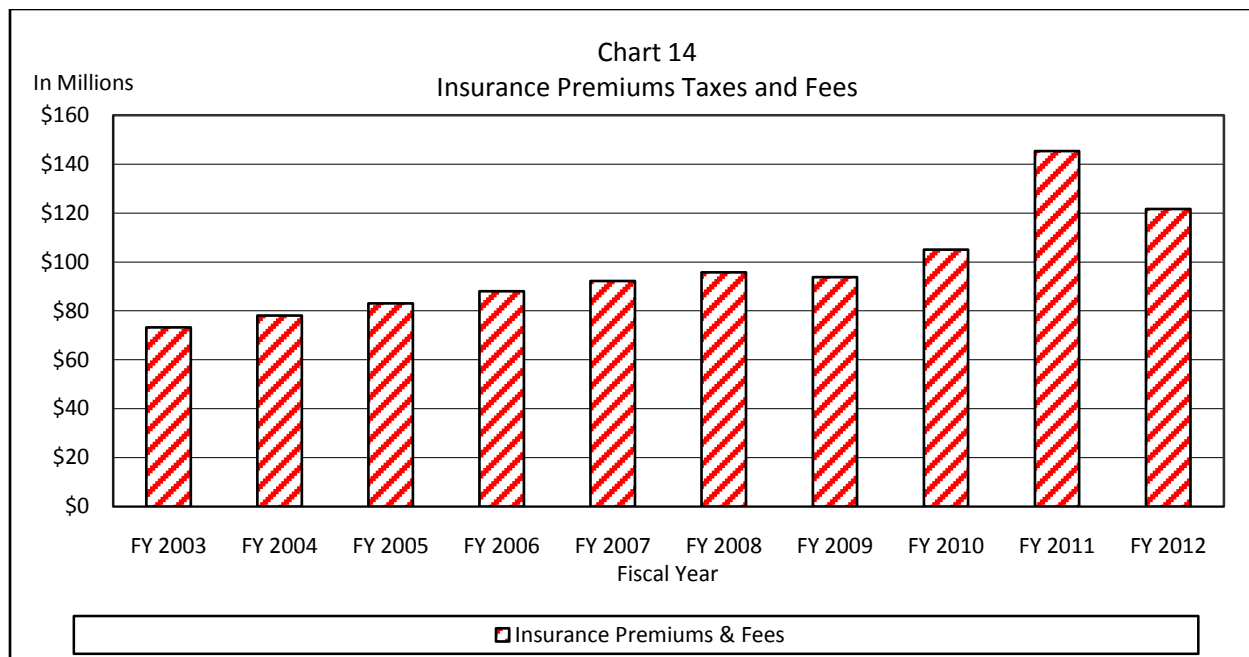
1.11.1 Overview

The insurance premium tax applies to insurance companies (underwriters) based on premiums written in Hawaii. The insurance premium tax is in lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. The tax rates are as follows: (1) Life Insurance, 2.75%; (2) Surplus Lines, 4.68%; (3) Ocean Marine, .8775% on gross underwriting profit; and (4) 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 chapter 431.

1.11.2 Revenue

During FY 2012, insurance premiums taxes and fees totaled \$121.6 million, compared to \$145.3 million in FY 2011, a decline of 16.3% (\$23.7 million).



1.11.3 Recent Legislation

Effective, July 1, 2010, Act 59, SLH 2010, temporarily increases (until July 1, 2014) certain insurance fees and specifies that the increased fees be deposited equally into the compliance resolution fund and the general fund.

1.12 LIQUOR TAX

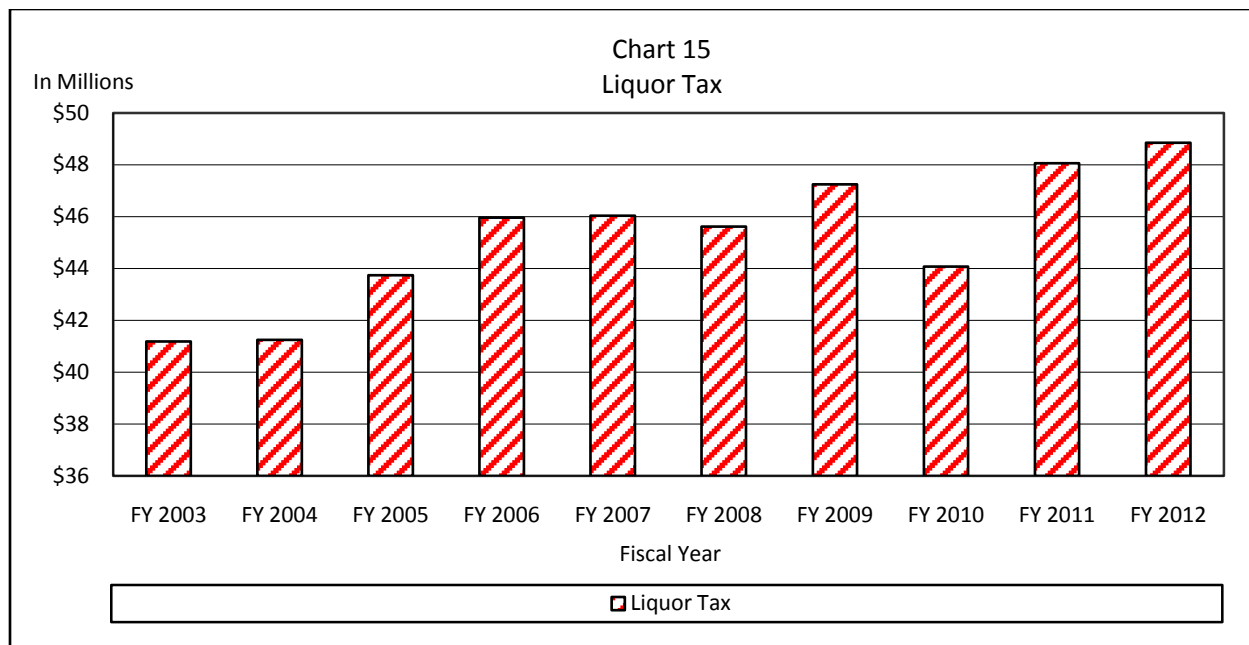
1.12.1 Overview

The liquor tax is a gallonage tax imposed upon “dealers” as defined in the law and upon 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, HRS, for exemptions from tax.

The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$0.85 on cooler beverages, \$0.93 on beer other than draft beer, and \$0.54 on draft beer.

1.12.2 Revenue

During FY 2012, the liquor tax and permit fees totaled \$48.9 million, compared to \$48.1 million in FY 2011, an increase of 1.7% (\$0.8 million).



1.13 CONVEYANCE TAX

1.13.1 Overview

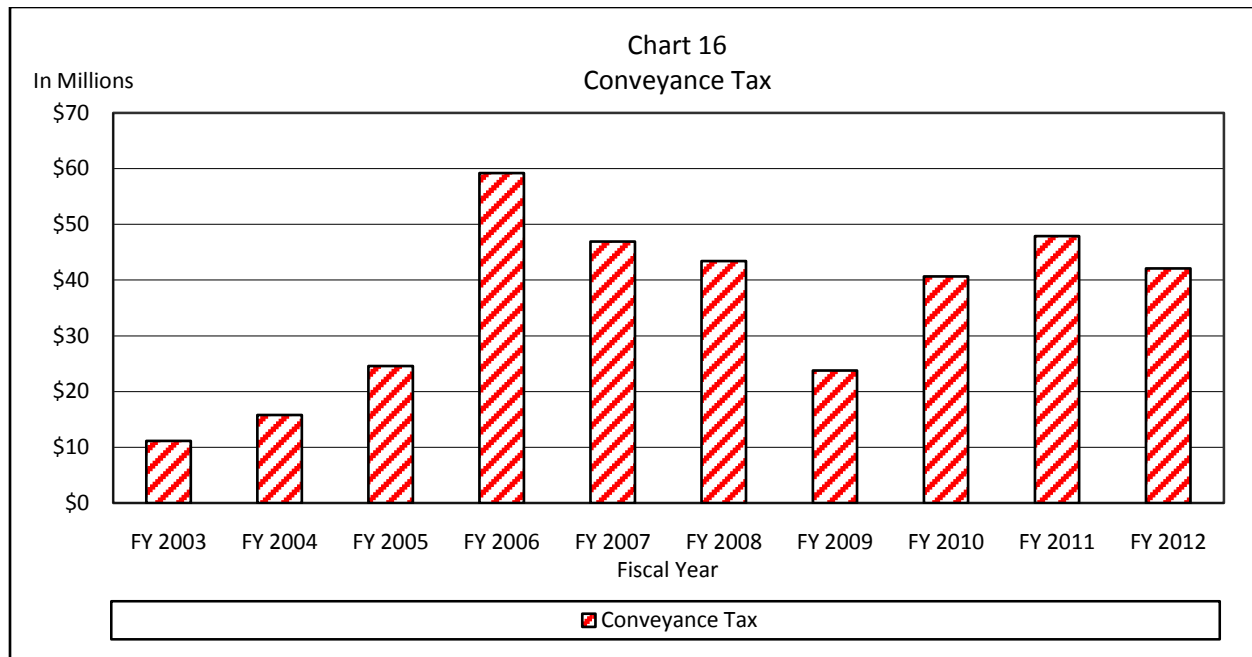
The conveyance tax is imposed on all documents transferring ownership or interest in real property and is based on the actual and full consideration paid or to be paid. The conveyance tax rate ranges from 10 cents per \$100 for properties with a value of less than \$600,000 to \$1 per \$100 for properties 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 cents per \$100 for properties with a value of less than \$600,000 to \$1.25 per \$100 for properties with a value of \$10,000,000, or greater.

The conveyance tax is collected by the Bureau of Conveyances under the Department of Land and Natural Resources.

1.13.2 Revenue

During FY 2012, revenue from the conveyance tax totaled \$42.1 million, compared to \$47.9 million in FY 2011, a decrease of 12.1% (\$5.8 million). Of the \$42.1 million, \$18.9 million was allocated to the General Fund, the remainder going to the Rental Housing Fund, the Natural Area Reserve Fund, and the Land Conservation Fund.



1.14 BANK AND OTHER FINANCIAL CORPORATIONS TAX

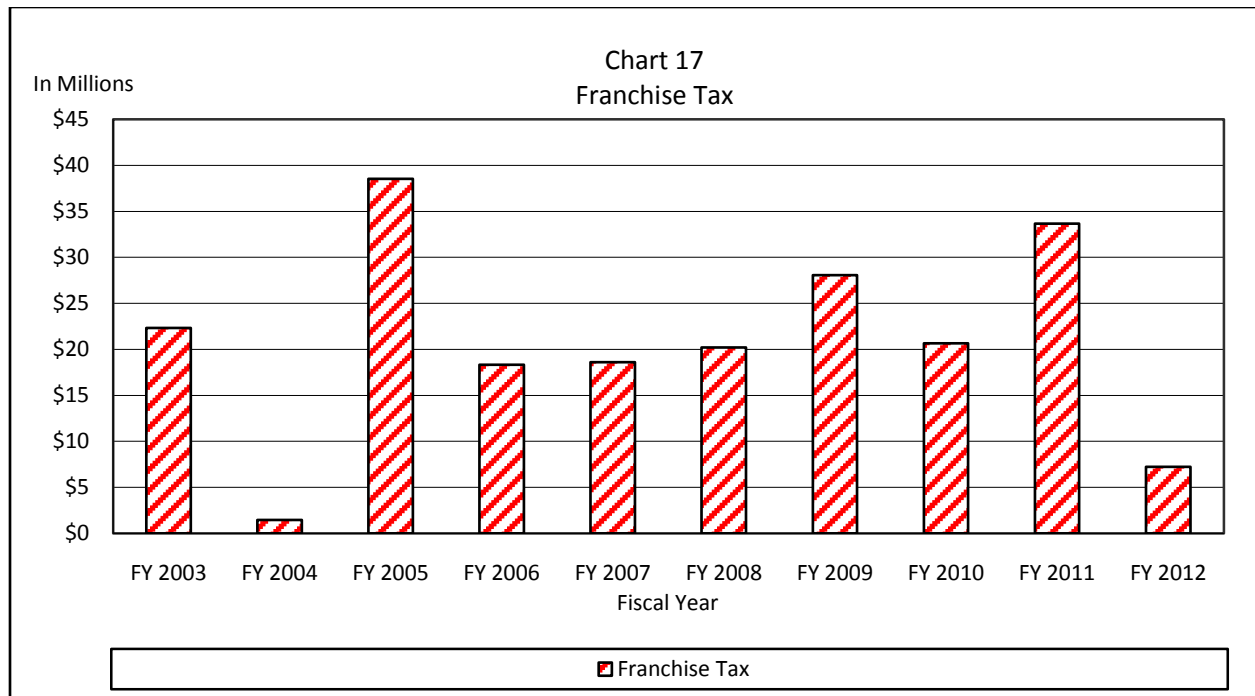
1.14.1 Overview

The tax on bank and other financial corporations is 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.

The tax is on net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. The rate of the tax is 7.92% of taxable income. The assessment date is January 1.

1.14.2 Revenue

During FY 2012, franchise tax collections totaled \$7.2 million, compared to \$33.7 million in FY 2011, a decrease of 78.6% (\$26.5 million). The decrease in FY 2012 is due partly to a one time transfer of \$16.5 million to the litigated claim fund.



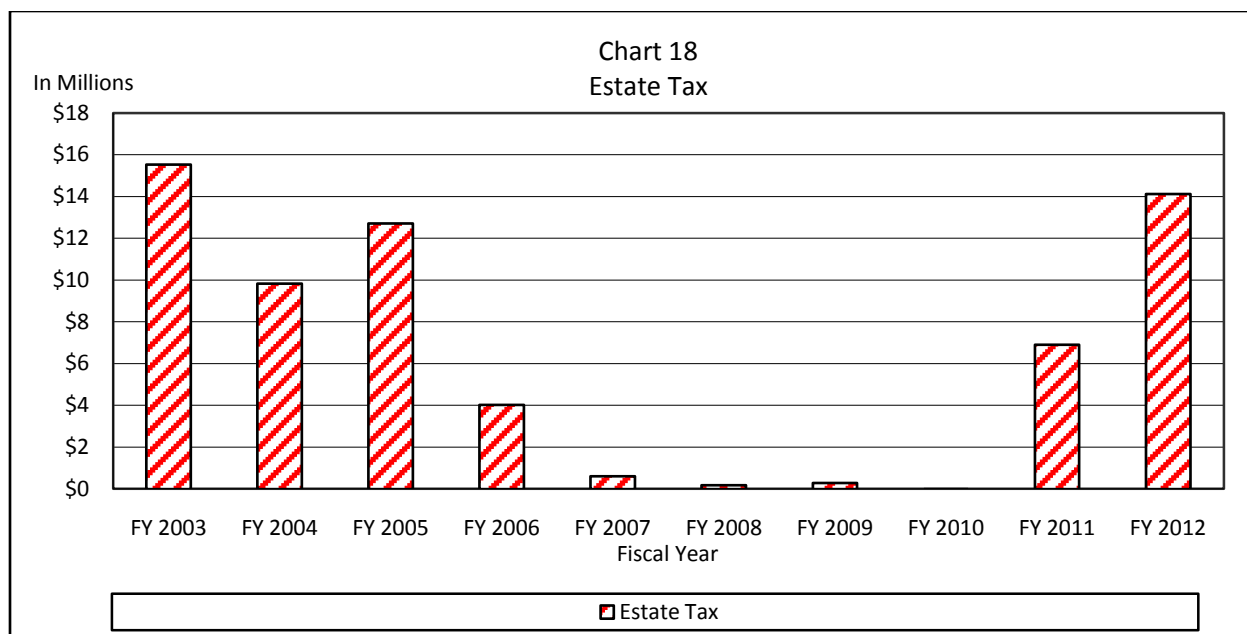
1.15 ESTATE AND TRANSFER TAX

1.15.1 Overview

“Hawaii taxable estate” means the federal taxable estate, but without regard for the deduction for state death taxes paid, with adjustments for nonresidents. The Hawaii exclusion amount is the same as the federal exclusion amount, or the exemption equivalent of the unified credit, without reduction for taxable gifts, with adjustments for nonresidents.

1.15.2 Revenue

During FY 2012, estate tax collections totaled \$14.1 million, compared to \$6.9 million in FY 2011, an increase of 104.3% (\$7.2 million).



1.15.3 Recent Legislation

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, SLH 2010, reenacted Hawaii's Estate and Transfer Tax for decedents dying after April 30, 2010. The new tax made 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 are used to define the Hawaii estate tax base, were made operative as of December 31, 2000. An applicable exclusion amount of up to \$3.5 million per decedent was provided. The tax also was imposed on transfers made by nonresidents who are not United States citizens.

Act 220, SLH 2012, altered the Estate and Transfer tax for decedents dying after January 25, 2012. The new tax is based on the federal taxable estate, but has its own rate schedule, with tax rates varying from 10% to 15.7%. The generation skipping tax is also based on the federal taxable estate, but has its own rate (2.25%).

Effective January 1, 2012, Act 1, SLH 2011, provides that all provisions of the IRC referred to in this chapter that apply to a husband and wife, spouses, or person in a legal marital relationship shall be deemed to apply in this chapter to partners in a civil union with the same force and effect as if they were "husband and wife", "spouses", or other terms that describe persons in a legal marital relationship.

1.16 CITY AND COUNTY OF HONOLULU SURCHARGE TAX

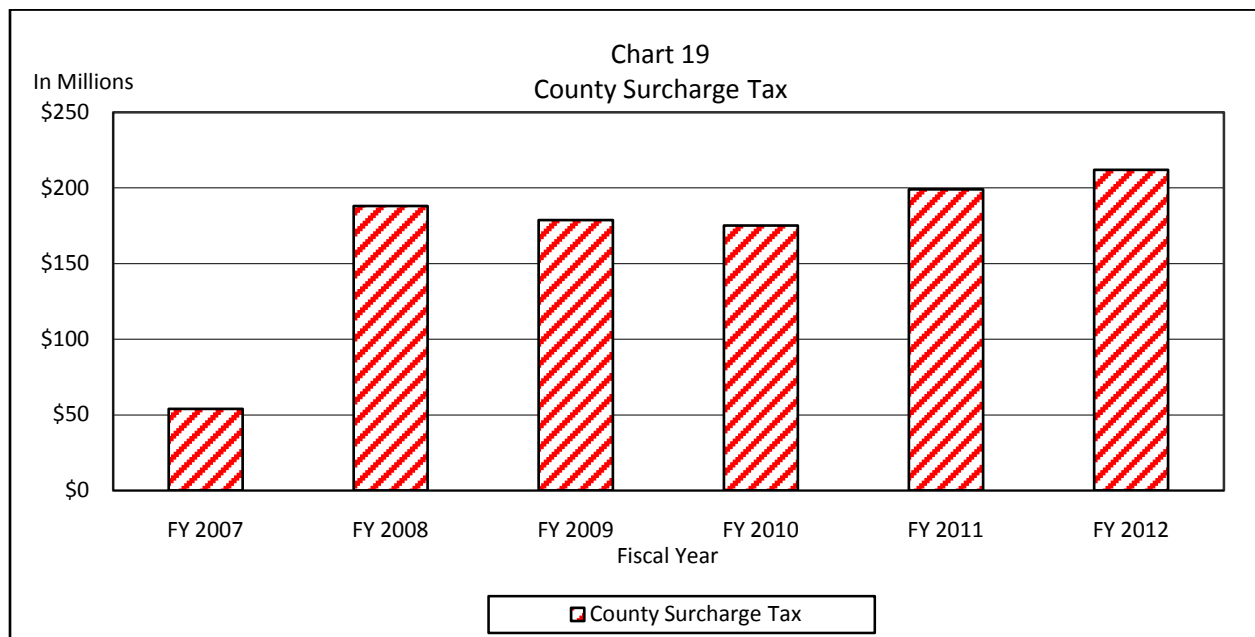
1.16.1 Overview

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% GET 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.

The state keeps 10% of the surcharge tax collected as administrative costs, and the Honolulu County receives 90% of the surcharge tax collected.

1.16.2 Revenue

In FY 2012, the Honolulu surcharge was \$211.9 million, an increase of 6.5% (\$12.8 million) compared to FY 2011. However, \$9.9 million of this amount was returned to the general fund in FY 2013.



1.17 TOTAL TAX COLLECTIONS

Total tax collections in FY 2012 amounted to \$6.0 billion, or about 13.4% more than the \$5.3 billion collected in the previous fiscal year. The Department collected the majority of the total taxes, but the counties collected \$105.3 million in State motor vehicle weight taxes and

registration fees, the Department of Commerce and Consumer Affairs collected \$121.6 million in insurance premium taxes and fees, the Department of Land and Natural Resources collected \$42.1 million in conveyance taxes, and the Department of Labor and Industrial Relations collected \$231.7 million in employment security contributions.

TABLE 8 - TAX COLLECTIONS
(In thousands of dollars)

SOURCE OF REVENUE	FY 2012		FY 2011	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	7,229	0.12%	33,677	0.64%
Conveyance	42,106	0.70%	47,906	0.90%
Employment Security Contributions	231,669	3.86%	190,511	3.60%
Fuel	193,101	3.21%	195,336	3.69%
General Excise & Use	2,697,951	44.90%	2,495,807	47.12%
Honolulu County Surcharge	211,850	3.53%	199,010	3.76%
Income – Corporations	73,026	1.22%	34,573	0.65%
Income – Individuals	1,541,051	25.65%	1,247,153	23.54%
Inheritance and Estate	14,125	0.24%	6,899	0.13%
Insurance Premiums & Fees	121,586	2.02%	145,325	2.74%
Liquor & Permits	48,854	0.81%	48,054	0.91%
Motor Vehicle Tax 1/	211,742	3.52%	106,166	2.00%
Public Service Companies	150,528	2.51%	117,940	2.23%
Tobacco & Licenses	138,798	2.31%	143,293	2.71%
Trans. Accom. Fees	11	0.00%	9	0.00%
Trans. Accom. Tax	323,940	5.39%	284,463	5.37%
All Others 2/	672	0.01%	939	0.02%
TOTAL	6,008,236	100.00%	5,297,062	100.00%

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

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

2/ Includes Fuel Retail Dealers Permits, Fuel Penalty and Interest, Permitted Transfers Tax, and General Excise Fees.

1.18 DISTRIBUTION OF TAXES

Of the total \$6.0 billion in tax revenues collected in FY 2012, \$5.0 billion or 82.9% was deposited into the State's General Fund. The four counties received \$165.3 million or 2.8% of the tax collections, which came from county fuel taxes and the transient accommodations tax. In addition, \$211.9 million was collected and credited to the City and County of Honolulu county surcharge tax.

The remaining \$653.2 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, \$237.5 million. All \$231.7 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: \$69.0 million to the Tourism Special Fund and \$35.6 million to the Convention Center Fund.

For FY 2012, 10% of the conveyance tax was allocated to the Land Conservation Fund, 25% was allocated to the Rental Housing Trust Fund and 20% was allocated to the Natural Area Reserve Fund. The balance of the conveyance tax collections (45%) was allocated to the General Fund.

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 2012		FY 2011	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$5,229	0.11	\$31,677	0.73
Conveyance	18,917	0.38	21,527	0.50
General Excise & Use	2,697,951	54.20	2,495,807	57.65
Income - Corporations	73,027	1.47	34,573	0.80
Income - Individuals	1,540,588	30.95	1,246,672	28.80
Inheritance & Estate	14,125	0.28	6,899	0.16
Insurance Premiums	116,777	2.35	140,456	3.24
Liquor & Licenses	48,854	0.98	48,054	1.11
Public Service Companies	150,528	3.02	117,940	2.72
Tobacco & Licenses	102,853	2.07	106,137	2.45
Trans. Accom. Tax	126,302	2.54	59,757	1.38
All Others 1/	82,698	1.66	19,812	0.46
TOTAL	\$4,977,849	100.00	\$4,329,311	100.00

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

1/ Includes Fuel Retail Dealers Permits, Fuel Penalty and Interest, Permitted Transfer Tax, General Excise Fees, Transient Accommodations Fees, Insurance Fees, Environmental Tax, and Rental Motor Vehicle Surcharge and Rental Vehicle Fees.

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

	FY 2012		FY 2011	
	Amount Distributed	% of Total	Amount Distributed	% of Total
STATE FUNDS:				
State General	\$4,977,848	82.85	\$4,329,311	81.73
State Highway	237,542	3.95	195,765	3.70
State Airport	4,353	0.07	4,045	0.08
Boating Special Fund	1,611	0.03	1,666	0.03
Environmental Fund	1,315	0.02	1,403	0.03
Cigarette Stamp Admin/Enf. Fund	2,290	0.04	2,231	0.04
Compliance Resolution Fund	2,000	0.03	2,000	0.04
Unemployment Trust	231,669	3.86	190,511	3.60
Election Campaign Fund	157	0.00	223	0.00
Tourism Special Fund	69,000	1.15	84,981	1.60
Rental Housing Fund	10,540	0.18	11,990	0.23
Land Conservation Fund	4,216	0.07	4,796	0.09
Natural Area Reserve Fund	8,432	0.14	9,592	0.18
Convention Center Fund	35,637	0.59	36,795	0.69
Public Libraries Fund	73	0.00	62	0.00
Domestic Violence/Child Abuse	154	0.00	129	0.00
School Repair & Maintenance Fund	77	0.00	66	0.00
Cancer Research Fund	16,828	0.28	17,496	0.33
Trauma System Fund	6,312	0.11	6,544	0.12
Emergency Medical Service Fund	4,203	0.07	4,341	0.08
Community Health Centers Fund	6,312	0.11	6,544	0.12
Energy Security Fund	3,944	0.07	3,499	0.07
Energy Systems Development Fund	2,629	0.04	2,332	0.04
Agricultural Dev. & Food Security Fund	3,944	0.07	3,499	0.07
Subtotal - State	\$5,631,089	93.72	\$4,919,822	92.88
HONOLULU COUNTY SURCHARGE:	\$211,850	3.53	\$199,010	3.76
REVENUES TRANSFERRED TO COUNTIES:				
Other County Revenues				
Fuel	\$72,297	1.20	\$75,299	1.42
Trans. Accom. Tax	93,000	1.55	102,931	1.94
Subtotal - Counties	\$165,297	2.75	\$178,230	3.36
TOTAL	\$6,008,236	100.00	\$5,297,062	100.00

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

1.19 TRENDS IN TAX COLLECTIONS

Table 11 provides data on tax collections for fiscal years 2003 through 2012.

TABLE 11 - HISTORICAL COLLECTIONS FOR SELECTED TAXES

(In thousands of dollars)

SOURCE OF REVENUE	Fiscal Year				
	2003	2004	2005	2006	2007
General Excise and Use	\$1,792,699	\$1,900,377	\$2,136,603	\$2,355,316	\$2,555,762
Income - Individuals	1,038,107	1,168,953	1,381,480	1,550,596	1,560,286
Transient Accommodations	170,874	181,860	198,784	217,008	224,942
Unemployment Insurance	135,991	15,828	134,459	149,388	134,612
Motor Vehicle Tax 3/	88,429	91,957	100,278	107,527	112,412
Fuel	148,680	160,127	162,873	166,138	169,712
Public Service Companies	114,115	99,505	108,686	120,679	124,017
Tobacco and Licenses	72,297	79,387	85,245	88,261	94,387
Insurance Premiums 1/	73,240	78,142	83,077	88,068	92,196
Income - Corporations	8,262	56,653	85,605	130,010	81,834
Liquor and Permits	41,186	41,250	43,737	45,955	46,034
Conveyance	11,130	15,767	24,583	59,201	46,887
Banks-Financial Corporations	22,341	1,466	38,520	18,324	18,599
Total Collections 2/	\$3,733,531	\$4,044,223	\$4,597,415	\$5,101,011	\$5,316,593

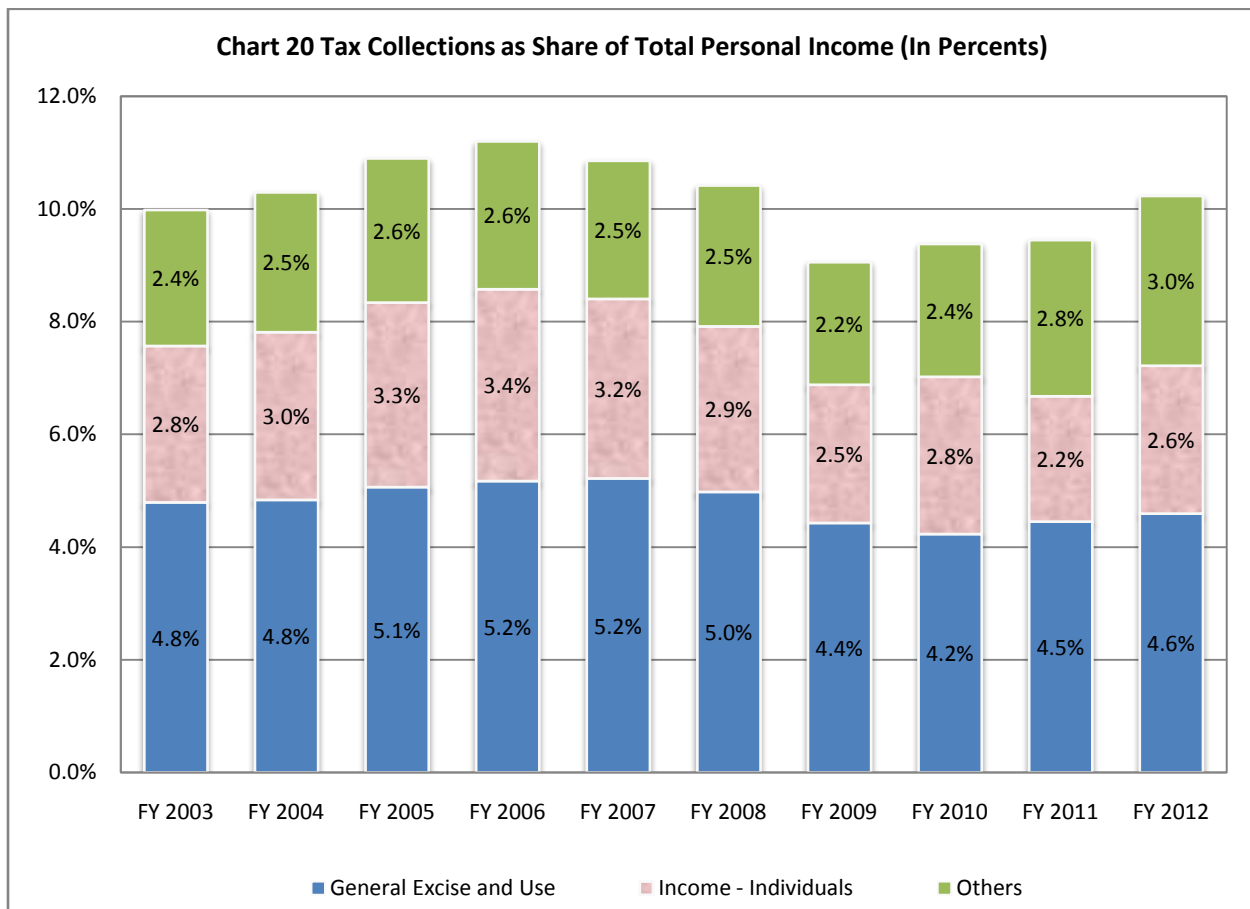
SOURCE OF REVENUE	Fiscal Year				
	2008	2009	2010	2011	2012
General Excise and Use	\$2,618,787	\$2,417,580	\$2,316,434	\$2,495,807	\$2,697,951
Income - Individuals	1,544,835	1,339,056	1,528,110	1,247,153	1,541,051
Transient Accommodations	229,388	210,622	224,252	284,472	323,951
Unemployment Insurance	92,279	49,071	82,017	190,511	231,669
Motor Vehicle Tax 3/	112,448	101,991	102,319	106,166	211,742
Fuel	169,927	165,717	155,703	195,336	193,101
Public Service Companies	127,481	126,069	157,661	117,940	150,528
Tobacco and Licenses	104,624	108,164	123,489	143,293	138,798
Insurance Premiums 1/	95,742	93,720	105,014	145,325	121,586
Income - Corporations	85,081	53,522	59,186	34,573	73,026
Liquor and Permits	45,620	47,242	44,074	48,054	48,854
Conveyance	43,421	23,772	40,634	47,906	42,106
Banks-Financial Corporations	20,212	28,075	20,666	33,677	7,229
Total Collections 2/	\$5,478,491	\$4,944,133	\$5,135,100	\$5,297,062	\$6,008,236

1/ Includes Insurance Fees in fiscal year 2010 and later years.

2/ Includes the Inheritance and Estate Tax, the Honolulu County Surcharge, fuel permits, interest and penalties on fuel taxes, and general excise fees.

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

Chart 20 shows tax collections relative to total personal income (TPI) in the State. For the period of FY 2003 to FY 2006, tax collections' share relative to TPI was increasing. Beginning FY 2007 to FY 2011, tax collections' share relative to TPI declined, with the biggest decline in the share of individual income tax relative to TPI.

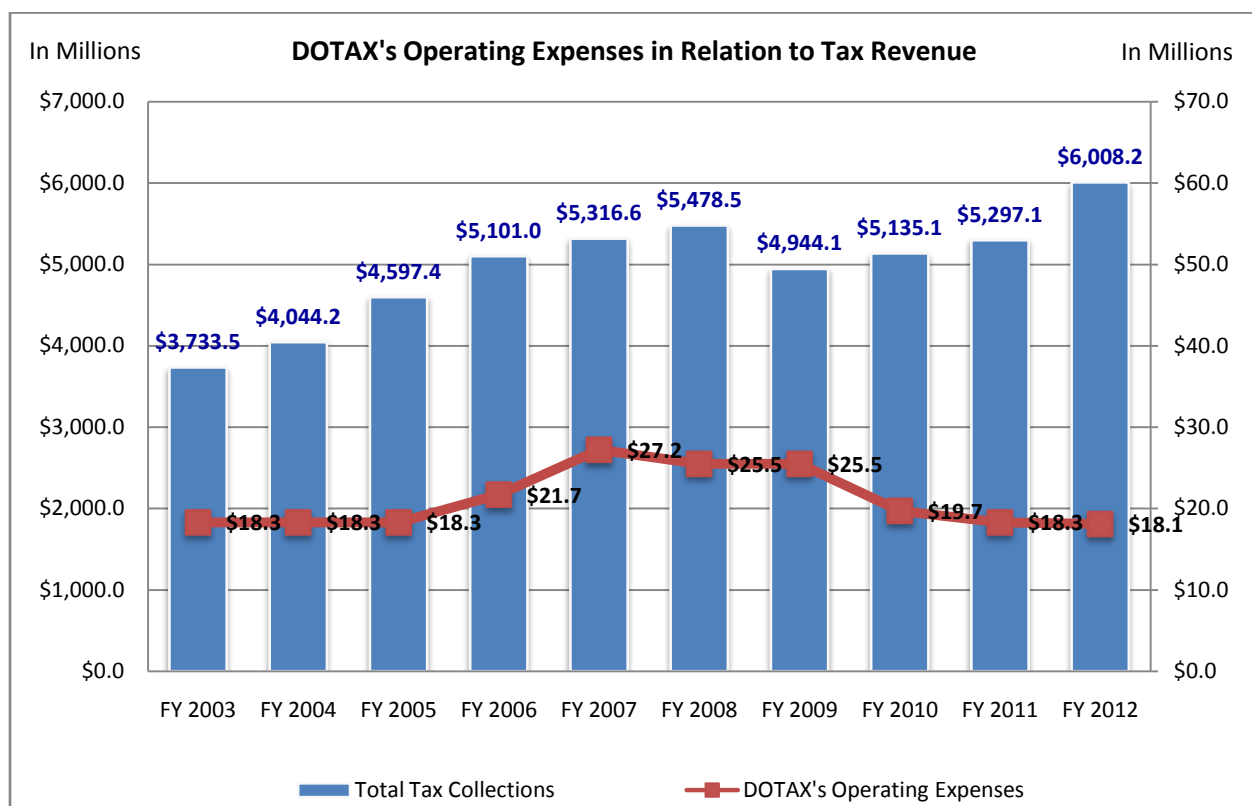


2.0 TAX ADMINISTRATION

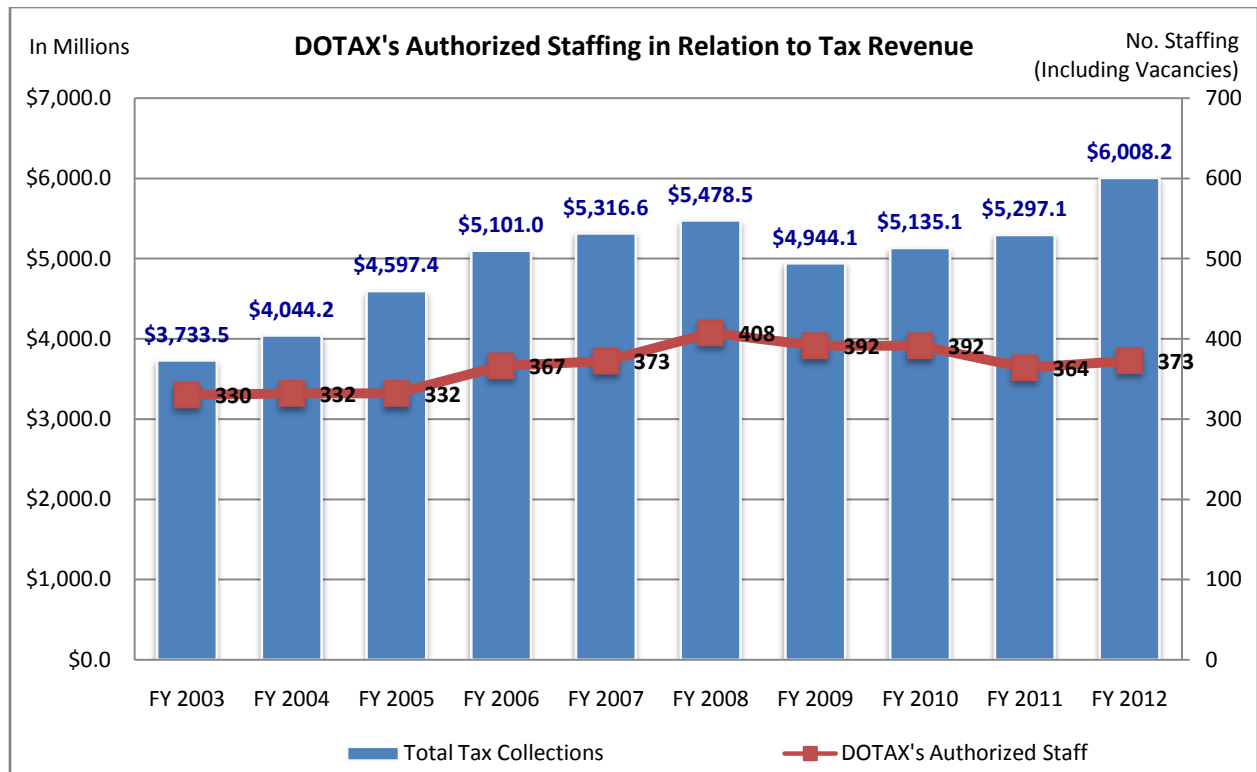
2.1 OVERALL PERFORMANCE

The Department of Taxation 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 Services Office, and the System Administration Office.

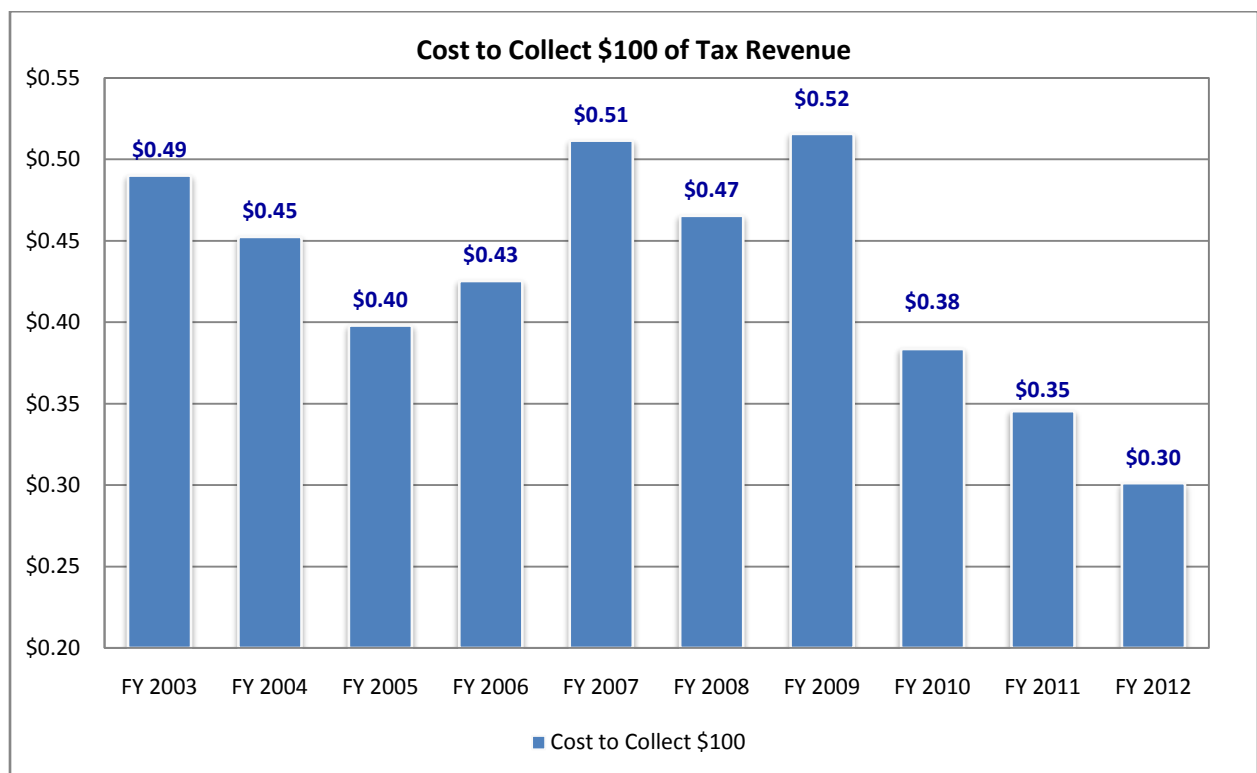
The Department's operating budget is a small fraction of total tax revenue. In FY 2012, the Department's operating expenses are about 0.3% of total tax revenue.



Beginning with FY 2009, the Department's operating budget and the number of authorized staffing has been reduced from its peak during FY 2008. The reduction in force in FY 2009, resulted in an 11% decrease in the Department's staffing. In addition, there was a hiring freeze. Positions that became vacant were not filled due to the hiring freeze resulted in a vacancy rate of approximately 20%. The Abercrombie Administration has lifted the hiring freezes. However, due to the lengthy hiring process, restoring the Department's staffing has been a challenge.



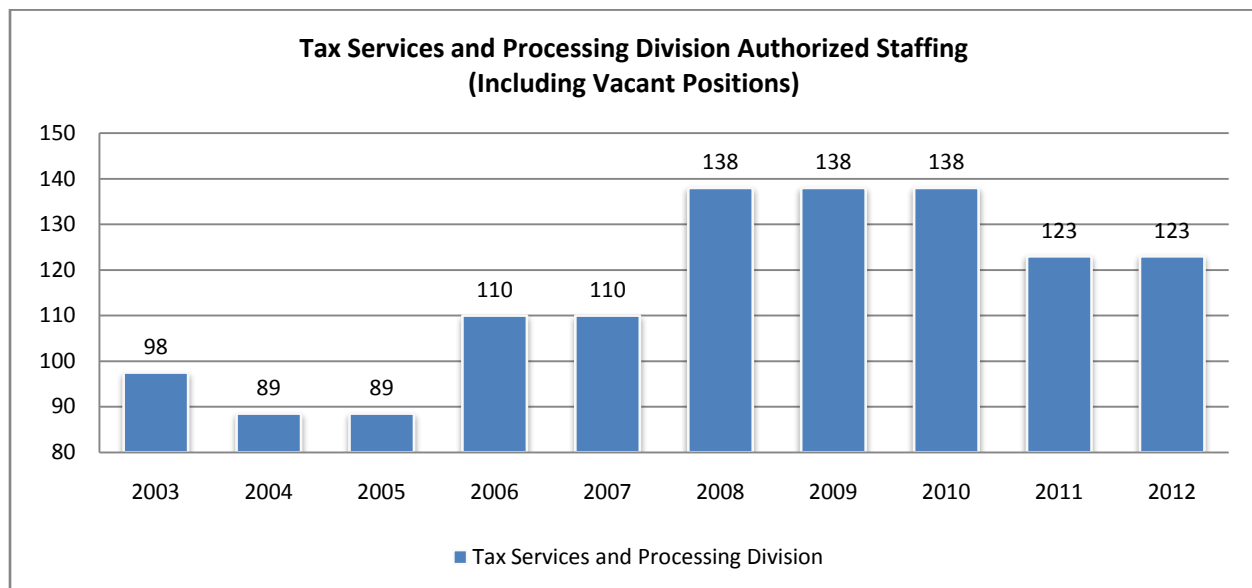
The cost to collect \$100 of tax revenue in FY 2012 is \$0.30 compared to \$0.35 in FY 2011.



2.2 TAX SERVICES AND PROCESSING DIVISION

2.2.1 Overview

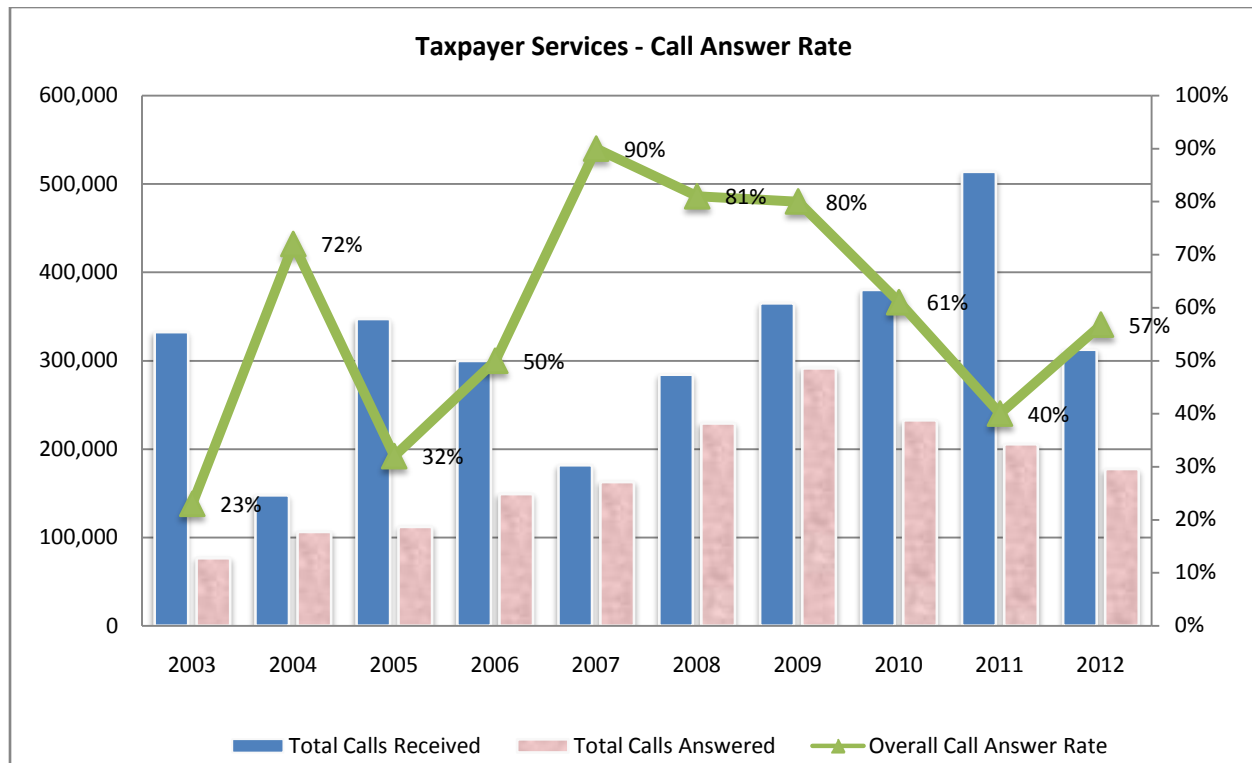
The Tax Services and Processing (“TSP”) Division consists of three branches: (1) Taxpayer Services, (2) Document Processing, and (3) Revenue Accounting. Each branch's objectives are unique to its specific functions, with an overall Division objective to perform all functions relating to the centralized 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 first half of fiscal year 2012, the TSP Division continued its transition from its historical Legislative performance measures (in Act 100 SLH 1999) to using performance measures that support the Department's "A New Day in Hawaii" strategic plan. The Division's strategic plan objectives and performance measures are still fluid at the end of FY 2012 and are intended to provide a starting point for future discussion, research, and extensive stakeholder involvement.

2.2.2 Taxpayer Services Branch

The main 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 2012, Customer Inquiry faced the task of properly servicing more than 330,000 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:	34,168
Total number of taxpayers serviced through the Call Center:	244,973
Total number of tax clearances issued:	27,229
Total number of paper and electronic mail (email) responses:	<u>25,627</u>
Total number of taxpayers serviced	331,997

With no major initiatives affecting Taxpayer Services, the call pickup rate for FY 2012 climbed from 40% in FY2011 to 57% in FY2012. The call statistics for fiscal years ending 2012, 2011, 2010, and 2009 are reported as follows:

FY	Total Incoming Calls	Total Calls Answered	Overall Call Answer Rate
2012	312,441	177,367	57%
2011	513,503	205,383	40%
2010	380,142	232,471	61%

Despite the challenges posed by such factors as reduced staffing, TPS continued to strive to improve its response to taxpayer requests made by telephone, by correspondence, and in person.

Account Management experienced a relatively smooth tax season during FY 2012. With minimal processing delays and technical problems, the worklist inventory was kept at a manageable level.

As a result, the normal rush to clear the refund returns off the worklist to avoid accruing interest did not occur this fiscal year.

Licensing processed 9,850 cancellations in FY 2012, a significant decline from FY 2011, during which 20,267 cancellations were processed. The decline in cancellations has continued from FY 2010 when, as a result of the non-filer project, thousands of taxpayers cancelled their dormant accounts. The total number of license applications processed in FY 2012 was 22,271, a decline from 27,630 applications processed in FY 2011.

2.2.3 Document Processing Branch

The major function of the Document Processing (“DP”) Branch is to orderly process and control all tax returns and documents; receive, to secure, deposit, and account for tax payments; and to store, file, and retrieve such documents. The branch has six sections: Receiving and Sorting, Data Preparation, Monetary Control, Imaging and Data Entry, File Maintenance, and Electronic Processing.

During FY 2012, the DP Branch processed 2,404,685 returns, 821,786 (34.2%) of which were electronically transmitted. The DP Branch also processed approximately 3.5 million payments totaling more than \$5.96 billion during the year, \$74 million more than in FY 2011.

The Joint Electronic Filing Program (“JELF”) with the Internal Revenue Service (“IRS”) is in its thirteenth and final year, as it is being phased out by the IRS and replaced with their Modernized e-Filing (“MeF”) application beginning 2013. As of October 2012, the MeF core team has completed the schema and business rules for the selected forms and is currently awaiting the finalization of the federal forms for tax year 2012 to begin testing with the IRS in order to “go live” in early 2013. The Electronic Processing Section supervisor was a member of the MeF core team.

The JELF Legacy program allows certain individual taxpayers who file either Form N-11 (the resident return) or Form N-15 (the non-resident return) to file electronically utilizing State-approved software vendors. The number of Hawaii returns filed through JELF increased by 11% from 383,360 returns last year to 424,624 returns this year.

Taxpayers may also electronically file Form N-13 (the short form of the individual income tax return), as well as certain business income tax returns and payments for corporation, partnership, fiduciary, individual, and other business taxes. In FY 2012, taxpayers electronically filed 679,434 returns and payments for various taxes through the Department's website, resulting in a 21.4% 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 decreased slightly by 1% in FY 2012, with 5,067 returns filed in FY 2012 versus 5,111 returns filed in FY 2011.

In total, the DP Branch processed an average of 71.5% of all returns and payments within six calendar days in FY 2012, and 26.2% of all remittances were cashiered within four calendar days from the postmark date.

The Department's Bulk Filing program, which allows practitioners and payroll companies to electronically transmit withholding tax returns in bulk, has been modified and improved. One of the main changes to this program allows for payroll companies and other agents to electronically transmit withholding payments in bulk, along with the withholding tax returns. About a dozen payroll and other companies have expressed interest in the new program. The Electronic Processing Section staff will be trained to assist companies in the bulk filing process.

2.2.4 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 preparing the Preliminary Report, the Statement of Tax Operations (STO), and related reports.

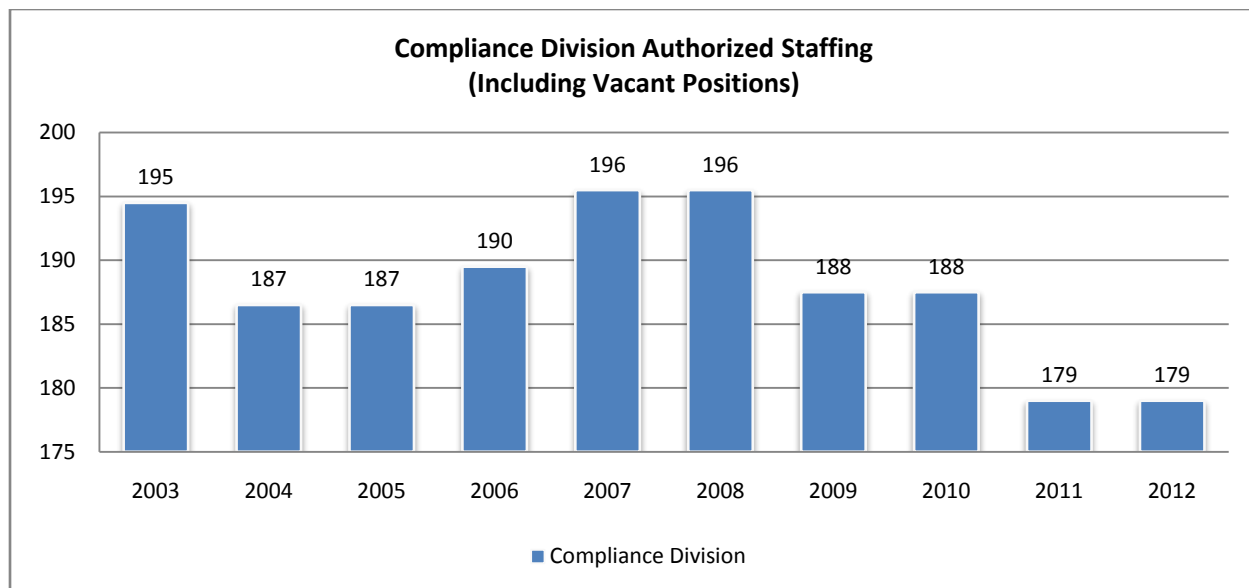
The Preliminary Report is a monthly, statewide summary of all revenues received by the Department, less the amount of tax refunds, which is prepared by the fifth working day of each month. The STO is a formal, detailed report of State revenues that is based on the Preliminary Report and that is prepared by the tenth working day of each month. The RA Branch has consistently met the critical deadlines for these reports throughout the fiscal year.

Secondary functions of this branch include statewide manual accounting activities for all miscellaneous tax collections, 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.

2.3 COMPLIANCE DIVISION

2.3.1 Overview

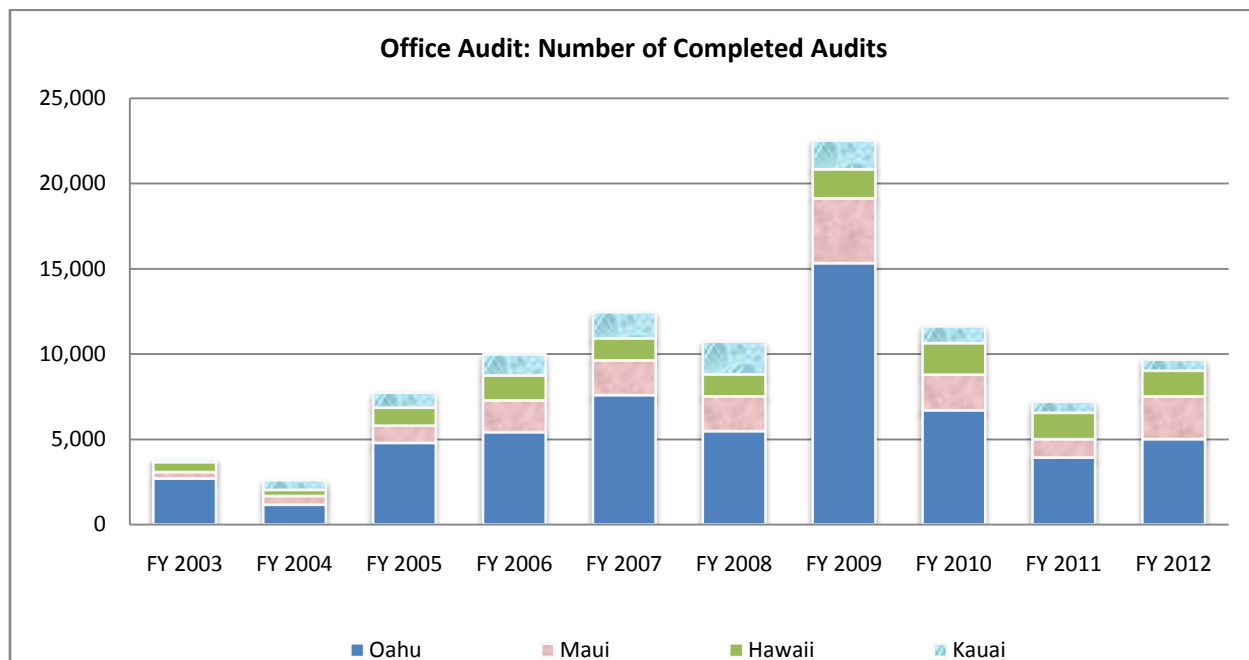
The objective of the Compliance Division is to maximize taxpayer compliance with Hawaii's tax laws in a consistent, uniform, and fair manner. The Compliance Division is composed of the Oahu Office Audit Branch, Oahu Field Audit Branch, Oahu Collections Branch, and the Maui, Hawaii, and Kauai District 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).

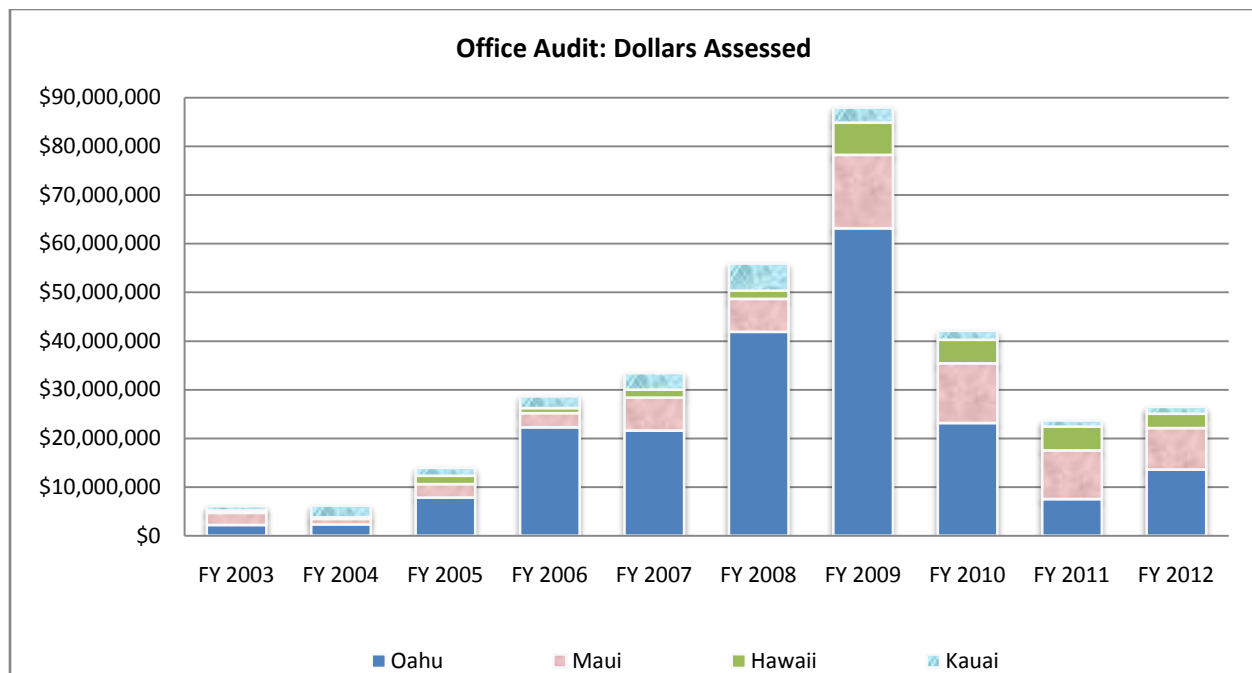


2.3.2 Office Audit Branch

The Office Audit Branch performed the examinations and audits to enhance voluntary compliance.

In FY 2012, the number of audits completed by Office Audit Branch was 9,675 cases, an increase of 34.3% (2,473 cases) compared to FY 2011, and the total dollars assessed was \$26.5 million, an increase of 11.8% (\$2.8 million) compared to FY 2011. The majority of the audits were performed by Oahu Office Audit Branch, followed closely by Maui District Office.





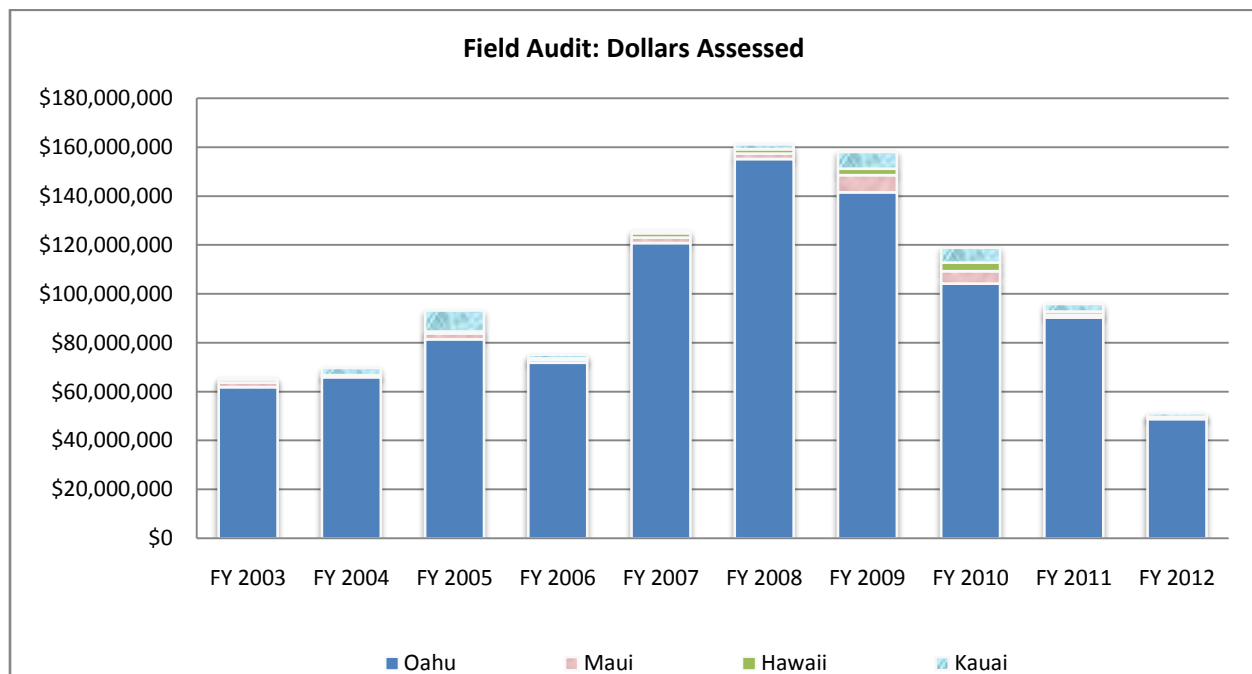
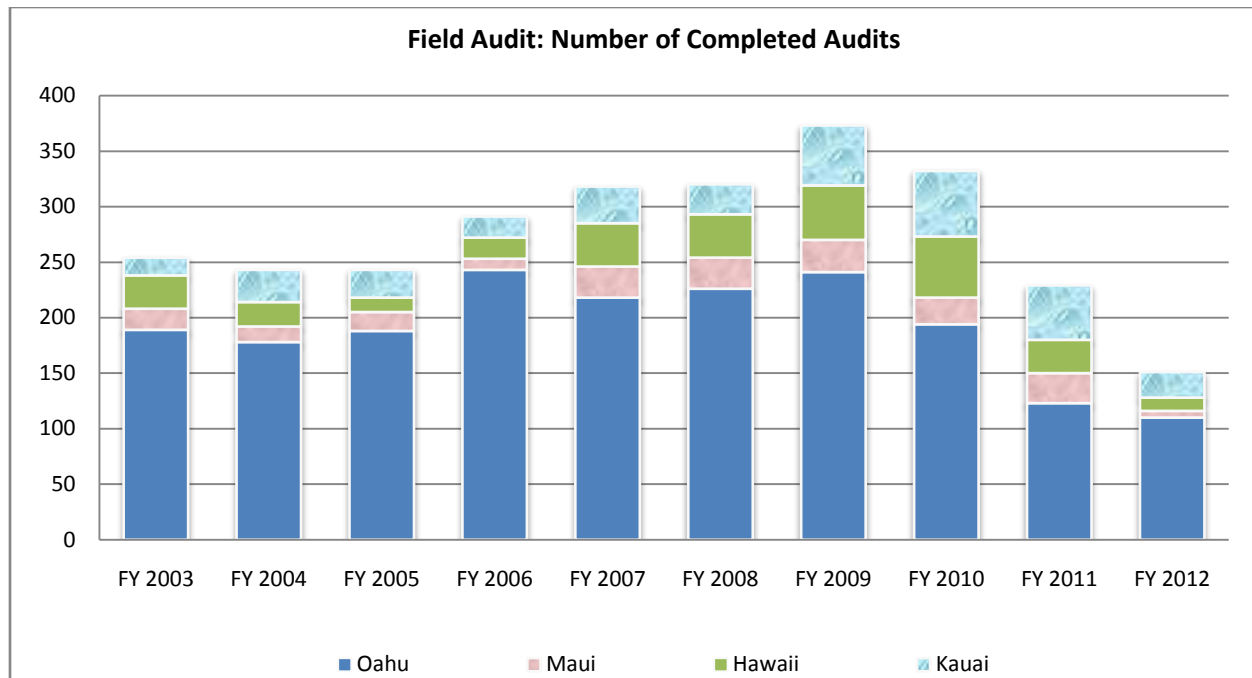
In FY 2012, the Office Audit section handled the processing of the Estate and Transfer Tax returns and collected \$5.0 million for estate tax returns.

2.3.3 Field Audit Branch

Similar to the Office Audit Branch, the Field Audit Branch performed examinations and audits to enhance voluntary compliance. Field Audit Branch handled more complex cases than Office Audit Branch.

In FY 2012, the number of audits completed by Field Audit Branch was 151 cases, a decrease of 34.1% (78 cases) compared to FY 2011, and the total dollars assessed was \$51.2 million, a decrease of .6% (\$44.7 million). The decline in the output of the Field Audit Branch was attributable to budget restrictions and cuts, employee hiring freeze, additional time off with the 5% pay cut, and the assignment of staff to work on special projects.

The majority of the audit was performed by Oahu Field Audit Branch.



2.3.4 Revenue – Office and Field Audit Assessments

The amount collected at the time the audits were closed and prior to the mailing of any billing notices increased from \$32.4 million in FY 2011 to \$55.7 million in FY 2012.⁴ The \$55.7 million represents a collection rate of 71.7%.

⁴ Dollars assessed are assessments generated during the 2012 fiscal year. The dollar amount collected is for collections during the 2012 fiscal year and may include assessments from prior fiscal years.

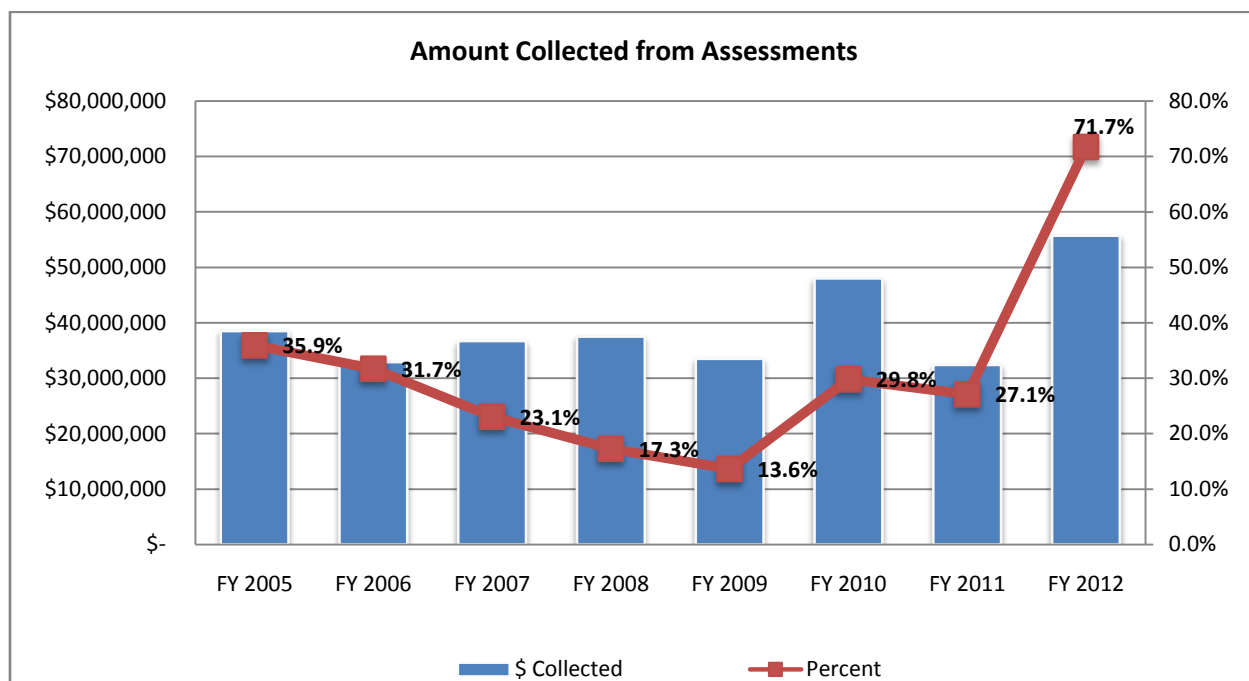


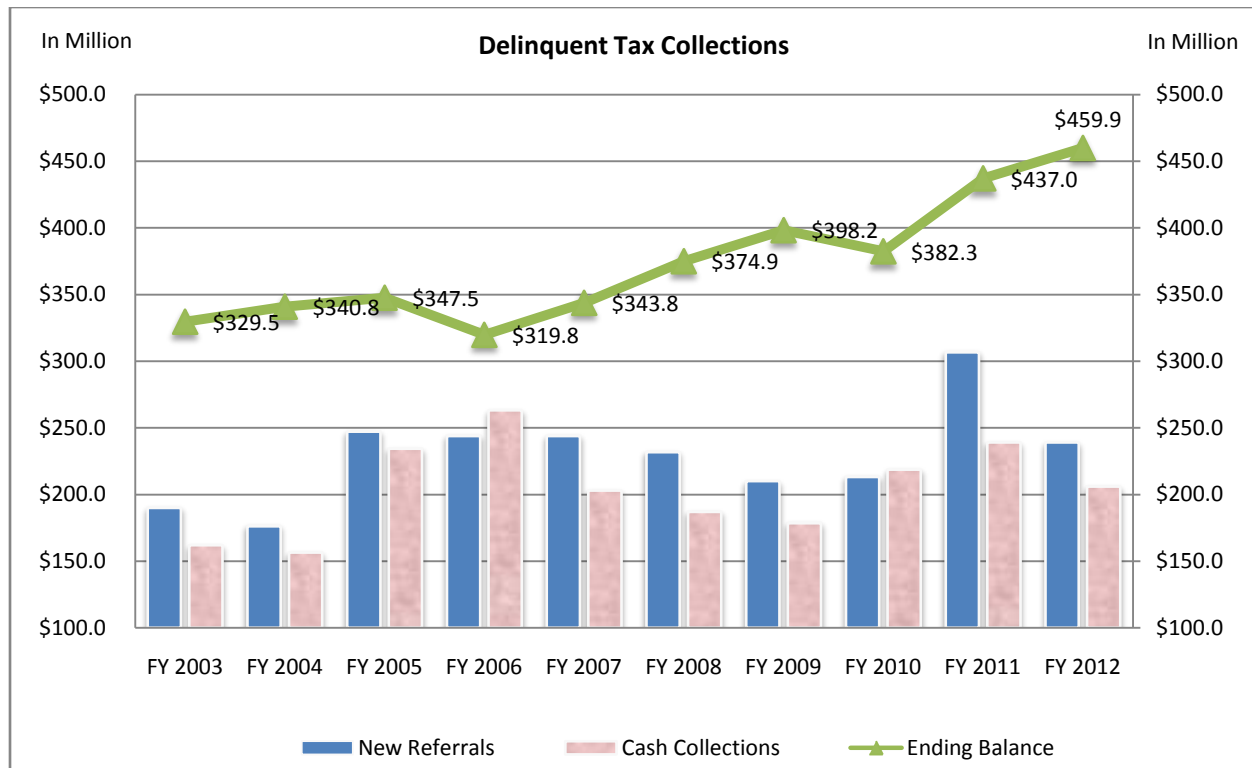
Table summarizing the audit assessments performed by Office and Field Audit Branches in FY 2012 is presented below.

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits Completed	Dollars Assessed	Number of Audits Completed	Dollars Assessed
Oahu	5,010	\$ 13,589,571	110	\$48,855,910
Maui	2,502	8,519,226	6	507,702
Hawaii	1,507	2,948,099	12	379,265
Kauai	656	1,420,524	23	1,489,656
Total FY 2012	9,675	\$26,477,420	151	\$51,232,533
Total FY 2011	7,202	23,682,638	229	95,912,070
Difference	2,473	\$2,794,782	(78)	(\$ 44,679,537)

2.3.5 Collection Branch

The operations of Compliance Division's Tax Collections program consist of the Oahu Collection Branch and the Collections Sections in the Maui, Hawaii, and Kauai District Tax Offices.

Combined tax collections for FY 2012 was \$205.9 million, a decrease of 12.9% (\$33.1 million) compared to delinquent tax collections in FY 2011. The decline in productivity was attributable to budget restrictions, hiring freezes, retirements and resignations.



A table of major performance measures for FY 2012 is presented below:

<u>Measure</u>	<u>FY 2012</u>	<u>FY 2011</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Total Delinquent Tax Balance (\$ Millions)	\$ 460.0	\$ 437.1	\$ 22.9	5.2
Total New Delinquent Referrals (\$ Millions)	\$ 239.0	\$ 306.6	\$ (67.9)	(22.0)
Total Cash Collected (\$ Millions)	\$ 205.9	\$ 239.0	\$ (33.1)	(13.8)
Uncollectible Tax Write-Offs (\$ Millions)	\$ 10.2	\$ 12.9	\$ 2.7	20.9
Payment Plans Initiated	30,658	31,753	(1,095)	3.4
Tax Liens Filed	5,022	6,896	(1,874)	(27.1)
Levies Served	20,700	12,862	7,838	60.9

An initiative was begun in 2003 to partner with the Internal Revenue Service to offset the delinquent taxes owed to the State using taxpayers' federal tax refunds. During FY 2012, there were 868 offsets to the State's delinquent taxpayers with a total of \$871,987.48 dollars collected.

2.3.6 Criminal Investigations Tax Unit

Criminal investigations resulted in a number of referrals to the Criminal Justice Section of the Department of the Attorney General, which in FY 2012 filed indictments and complaints against 13 taxpayers. A total of \$57,500 in judicial fines and over \$1 million in tax assessments were

imposed. In addition, the collector assigned to criminal cases collected \$1.4 million in taxes, penalty and interest charges, and fines.

2.3.7 Special Enforcement Section

Act 134, SLH 2009, provided resources for the creation of the Special Enforcement Section (SES), which is 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 SES began conducting high-risk and complex civil tax investigations in FY 2010.

In FY 2012 the unit was staffed with only three investigators. In the prior year, the unit was staffed with four investigators, a supervisor, and an auditor assigned to assist investigators on SES cases. Despite the staff shortage, the unit produced the following results in FY 2012:

	FY 2012
Complaints Filed	147
Vendors Educated	1,608
Site Visitations	27
Investigations Completed	32
Investigations Sent to Audit	12
Total Dollars Assessed	\$105,990
Total Dollars Secured Returns	\$1,254,409
Total Dollars Collected	\$903,559

2.3.8 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, 17 audits were completed and resulted in \$7.4 million in assessments.
- Referral Cases from Criminal Investigation Unit: During this fiscal year, 26 cases that were either originally considered for possible criminal prosecution or arose pursuant to a criminal investigation were completed, resulting in \$11.2 million in assessments.
- Research Tax Credit: During this fiscal year, 11 audit cases involving the research tax credit were completed resulting in \$5.3 million in assessments.
- Online Travel Companies: The Field Audit Branch assisted the Attorney General's office and issued additional assessments to 15 on-line travel companies. The additional assessments totaled \$833.4 million. The cases have been appealed and are being handled by outside counsel. The number of audits and dollars assessed are not included under Field Audit on the previous page.

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 which targeted rental income and the renter's credit during the fiscal year and which resulted in \$1,578,960 in assessments and \$294,038 dollars collected.
- Sports Tournament Participants: The project, which informed the participants of a particular 2010 sports tournament that tournament winnings were subject to general excise taxes, has had a lasting impact and resulted in general tax collections of \$146,303 this fiscal year. The project may be expanded to other sporting events.

2.3.9 Voluntary Disclosure Program

On August 17, 2010, Tax Information Release (TIR) No. 2010-07 was issued giving the Department's guidelines on the informal practice allowing taxpayers to voluntarily disclose erroneous, fraudulent or potentially criminal tax related behavior. The practice had been ongoing prior to TIR No. 2010-07 and has been maintained through FY 2012.

Taxpayers are required to initiate contact with the Voluntary Disclosure Coordinators, who determine the taxpayers' eligibility for the Hawaii program. Taxpayers who have submitted voluntary disclosures pursuant to the TIR were generally not referred to the Department for criminal prosecution and were not assessed any civil penalties on any timely and complete submissions.

The Department's practice is to assert tax, penalties, and interest for a ten year period. The taxpayers generally were given consideration for waivers of penalties.

During FY 2012, a total of 55 taxpayers came forward to participate in the voluntary disclosure program. The Department generated revenues of \$6,847,301.21 for FY 2012, which includes interest. For the taxpayers who came forward and who continue to conduct business in the State, the Department would also realize revenues in the current and future years.

2.3.10 District Offices - Taxpayer Assistance

During FY 2012, 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 2012</u>	<u>FY 2011</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Counter	75,024	80,155	(5,131)	(6.4)
Phone Services	53,758	52,471	1,287	2.5
Tax Clearances	4,934	6,449	(1,515)	(23.5)
Correspondence	17,643	16,668	975	5.8

The taxpayer services sections were able to maintain telephone services despite the centralization of customer services within the Oahu TSP Division. The Districts 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 filling, forms design, and mail processes.

The taxpayer services section has also been able to maintain phone services and correspondence despite the effects of budget cuts that came in response to the decline in the State's economy, including employee furloughs and unfilled vacant positions.

The decrease in the number of tax clearances occurred, because contractors' licenses are renewed biannually, so renewals occur in September of even numbered years. Taxpayers with City, County or State government contracts are required to apply online with the Hawaii Compliance Express (Act 190, SLH 2011).

The assistance provided to taxpayers is part of the Compliance Division's continuing emphasis on taxpayer education and problem resolution. The Compliance Division believes it is important to maintain taxpayers' willingness to accurately and voluntarily comply with the State tax laws, so the Division will continue to emphasize its "taxpayer enabling and empowering" activities.

2.4 STAFF OFFICES

2.4.1 Administrative Services Office

2.4.1.1 Fiscal Office

The Administrative Services Office submitted the supplemental budget for FY 2013 to the 2012 Legislature. For FY 2013, \$22.8 million was appropriated for the Department.

For FY 2012, \$23.4 million was appropriated for the Department. In discharging its duties and responsibilities, the Department incurred operating expenses of \$18.1 million for fiscal year 2012. Net collections of taxes administered and collected by the Department were \$6.00 billion in FY 2012. As a result, the cost to collect \$100.00 of taxes was about \$0.30.

2.4.1.1 Personnel Management

The Department had 373 authorized permanent positions for FY 2012, which was an increase of 9 positions from FY 2011. Employees were geographically distributed as follows: Oahu, 310; Hawaii, 27; Maui/Molokai, 21; and Kauai, 15. For FY 2013, the Department has 383 authorized permanent positions distributed as follows: Oahu, 316; Hawaii, 27; Maui/Molokai, 24; and Kauai, 16.

Personnel actions included 3 new exempt hires, 7 civil service new hires, 91 temporary tax season hires, 32 promotions, 9 transfers, 19 retirements, and 11 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>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Headquarters Administration	72.0	71.0	62.0	66.0	66.0
Tax Services and Processing Division	122.0	123.0	123.0	138.0	138.0
Compliance Division	<u>189.0</u>	<u>179.0</u>	<u>179.0</u>	<u>187.5</u>	<u>187.5</u>
TOTAL	383.0	373.0	364.0	391.5	391.5

2.4.2 Rules Office

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

2.4.2.1 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 legislative and tax policy 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 to the Department's compliance function in interpreting issues under audit, settlement negotiations and closings, and appeared on behalf of the Department before the Boards of Taxation Review. The Rules staff also assisted the Deputy Attorney General Tax Division with the Department's tax cases being litigated.

For the 2012 legislative session, the Rules staff drafted and submitted three 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 bills introduced to the 2012 Legislature, the Director's Office and the Rules staff determined there were about 400 measures proposing tax law changes and analyzed them in

depth. These measures were also tracked throughout the legislative session. The Rules staff prepared written testimonies regarding both tax measures scheduled for public hearing before legislative committees and Governor's Messages for consideration and confirmation of members of the Tax Review Commission as well as the Tax Board of Review. Rules Staff also drafted letters to legislative committee chairs after the public hearings to respond to specific questions or to address certain concerns of committee members.

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 four official Department of Taxation Tax Information Releases and seventeen 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 549 requests for the high technology business investment tax credit and 35 requests for the credit for research activities in accordance with Act 215, Session Laws of Hawaii (SLH) 2004. The Rules staff also responded to 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 2010-2013 Tax Review Commission, which has a late start and held its first meeting on July 15, 2011.

2.4.2.2 Technical Section

The Technical Section is tasked with varying responsibilities to carry out the Department's projects, goals, initiatives, and to support the Department's operational needs. Specifically, the Technical Section assists and advises all divisions within the Department and outside parties such as individual and corporate taxpayers and tax professionals on complex areas of state tax. For fiscal year 2012, the Technical Section responded to 86 formal requests including requests for letter rulings/information letters, determination of tax status (e.g., air-pollution control facility), multi-level marketing agreements, and tax surveys and questionnaires for other government agencies, educational institutions, and major tax service product providers. The Technical Section assisted with workshops given by the Department including a workshop provided to the probation officers of the U.S. Probation Office in Hawaii and responded to over an estimated 1,000 email inquiries and 5,000 telephone inquiries from the public.

The Technical Section also reviews, researches, analyzes, and provides comments and recommendations on the technical and procedural aspects of legislative bills, administrative rules, and tax information releases. The staff is responsible for revising and/or creating the

State's tax forms and instructions and incorporating all applicable federal and state tax law changes. During fiscal year 2012, the Technical Section reviewed 326 tax forms, 55 tax form instructions, developed 2 new tax forms, 2 new tax form instructions, and terminated 9 tax forms and 2 instructions that were determined to be obsolete.

Other duties include the analysis and review of certain applications for tax exemptions. During fiscal year 2012, 353 applications for an exemption from the general excise tax were received, 230 applications were reviewed and processed, and 236 applications are pending further action. During fiscal year 2012, 3,314 requests for a conveyance tax exemption were received and processed.

2.4.3 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; (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 Legislature, and for the Governor, and for other agencies in the Administration; and (5) provide administrative and technical support for the Tax Review Commission when it is in session.

The TRP Office prepares 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*.

In fiscal year 2012, the TRP Office worked on the Department of Taxation's *Annual Report: 2010–2011*, which was completed and transmitted in May 2012. The Office also compiled statistics on tax credits claimed by taxpayers. The statistics were used to estimate the revenue consequences of legislative proposals, but due to staff shortages, for the past several years, the Office has been unable to produce a report on the tax credits to make the data available to the public.

For the 2012 Legislative session, TRP staff reviewed and tracked tax-related legislative bills and resolutions, and prepared more than 240 revenue estimates for various drafts of the bills. Revenue estimates were also prepared for various proposals in response to requests from the Administration, legislators and others.

One of the most important functions of the TRP Office is to provide administrative and technical support to help the Council on Revenues produce its forecasts of tax revenues. 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 also 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, as required by the State's Constitution.

TRP staff applied advanced econometric modeling techniques to data on State tax collections and to data on other economic variables to help the Council produce its forecasts. The Council's last General Fund forecast for fiscal year 2012 was produced on May 29, 2012. The forecast called for tax collections dedicated to the Fund to grow by 12.0% over fiscal year 2011. The actual growth rate was 15.0%, as General Fund collections rose from \$4,329 million in fiscal year 2011 to \$4,978 million in fiscal year 2012. The Council's last forecast for total personal income for calendar year 2011 was produced in November of 2011 and called for growth of 4.5% over calendar year 2010. The actual growth was 4.7%, from \$56,647 million in 2010 to \$59,297 million in 2011.

The TRP Office continued to use the econometric model that was developed under a contract with UCLA Anderson Forecast to predict General Fund tax collections based on the Council's forecasts for economic variables. The Office also continued to provide results based on its own model, which is now similar in form to the model developed by UCLA Anderson Forecast. At the request of the Council on Revenues, the TRP Office also added a new single-equation regression to predict General Fund tax revenues.

The TRP Office provided technical support to the 2010-2013 Tax Review Commission, which had a late start and held its first meeting on July 15, 2011.

2.4.4 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 2012, the ITS Office focused on managing, administering, and maintaining the Integrated Tax Information Management System (ITIMS) without the assistance from outside vendor, CGI Technologies, whose contract with the Department ended on June 30, 2011.

Key initiatives continued or accomplished during FY 2012 include: (1) performing system modifications to implement mandated tax law changes; (2) continuing the non filer collection initiative for General Excise Taxes; (3) continuing work for the eventual migration from the Joint Electronic Filing program (JELF) to the Modernized Electronic Filing (MeF) program in early January, 2013; (4) strengthening security for ITIMS applications, as well as for supporting network and database infrastructures; (5) continuing work to develop and refine an intranet for the Department; (6) upgrading the department's bulk filing website, with implementation of the upgrade to go live towards the end of 2012; (7) implementing the automation of the Hawaii Compliance Express (HCE) tax clearance process in response to Act 190 Session Laws of Hawaii (SLH) 2011, which significantly increased the number of tax clearance requests; (8) implementing House Bill (HB) 1039, which increased the Rental Motor Vehicle and Tour

Vehicle Surcharge tax rate from \$3.00 to \$7.50; and (9) refreshing selected local area network hardware components.

Activities that most likely will continue into the next reporting period include (1) migrating from the Joint Electronic Filing program (JELF) to the Modernized Electronic Filing (MEF) program; (2) participating in the Tax Modernization Project, which will lead to the eventual replacement of the Department's current ITIMS system; (3) participating in the IBM Business Analytics Project, which is aimed at improving the collections process; (4) participating in the state-wide Enterprise Resources Planning (ERP) Project; (5) further strengthening security for ITIMS applications, as well as for supporting network and database infrastructures; and (6) continuing to work on the development and refinement of an intranet for the Department.

2.4.5 System Administration Office

The System Administration Office provides technical support for implementing the changes to the computer system that are mandated by tax law changes or requested by users. During FY 2012 the following changes were initiated or completed:

- Tax Law Change – Sunset of Act 104 Rental Motor Vehicle Surcharge tax rate increase
The Rental Motor Vehicle Surcharge Tax rate of \$7.50 per day reverted back to \$3 per day effective July 1, 2012. Analysis and testing of the system modifications for this rate change were required to ensure that taxes are calculated using the appropriate tax rates.
- Tax Law Change – Act 190 Extend use of Hawaii Compliance Express (HCE) for small-business vendors for all contracts and procurements of \$2,500 or more
Act 190 significantly increased the volume of tax clearances to process. To help process the clearances more efficiently, a system enhancement was done to automate the process of verifying tax compliance was implemented. The enhancement made processing the tax clearances faster and easier, reducing the backlog of tax clearances and saving the Department the expense of scheduled overtime. In addition, the businesses that use HCE saw improved, faster service from the Department. Other benefits include increased confidence in the system, resulting in greater user acceptance and better employee morale.
- Modernized Electronic Filing (MeF)
MeF is a national program that allows tax professionals to electronically file federal and state returns through the Internal Revenue Service (IRS). The Department processes over 400,000 Individual Income returns via the legacy JELF program, so implementation of the replacement MeF program was critical. MeF uses new architecture for electronic filing and introduces a more fully automated, real-time, and scalable efile system. Certain documents previously unsupported by the legacy system will be accepted as a PDF attachment so more taxpayers will be eligible to file by MeF. Benefits include faster processing, increased accuracy of the returns received, faster refunds, the ability to accept payments, the ability to capture additional return data, and the ability to adopt other returns to the program.

- Non-Filer Project – 2010 GE ongoing
The Non-Filer project identified registered businesses that have not filed the 2010 General Excise Annual return. The goals established for the program were to (1) notify taxpayers to file and pay the required outstanding return, (2) adjust taxpayer behavior so they voluntarily comply to filing returns going forward, (3) contact taxpayers soon after their return is due to allow the taxpayer to come into compliance before they accumulate more liabilities, (4) allow the Department to better collect taxes legally owed to the State of Hawaii, and (5) encourage closed businesses to cancel their registration.
- Bulk Filing Application Upgrade
The Department partnered with Hawaii Information Consortium (HIC), which serves as the Portal Manager for the State of Hawaii to create a Bulk Filing website which allows the upload of files for the purpose of filing returns and payments in bulk. Benefits include faster processing times, significant increases in the accuracy of the returns received, and the ability to accept payments. The initiative supports the Department's goal to increase electronic filing and reduce paper returns processing. The Periodic Withholding Tax return (HW-14) will be the initial tax return supported on the website. In the future, additional forms can be added to allow more companies and tax professionals to file and pay taxes online.
- 487J Social Security Number Protection
Section 487 of the Hawaii Revised Statute places limitations on the use of Social Security Numbers in correspondence or other communications with the taxpayer that may be inadvertently misdirected. A review was completed to determine the scope of the required correspondence template changes and work on the modification of the templates has begun.

2.4.6 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.

The Taxpayer Advocacy Program helped taxpayers resolve tax matters that included erroneous billings, nonreceipt 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.

The Taxpayer Advocate identified systemic issues or was made aware of systemic issues with tax forms, tax clearance process, office procedures, and tax issues, 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 GET license applications, assessment notice explanations, payment plan arrangements, voluntary compliance, penalty and interest waivers, IIT and GET return preparation, and assistance with general tax questions.

2.5 MANAGEMENT PERSONNEL

As of June 30, 2012

OFFICE OF THE DIRECTOR

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

STAFF OFFICES

Public Information Officer..... Mallory Fujitani
Rules OfficerKevin Wakayama
 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 Vacant
 Personnel Officer..... Sharon Iwamura
Taxpayer Advocate Fern Elizares

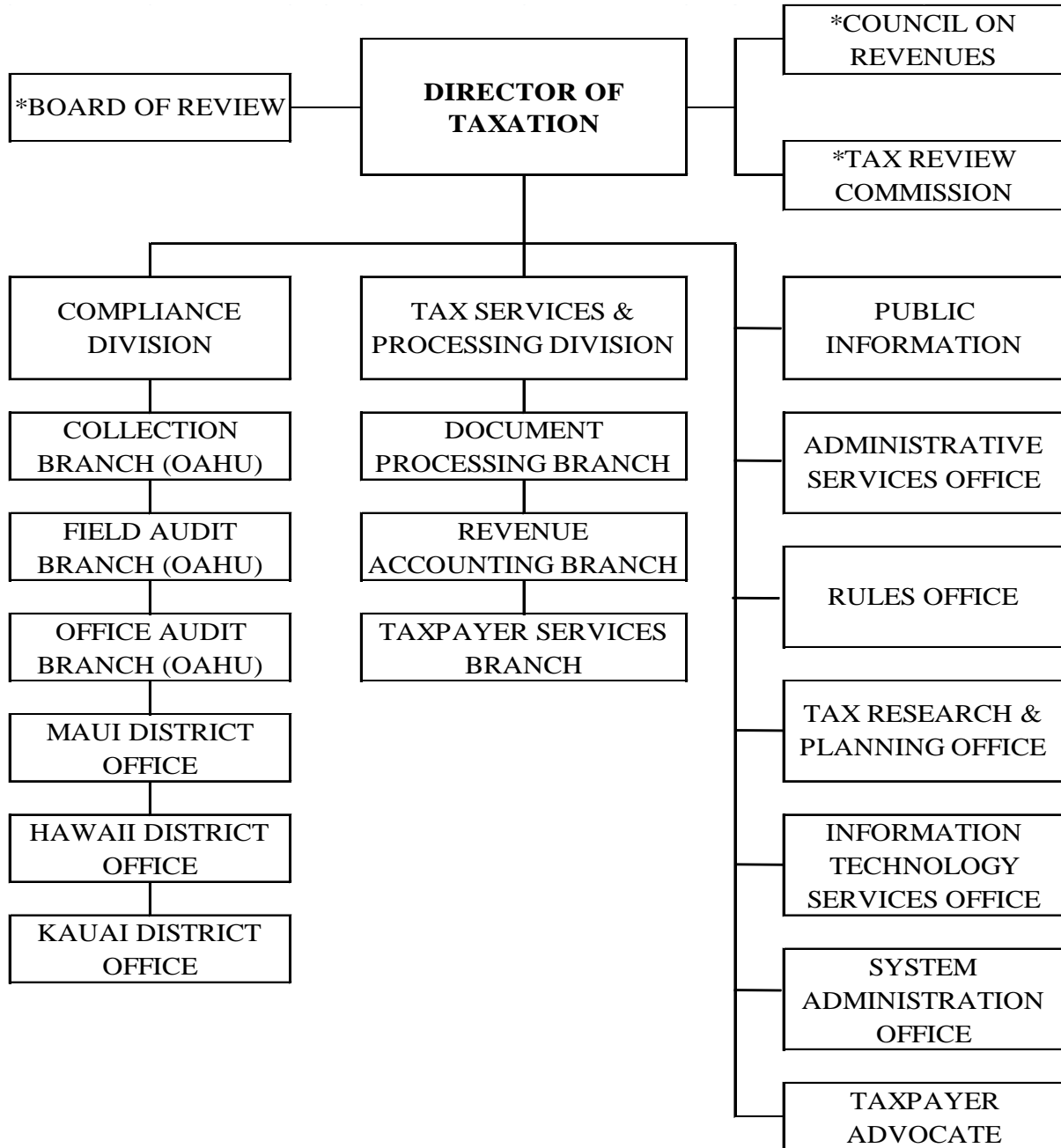
OPERATIONS STAFF

Compliance Division Chief..... Vacant
 Tax Collection Technical CoordinatorKathleen Uehara
 Oahu Field Audit Branch Chief..... Vacant
 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 ChiefJoan Bolte
 Taxpayer Services Branch ChiefAnnette Yamanuha
 Document Processing Branch Chief..... Vacant
 Revenue Accounting Branch Chief..... Deanne Obatake

2.6 ORGANIZATION CHART

Department of Taxation
State of Hawaii



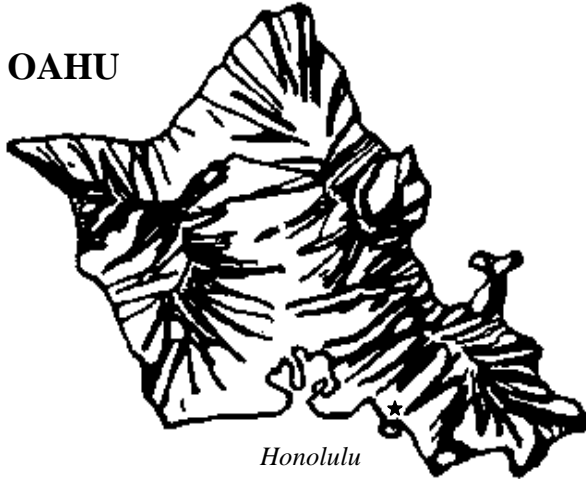
*For Administrative Purposes

2.7 DISTRICT OFFICES

FIRST TAXATION DISTRICT

City & County of Honolulu

OAHU



Honolulu

Oahu Office
830 Punchbowl Street
Honolulu, Hawaii 96813

SECOND TAXATION DISTRICT

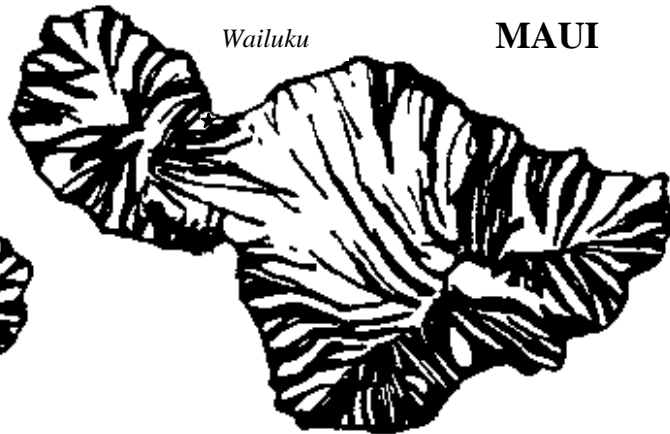
Counties of Maui and Kalawao



Kaunakakai

MOLOKAI

LANAI



Wailuku

MAUI



KAHOOLAWE

Maui Office
54 South High Street
Wailuku, Hawaii 96793

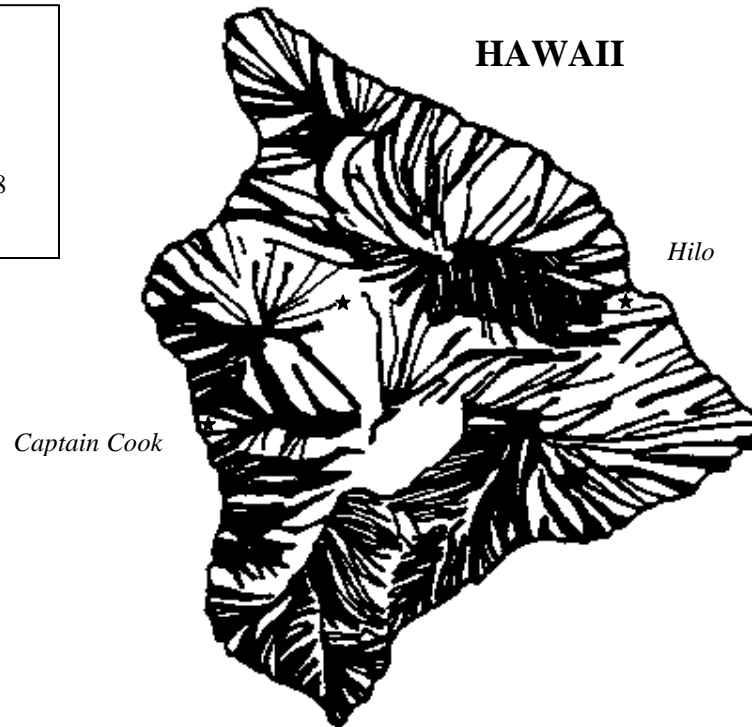
Molokai Office
35 Ala Malama Street #101
Kaunakakai, Hawaii 96748

THIRD TAXATION DISTRICT

County of Hawaii

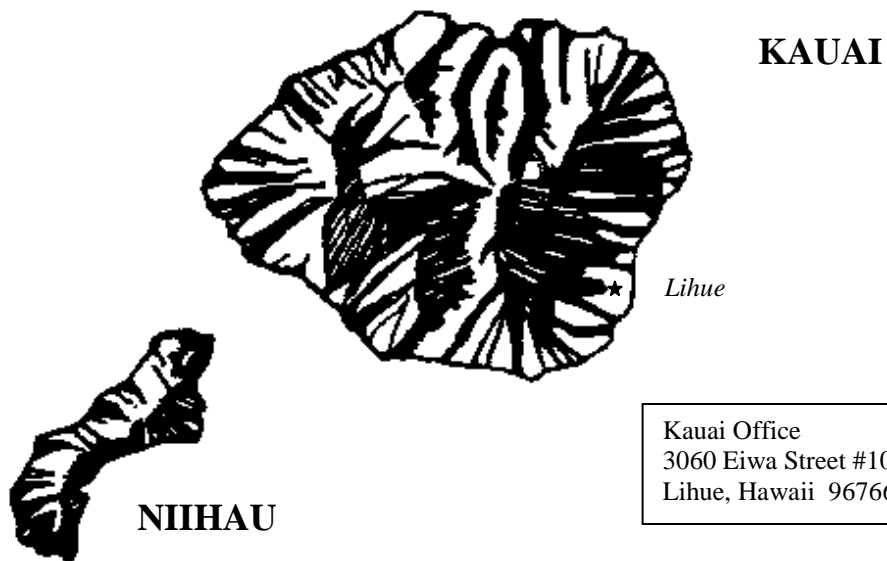
Hilo Office
75 Aupuni Street
Hilo, Hawaii 96720

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

3.0 TAX APPEALS AND LITIGATION

3.1 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 114 pending tax appeals. During FY 2012, 31 new appeals were filed, 15 appeals withdrawn, and 9 appeals settled; a total of 121 appeals to the Boards of Taxation Review were pending at the 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)	88	9	3	10	4	114
New Appeals	12	5	2	9	3	31
Appeals Withdrawn	5	7	0	2	1	15
Appeals Settled	3	1	4	0	1	9
Appeals Pending (Ending)	92	6	1	17	5	121

3.2 CIVIL DECISIONS, SETTLEMENTS, AND OTHER LEGAL MATTERS

During the last fiscal year, the Tax & Charities Division (“Division”) closed 926 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 COLLECTED⁵</u>
Appeals106	Tax Appeals \$3,771,722
Bankruptcies524	Foreclosures 12,862
Contracts40	Bankruptcies 1,201,327
Foreclosures198	Trusts 79,280
Legislation.....0	Miscellaneous 171
Opinions.....7	TOTAL <u>\$5,065,362</u>
Quiet Title9	
Subpoenas9	
Miscellaneous33	

⁵The Division 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.

3.2.1 Settled Cases

Tax Appeal Court

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 and subsequently dismissed.

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. These cases were settled and the appeals dismissed.

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-halfself-employment tax adjustment. Taxpayers also challenged the applicability of the negligence penalty that was assessed. This case was settled and the appeal dismissed.

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. This case was settled and the appeal dismissed.

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. This case was settled.

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. This case was settled and dismissed.

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

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. This case was settled and the appeal dismissed.

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: (1) it qualified for the general excise tax exemption as a tour packager under sec. 237-18(f), HRS; (2) the assessment conflicted with and is preempted by the Maritime Transportation Security Act of 2002; (3) the United States Constitution prohibited Hawaii from laying a "duty of tonnage" without the consent of Congress; (4) the assessments improperly apportioned and sourced Taxpayer's income; (5) the assessments violated the United States and Hawaii Constitutions and are otherwise illegal; and (6) Taxpayer timely filed a refund claim. This case was settled and dismissed.

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: (1) it qualified for the general excise tax exemption as a tour packager under sec. 237-18(f), HRS; (2) the assessment conflicted with and was preempted by the Maritime Transportation Security Act of 2002; (3) the United States Constitution prohibited Hawaii from laying a "duty of tonnage" without the consent of Congress; (4) the assessments improperly apportioned and sourced taxpayer's income; (5) the assessments violated the United States and Hawaii Constitutions and was otherwise illegal; and (6) Taxpayer timely filed a refund claim. This case was settled and dismissed.

3.2.2 Court Decisions

Tax Appeal Court

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. This case was dismissed.

In the Matter of the Tax Appeal of Ronald Au, T.A. No. 11-1-0144, Tax Appeal Court, State of Hawaii.

The Taxpayer filed a petition to compel the Board of Review to prepare findings of fact and conclusions of law. The court denied the petition but granted leave to the taxpayer to file a notice of appeal from general excise tax assessments for the period 2002 through 2005 totaling \$175,000.00. The court subsequently granted the Department of Taxation's motion to dismiss the appeal for lack of subject matter jurisdiction by order filed February 29, 2012. A motion for reconsideration of the order was deemed denied on June 6, 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. Taxpayer dismissed his case

3.2.3 Pending Appeals

3.2.3.1 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.

3.2.3.2 Tax Appeal Court

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 January 21, 2013.

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 argued that Taxpayer has, among other things, not made an "investment" as required by § 235-110.9, HRS, to claim this credit. Trial is set for January 14, 2013.

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: (1) its income was exempt under § 237-26, HRS; (2) its income was for out-of-state activities; (3) its income was exempt under the federal immunity doctrine; (4) the assessments were unconstitutional; (5) the assessments were excessive; (6) its income was exempt under § 237-25, HRS; and (7) Taxpayer should not be subject to penalties and interest. Trial is scheduled for December 12, 2012.

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 AOAO. 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 set for June 3, 2013.

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. This case has been taken off the calendar to give the parties time to work on settlement.

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 set for July 8, 2013.

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 set for September 16, 2013.

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: (1) the assessment erroneously included general excise tax on amounts that were not gross income but, rather, were rebates of expenses; (2) penalties were erroneous because non-filing and/or underpayment was not due to negligence or intentional disregard of rules; and (3) the assessments violated the due process, commerce and/or equal protection clauses of the United States Constitution. Trial is set for April 22, 2013.

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 December 9, 2013.

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 January 14, 2013.

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 January 14, 2013.

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 June 10, 2013.

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 June 10, 2013.

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 June 10, 2013.

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 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 non-filing 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 June 3, 2013.

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 July 8, 2013.

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 July 8, 2013.

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 is set for May 20, 2013.

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 being reset.

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 being reset.

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 being reset.

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 being reset.

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