

DEPARTMENT OF TAXATION STATE OF HAWAII



ANNUAL REPORT 2012–2013

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

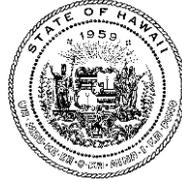
"Our mission is to administer the tax laws for the State of Hawaii in a consistent, fair and uniform manner."

GOALS

1. To *"Increase Voluntary Compliance"* by improving approaches to
 - a. Educate New Filers
 - b. Facilitate Filing for Compliant Taxpayers
 - c. Enforce Tax Laws on the Non-compliant
2. To *"Improve Processing"* which will be accomplished in three ways
 - a. Redesign Business Processes
 - b. Expand Electronic Services
 - c. Modernize Tax Systems
3. To *"Enhance Productivity"* covering three areas
 - a. Develop Employees
 - b. Provide Resources - Internal and External
 - c. Design/Utilize Management Information Reports

NEIL ABERCROMBIE
GOVERNOR

SHANTSUTSUI
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

March 4, 2014

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

Dear Governor Abercrombie:

Thank you for the opportunity to present you with the attached Annual Report summarizing the major operations of the Department of Taxation (DOTAX) for the fiscal year (FY) ending June 30, 2013.

DOTAX plays a key role in public finance by collecting most of the revenues for the operations of the State of Hawaii. During FY's 2009-2011, DOTAX experienced a reduction-in-force, freezing of positions when they became vacant, and 36 furlough days. These staffing cuts resulted in significantly slowing DOTAX operations, creating a backlog of work-in-progress that negatively affected revenue collections.

Following your lifting of the freeze and ending furloughs during your first year in office, we have begun hiring and training employees to carry out our strategic plan, which we introduced in March 2011. Our Vision statement is to more efficiently and more effectively collect the revenues used to fund the services and programs that the State provides to the residents and businesses of Hawaii.

We have begun a business transformation of DOTAX by identifying areas for improvement in our manual processes and by determining the business requirements for using 21st century technology in our Tax Systems Modernization (TSM) project. TSM will be a complete design and implementation of a new computer system to replace the now totally outdated system that was introduced at the turn of the century. TSM will be a multi-year project that will facilitate compliance with tax laws by expanding electronic services, including the electronic filing of all tax returns and electronic payments, as well as automating licensing, tax clearances and compliance processes.

In 2013, I served as Chair of the Western States Association of Tax Administrators, which is comprised of the 14 Western member States of the Federation of Tax Administrators. DOTAX staff put together a well attended conference that we titled "TNT – Technology and Taxes" and that expanded on our objectives of bringing 21st century technology into tax administration. The feedback from member states was completely positive.

Beginning with the FY 2012 annual report, we began a new section covering multi-year trend analyses of Hawaii taxes, because the various sources of revenue for the State are major factors to consider in public finance. This section shows that for FY 2013, the total collections of taxes administered by the State were \$6.54 billion, a 9% increase over the FY 2012 amount of \$6.0 billion. This represents continued growth since the time of the economic recession, which saw total tax collections fall from \$5.48 billion in FY 2008 to \$4.94 billion in FY 2009, before climbing to \$5.14 billion in FY 2010, and \$5.30 billion in FY 2011. When comparing FY 2010 and FY 2011, the impact of the delay in paying income tax refunds by the previous Administration should be considered. Refunds of individual and corporate income taxes totaling \$187.4 million were withheld toward the end of FY 2010 and paid out in the first month of FY 2011. If the refunds had been timely released, net total collections would have been \$5.5 billion in FY 2011. DOTAX accounts for the great bulk of the total tax collections. In FY 2013 it collected \$6.23 billion in taxes, or 95.3% of the total tax collections.

The General Excise Tax (GET) is Hawaii's largest source of revenue and accounts for nearly half of the total tax collections. Revenue from the GET grew from \$2.70 billion in FY 2012 to \$2.94 billion in FY 2013, an increase of 9.1%. Unlike the sales taxes imposed by many States and localities, the GET is imposed on the business rather than on the customer. While other States seek revenue by increasing the sales tax rate or widening the basis for taxation, the GET is imposed on a broad base of business activity including services, and has remained at the low rate of 4% since July 1, 1965.

DOTAX continues to improve operations that were significantly impaired by the staffing reductions of FY 2009-2011. The 43 abolished positions and 59 frozen positions represented a 26% reduction in available staff hours and along with the 36 furlough days resulted in a significant backlog of work. While we have been actively recruiting to fill positions, the vacancy rate remains high due to separations stemming from a high retirement eligibility rate.

We recognized that taxpayers may fall out of compliance if they are not promptly served when they have questions about filing or paying their taxes. Our call answer rate, the number of incoming calls answered, had fallen from 80% in FY 2009 to 61% in FY 2010 and to 40% in FY 2011. While we continue efforts to answer more calls, the high vacancy rate in the call center resulted in moderate increases to 57% in FY 2012 and 59% in FY 2013.

We have focused on shortening the processing time for clearing check payments. In December 2010, a major Hawaii business magazine reported that taxpayers complained that DOTAX was taking up to two months to process checks. In reviewing processes, we reprioritized the incoming work and in April 2011, the new process resulted in an increase in tax collections of more than \$100 million over the prior April. Since then, most of tax returns processing is completed within two weeks and our monetary control section aims to process payments within 4 days of receipt.

For future processing, we are increasing public interest in transitioning from mailing paper tax returns and check payments to electronically filing returns and arranging electronic funds transfers. Electronic filing began with 140,000 electronically filed returns in FY 2004 and increased to 1,530,000 in FY 2013. As a percentage of all returns filed, e-filing has increased

from 30% in FY 2012 to 41% in FY 2013. As a percentage of all payment amounts, e-payments have increased from 69.5% in FY 2012 to 72.3% in FY 2013. Our objective is to expand electronic filing to all 13 types of revenue and 27 types of tax returns as part of our TSM project.

DOTAX's compliance programs also continued to operate under challenging conditions after the FY 2009-2011 staffing reductions. The total number of completed audit cases declined from 9,826 cases in FY 2012 to 7,701 cases in FY 2013, a decrease of 21.6%. However, total assessments increased by 12%, from \$77.7 million in FY 2012 to \$87.1 million in FY 2013. In addition, our compliance staff audited internet transactions of Online Travel Companies (OTC) and issued assessments totaling \$817.7 million, including taxes, penalties and interest. These cases have been appealed to the Tax Appeals Court.

Since the hiring freeze was lifted, section heads have been focusing on filling vacant positions, which will result in increased assessments and collections of additional tax revenue. We have arranged training to help our staff in auditing cross border transactions and nexus issues. While our compliance staffing can currently audit about 1% of total taxpayer accounts, the strategic plan aims to increase compliance efforts through market segment specialization and an audit plan covering 2% to 3% of the taxpayer population. This will be accomplished not only through expanded staffing, but also by using technology for audit selection and data matching that will be facilitated through the TSM project.

In summary, while DOTAX's operations have continued to suffer from the 2009-2011 reduction in staffing and accompanying budget cuts, we have made great strides in executing our strategic plan to position the department for the 21st century by achieving goals of increased voluntary compliance, improved processing and enhanced productivity. Much progress has been made during the last two fiscal years in redesigning business processes to improve manual operations as well as to identify business requirements for our TSM project. I am proud to report that DOTAX's employees continue to advance towards our vision of becoming more efficient in operations and more effective in carrying out our key role of collecting the revenue for our State. Those revenues fund services and programs that are essential for maintaining the quality of life in Hawaii.

Sincerely,

/s/

FREDERICK D. PABLO
Director of Taxation

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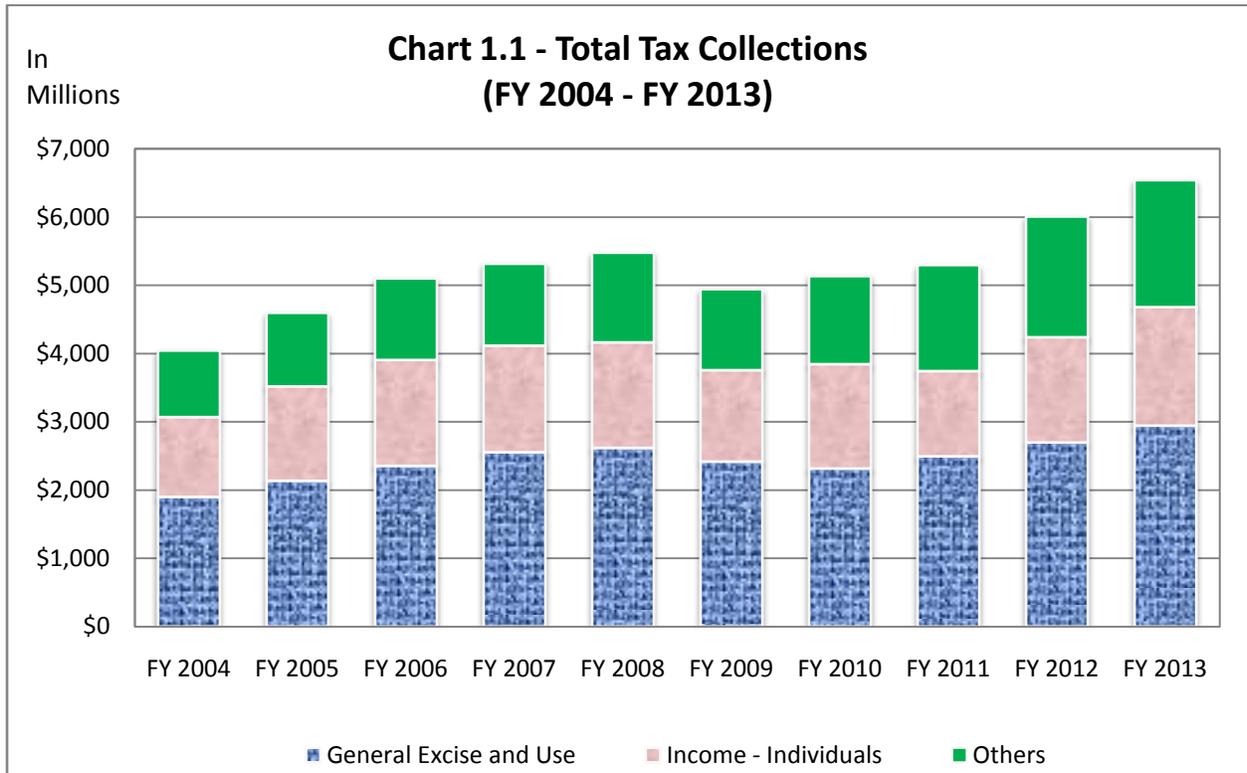
1.0 COLLECTION AND DISTRIBUTION OF TAXES

1.1 OVERVIEW

The Department of Taxation collects the revenues from most of the various taxes imposed by the State. In addition, the Department collects the County Surcharge imposed by the City and County of Honolulu and fuel taxes imposed by the counties. In fiscal year (FY) 2013, the Department collected a total of \$6.23 billion in net tax revenues, up by 8.6% from \$5.74 billion that was collected in FY 2012.

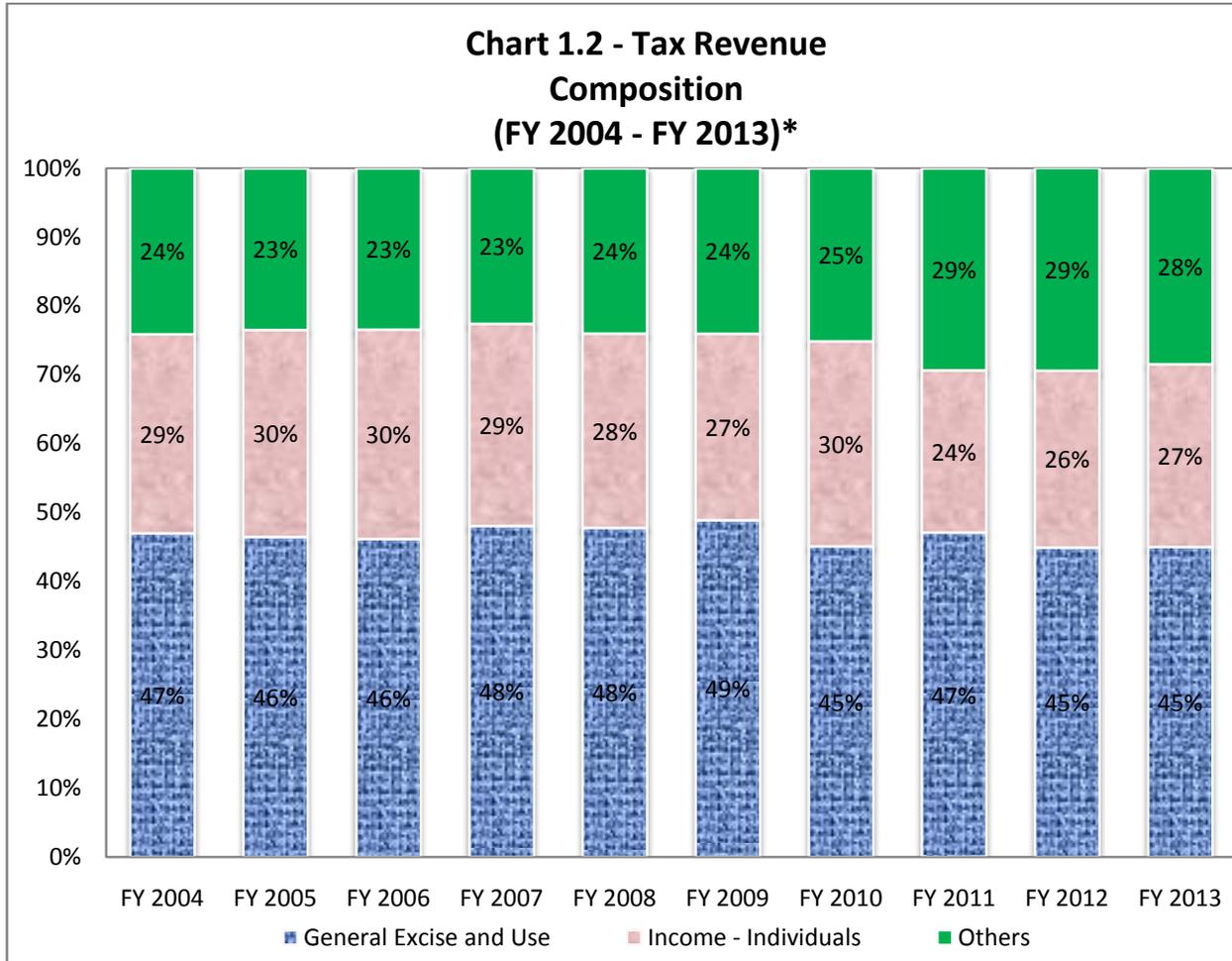
The Department's Office of Tax Research and Planning (TRP) tracks revenues from the taxes collected by the Department, and also from taxes that are administered by the State, but that are collected by other State agencies or by the counties.¹ Henceforth, revenues from the taxes tracked by TRP will be referred to as "total tax collections."

Total tax collections were \$6.54 billion in FY 2013, up from \$6.00 billion in FY 2012. In FY 2009, Hawaii experienced a decline in total tax collections as the Great Recession reduced incomes and spending of consumers and businesses. Since then, total tax collections have risen steadily due to temporary tax measures, an improving economy, and much improved tax administration. Chart 1.1 shows the main components of the total tax collections for FY's 2004 through 2013.



¹ The taxes tracked by TRP are listed in Table 8. They include all of the taxes that contribute revenue to the State's General Fund.

The State's biggest sources of tax revenue are the General Excise Tax (GET)² and the Individual Income Tax (IIT). In FY 2013, net GET collections amounted to \$2.94 billion and accounted for 45.0% of total tax collections, and net collections of the IIT amounted to \$1.74 billion and accounted for 26.5% of total tax collections. Chart 1.2 shows the shares of total tax collections accounted for by the GET and the IIT for FY's 2004 through 2013.

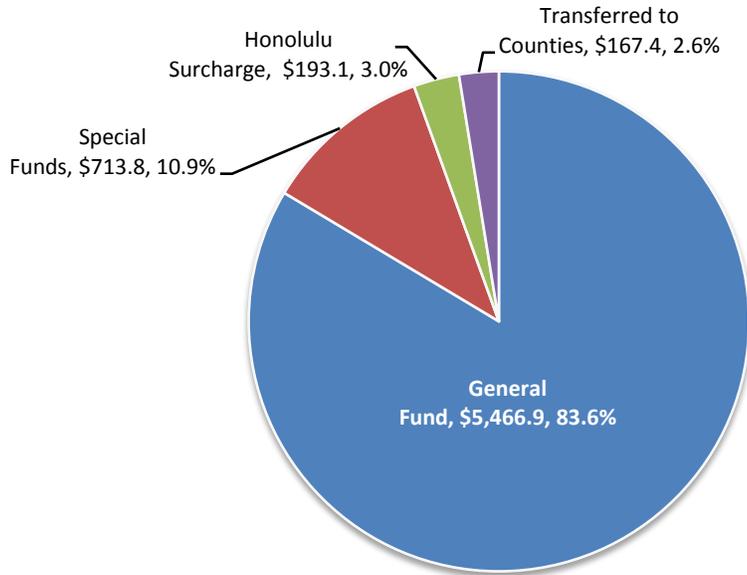


* Details may not add to totals due to rounding.

Of the total tax collections in FY 2013, \$5.47 billion, or 83.6% was deposited into the State's General Fund and \$360.5 million (5.5%) was transferred to the counties, including transfers of the County Surcharge imposed by the City and County of Honolulu, fuel taxes imposed by the counties, and revenues from the Transient Accommodations Tax that were allocated to the counties. The remainder (\$713.8 million, or 10.9%) was transferred to various other State special funds. Chart 1.3 shows how the total tax collections were distributed in FY 2013.

² Throughout this report, the term "GET" will be used to include both the General Excise Tax and the Use Tax. The Use Tax complements the General Excise Tax and is levied on imports into the State from an unlicensed seller.

Chart 1.3 - FY 2013 Distribution of Tax Revenues* (In \$Millions)



* Details may not add to totals due to rounding.

The tax revenues deposited into the General Fund are used to pay most of the State's operating expenses.

1.2 GENERAL EXCISE AND USE TAXES

1.2.1 Overview

Unlike the sales taxes imposed by many States and localities, Hawaii's GET is imposed on the business, rather than on the customer, and covers virtually all forms of business activity, including services. Despite the relatively low tax rates, the GET generates substantial revenue, because the tax base is very broad. The rate for the GET has been 4% since July 1, 1965.

The GET is imposed at the rate of 0.5% on wholesaling, wholesale services, producing, sugar processing and pineapple canning; at the rate of 4.0% on most other activities, including retailing, business and professional services, contracting, theatre, amusement, radio, interest, commissions, and rentals; and at the rate of 0.15% on insurance commissions received by general agents, subagents and solicitors. The fee for a GET license is a one-time charge of \$20.

1.2.2 Revenue

Revenue from the GET grew from \$2.70 billion in FY 2012 to \$2.94 billion in FY 2013, an increase of 9.1%. All of the main components of the tax (Retailing, Services, Contracting, Hotel

Rentals and Other Rentals) were higher in FY 2013 than in FY 2012: Retailing revenues increased by \$21.6 million (1.9%), Services revenues increased by \$11.6 million (2.3%), Contracting revenues increased by \$51.8 million (20.7%), revenues from Hotel Rentals increased by \$17.6 million (12.8%) and revenues from Other Rentals increased by \$8.9 million (3.6%). Chart 1.4 shows the total revenues from the GET and from the tax levied on the various categories of income for FY's 2004 through 2013. Table 1.1 shows collections of the GET in greater detail for FY's 2012 and 2013.

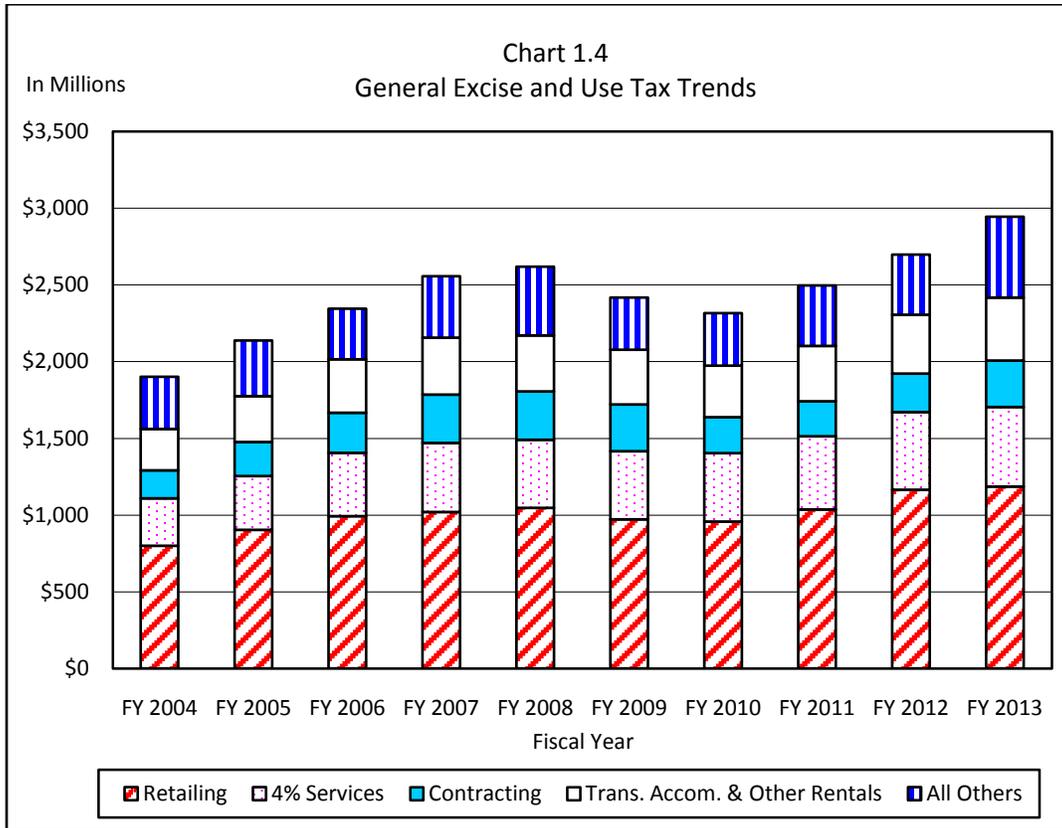


TABLE 1.1 - GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 2013 & 2012
(In thousands of dollars)

SOURCE OF REVENUE	Rate	FY 2013	FY 2012	Difference	
				Amount	% Change
TAX BASE					
Retailing		\$29,636,156	\$29,095,118	\$541,038	1.9
Services		12,985,478	12,696,608	288,870	2.3
Contracting		7,546,884	6,253,047	1,293,837	20.7
Transient Accommodations Rentals		3,870,919	3,430,541	440,378	12.8
All Other Rentals		6,376,847	6,153,777	223,070	3.6
All Others (4%)		5,336,619	5,160,338	176,281	3.4
Subtotal		\$65,752,903	\$62,789,429	\$2,963,474	4.7
Producing		\$399,431	\$400,836	(\$1,405)	(0.4)
Manufacturing		638,782	680,454	(41,672)	(6.1)
Wholesaling		14,429,710	14,442,067	(12,357)	(0.1)
Use (1/2%)		8,867,289	8,005,211	862,078	10.8
Wholesale Services		627,805	652,996	(25,191)	(3.9)
Insurance Commissions		464,509	477,268	(12,759)	(2.7)
Subtotal		\$25,427,525	\$24,658,831	\$768,694	3.1
TOTAL-ALL ACTIVITIES		\$91,180,428	\$87,448,260	\$3,732,168	4.3
TAX					
Retailing	4.00%	\$1,185,446	\$1,163,805	\$21,641	1.9
Services	4.00%	519,419	507,864	11,555	2.3
Contracting	4.00%	301,875	250,123	51,752	20.7
Transient Accommodations Rentals	4.00%	154,837	137,222	17,615	12.8
All Other Rentals	4.00%	255,074	246,151	8,923	3.6
All Others	4.00%	213,465	206,412	7,053	3.4
Subtotal		\$2,630,116	\$2,511,577	\$118,539	4.7
Producing	0.5%	\$1,997	\$2,004	(\$7)	(0.4)
Manufacturing	0.5%	3,194	3,402	(208)	(6.1)
Wholesaling	0.5%	72,149	72,210	(61)	(0.1)
Use (1/2%)	0.5%	44,336	40,026	4,310	10.8
Wholesale Services	0.5%	3,139	3,265	(126)	(3.9)
Insurance Commissions	0.15%	697	716	(19)	(2.7)
Subtotal		\$125,512	\$121,623	\$3,889	3.2
Unallocated 1/		\$188,859	\$64,750	\$124,109	191.7
TOTAL-ALL ACTIVITIES		\$2,944,487	\$2,697,951	\$246,536	9.1

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 suspended certain exemptions and deductions from the GET and required the payment of taxes at 4% on the previously exempt amounts. The Act took effect July 1, 2011 and expired June 30, 2013. The Council on Revenues adopted estimates that the suspension of the exemptions and deductions added about \$50 million to total GET collections in FY 2012 and added about \$70 million in FY 2013.

Act 160, SLH 2013, eliminates the GET exemption for liquor, tobacco and food sold to common carriers for taxable years beginning after December 31, 2013.

Act 163, SLH 2013, makes permanent the GET exemptions for common expenses paid by managers, sub-managers, and sub-operators and for hotel employee expenses paid by hotel operators and timeshare projects. The Act also eliminates the aggregate cap on the exempt amounts for taxable years beginning after December 31, 2012.

1.3 INDIVIDUAL INCOME TAX

1.3.1 Overview

Hawaii's Individual Income Tax (IIT) generally follows the federal definitions for determining net taxable income, but it has its own exemptions, tax credits and tax rates. The IIT has twelve brackets, with tax rates ranging from 1.4% to 11.0%.

1.3.2 Revenue

The IIT is the State's second biggest source of tax revenue. The biggest part of the total IIT collections is from taxes withheld on employee wages. In FY 2013, withholding tax collections were \$1.56 billion, an increase of 7.0% over the \$1.46 billion withheld in FY 2012. Total IIT refunds in FY 2013 were \$442.5 million. The net IIT collections in FY 2013 were \$1.74 billion, an increase of 12.7% over the \$1.54 billion collected in FY 2012. Chart 1.5 shows total collections of the IIT, along with wage withholding, payments with returns, and refunds, for FY's 2004 through 2013. Table 1.2 shows the figures for total collections of the IIT, broken down by its components, in FY's 2012 and 2013.

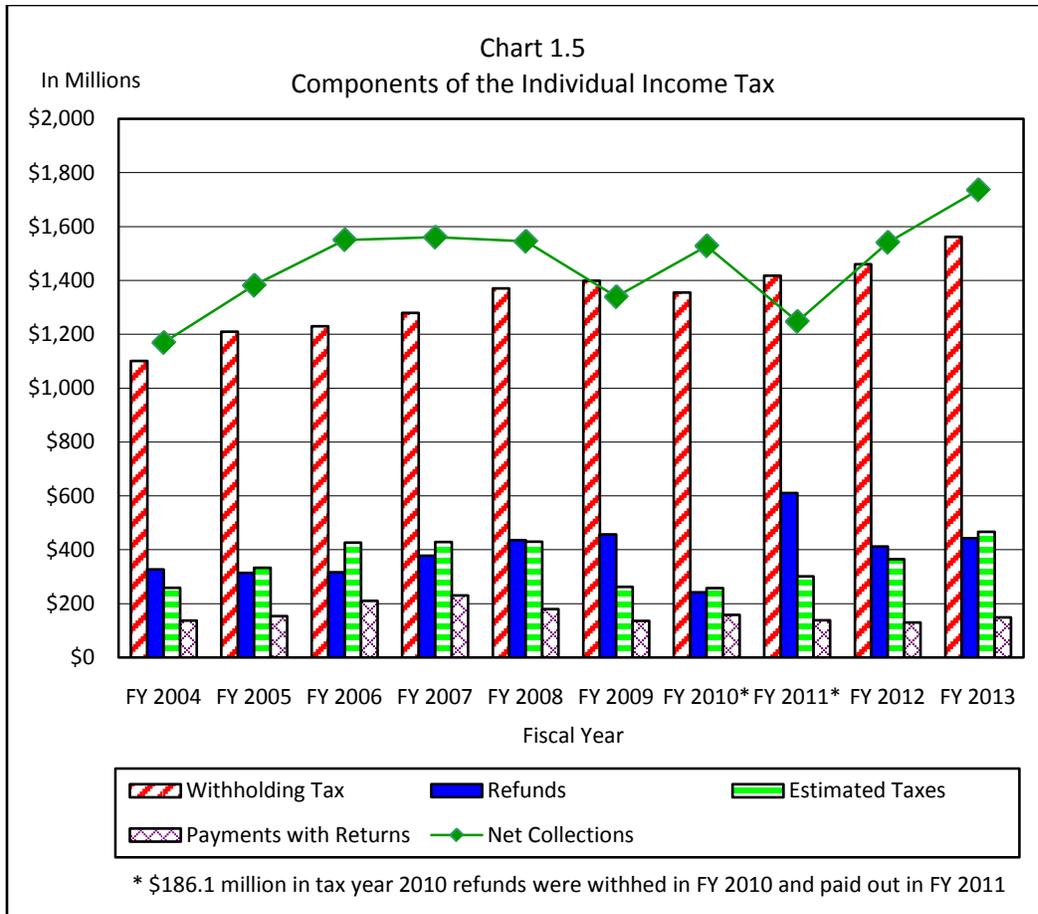


TABLE 1.2 - TAXES PAID BY INDIVIDUALS
(In thousands of dollars)

	FY 2013	FY 2012	Difference	
			Amount	%
Declaration of Estimated Taxes	\$466,936	\$364,470	\$102,466	28.1
Payment with Return	149,277	129,671	19,606	15.1
Withholding Tax on Wages	1,562,326	1,459,769	102,557	7.0
Subtotal	\$2,178,539	\$1,953,910	\$224,629	11.5
Refunds	442,532	412,859	29,673	7.2
NET	\$1,736,007	\$1,541,051	\$194,956	12.7

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

1.3.3 Recent Legislation

Act 60, SLH 2009, raised the tax rates for single individuals with taxable incomes over \$150,000 and for married couples filing jointly with income over \$300,000, by adding new high-end tax brackets with marginal tax rates that range from 9% to 11%. Before Act 60, the highest income

tax rate was 8.25%. The tax rate increases imposed by Act 60 are effective for taxable years beginning after December 31, 2008 and ending before January 1, 2015.

Act 97, SLH 2011, eliminates the deduction for state income taxes paid for individuals with Federal adjusted gross income above specified thresholds. The Act also places temporary limits on claims for itemized tax deductions. The Act is effective for taxable years beginning after December 31, 2010, but the limits it imposes on itemized deductions expire December 31, 2015. The Act delayed the increases in the standard deduction and personal exemption that were approved under Act 60, SLH 2009 until taxable years beginning after December 31, 2012, and makes the increases permanent.

Effective January 1, 2012, Act 1, SLH 2011, provides that all provisions of the IRC that apply to a husband and wife, to spouses, or to persons in a legal marital relationship shall, for purposes of Hawaii's net income and estate taxes, 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.

Act 256, SLH 2013, removed charitable deductions from the limits on itemized deductions that were imposed by Act 97, SLH 2011. Act 256 is effective for taxable years beginning after December 31, 2012.

1.4 CORPORATE INCOME TAX

1.4.1 Overview

Hawaii's Corporate Income Tax (CIT) has three tax brackets. The brackets (and the corresponding tax rates) are as follows: 4.4% on taxable income up to \$25,000; 5.4% on taxable income over \$25,000 but not over \$100,000; and 6.4% on taxable income over \$100,000. The tax rate for corporate capital gains is 4%.

1.4.2 Revenue

Net CIT collections totaled \$101.0 million in FY 2013, an increase of 38.3% over the previous year's total of \$73.0 million. CIT collections are highly cyclical, but they are a relatively small part of Hawaii's total tax collections. In FY 2013, the CIT accounted for just 1.5% of total tax collections. Chart 1.6 shows total collections of the CIT, broken down by its components, for FY's 2004 through 2013. Table 1.3 shows data on collections of the CIT for FY's 2012 and 2013.

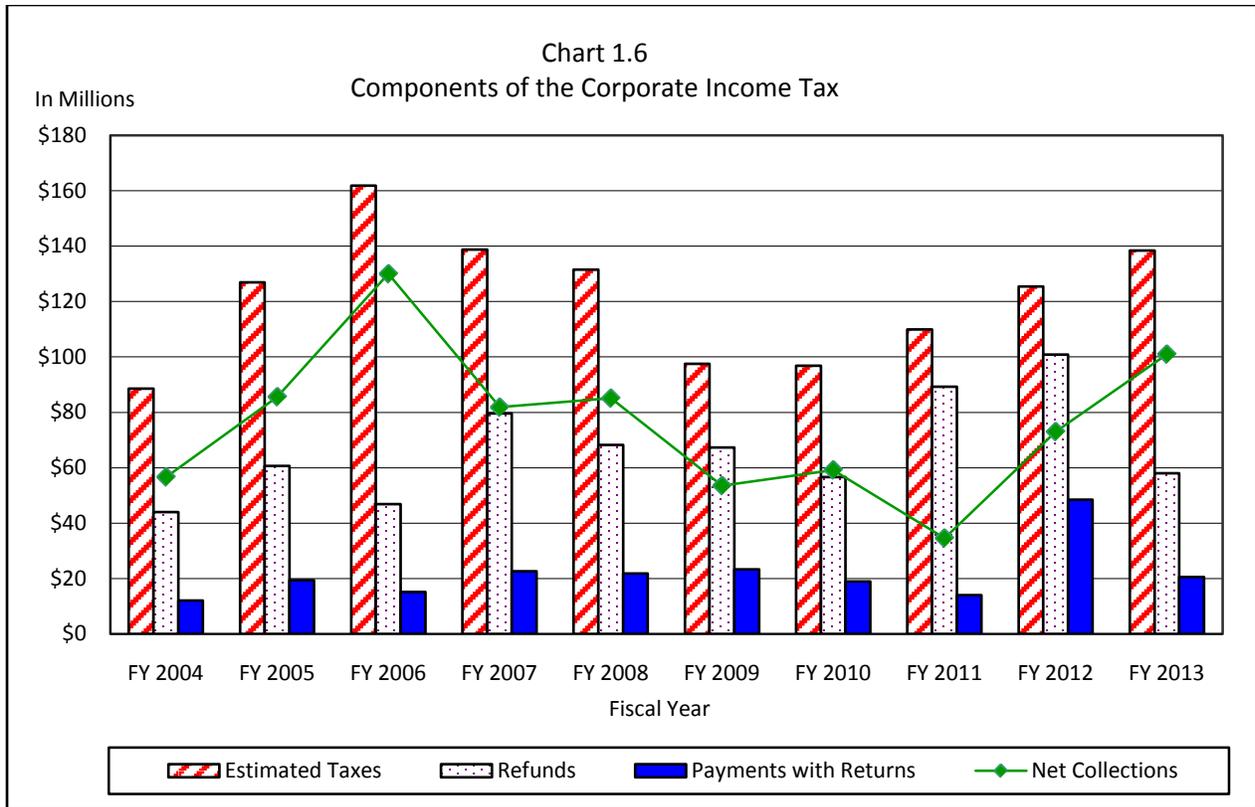


TABLE 1.3 - TAXES PAID BY CORPORATIONS
(In thousands of dollars)

	FY2013	FY2012	Difference	
			Amount	%
Declaration of Estimated Taxes	\$138,349	\$125,383	\$12,966	10.3
Payment with Return	20,586	48,494	(27,908)	(57.5)
Subtotal	\$158,935	\$173,877	(\$14,942)	(8.6)
Refunds	57,947	100,851	(42,904)	(42.5)
NET	\$100,988	\$73,027	\$27,961	38.3

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

1.5 TRANSIENT ACCOMMODATIONS TAX

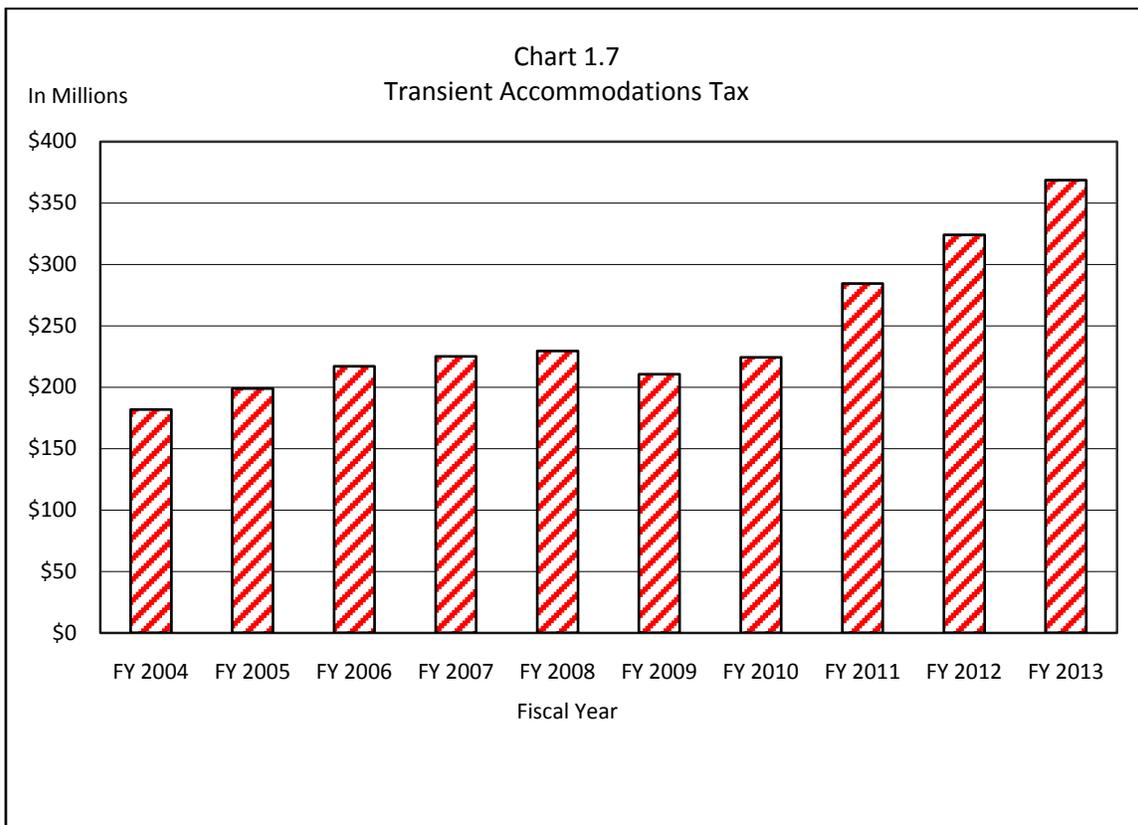
1.5.1 Overview

The Transient Accommodations Tax (TAT) is 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. The rate for the TAT has been 9.25% since July 1, 2010. 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 each registration of 6 or more units. Plan managers of time share units pay TAT of 7.25% on the fair market rental value of the units.

1.5.2 Revenue

TAT collections totaled \$368.6 million for FY 2013, an increase of 13.8% from the \$324.0 million collected in FY 2012. In FY 2013, collections from the TAT were distributed as follows: \$93.0 million went to the counties; \$33.0 million went to the Convention Center Enterprise Special Fund; \$71.0 million went to the Tourism Special Fund; and the remainder (\$171.6 million) went to the General Fund. Chart 1.7 shows collections of the TAT for FY's 2004 through 2013. Chart 1.8 shows the allocations of the tax among the various funds. Table 1.4 shows TAT collections and allocations in FY's 2012 and 2013.



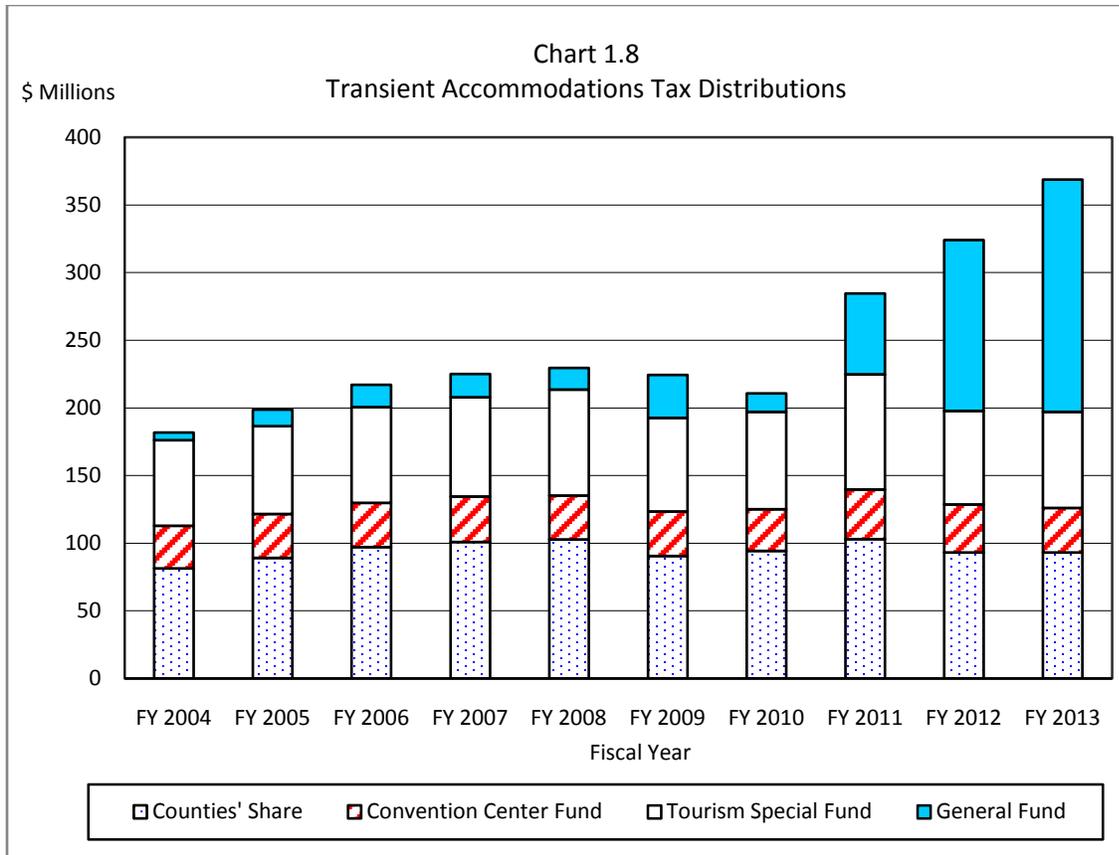


TABLE 1.4 - TRANSIENT ACCOMMODATIONS TAX
(In thousands of dollars)

	FY 2013	FY 2012	Difference	
			Amount	%
COLLECTION				
Transient Accommodations Tax	\$354,082	\$308,974	\$45,108	14.6
Time Share Occupancy Tax	14,474	14,965	(491)	(3.3)
Transient Accommodations/Time Share Occup. Fees	20	11	9	85.1
TOTAL	\$368,576	\$323,950	\$44,626	13.8
DISTRIBUTION *				
Counties' Share	\$93,000	\$93,000	\$0	0.0
Convention Center Fund	33,000	35,637	(2,637)	(7.4)
Tourism Special Fund	71,000	69,000	2,000	2.9
General Fund	171,576	126,313	45,263	35.8
TOTAL	\$368,576	\$323,950	\$44,626	13.8

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

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

1.5.3 Recent Legislation

Act 161, SLH 2013, makes permanent the TAT rate of 9.25% and makes permanent the caps on allocations of the TAT for each fiscal year as follows: \$82 million to the Tourism Special Fund, \$93 million to the counties, and \$33 million to the Convention Center Enterprise Fund. (The TAT rate was scheduled to return to 7.25% on July 1, 2015, and the caps on allocations of the TAT to the counties and to the Tourism Special Fund were scheduled to expire on June 30, 2015. The previous caps were the same as those in Act 161, except that the cap on the Tourism Special Fund was \$71 million.) Act 161 also eliminated the \$10 daily TAT on each transient accommodation furnished on a complimentary basis that was imposed by Act 103, SLH 2011. Act 161 took effect July 1, 2013.

1.6 FUEL TAXES

1.6.1 Overview

The State and county fuel taxes are imposed on the distributors. The State Legislature sets the State fuel tax rates, whereas county councils set the county rates. There is also an Environmental Response Tax (officially renamed as the "Environmental Response, Energy and Food Security Tax" by Act 73, SLH 2010) that is levied on each barrel of petroleum products. The effective rates for the fuel taxes and for the Environmental Response Tax in FY 2013 are shown on the following page.

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 (not including the Environmental Response Tax) amounted to \$166.8 million in FY 2013, a slight increase over the \$165.5 million collected in FY 2012. Total taxable fuel consumption decreased by 3.7% to 862.9 million gallons in FY 2013. The biggest consumption of taxable fuel is gasoline (443.1 million gallons, or 51.4% of total taxable fuel consumption in FY 2013). The second biggest consumption of taxable fuel is aviation fuel (235.4 million gallons, or 27.3% of total taxable consumption in FY 2013). Together, gasoline and aviation fuel accounted for 78.6% of the total consumption of taxable fuel in FY 2013.

Collections of the Environmental Response Tax amounted to \$27.2 million in FY 2013, a slight decrease from the \$27.6 million collected in FY 2012. The Environmental Response 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. The Environmental Response Tax was levied on 25.9 million barrels of petroleum in FY 2013, a decline of 1.5% from FY 2012. Chart 1.9 shows total collections of the fuel taxes and of the Environmental Response Tax combined, and the gallons consumed of the various fuel types, for FY's 2004 through 2013. Data for taxable gallons consumed for FY's 2012 and 2013 are given in Table 1.5.

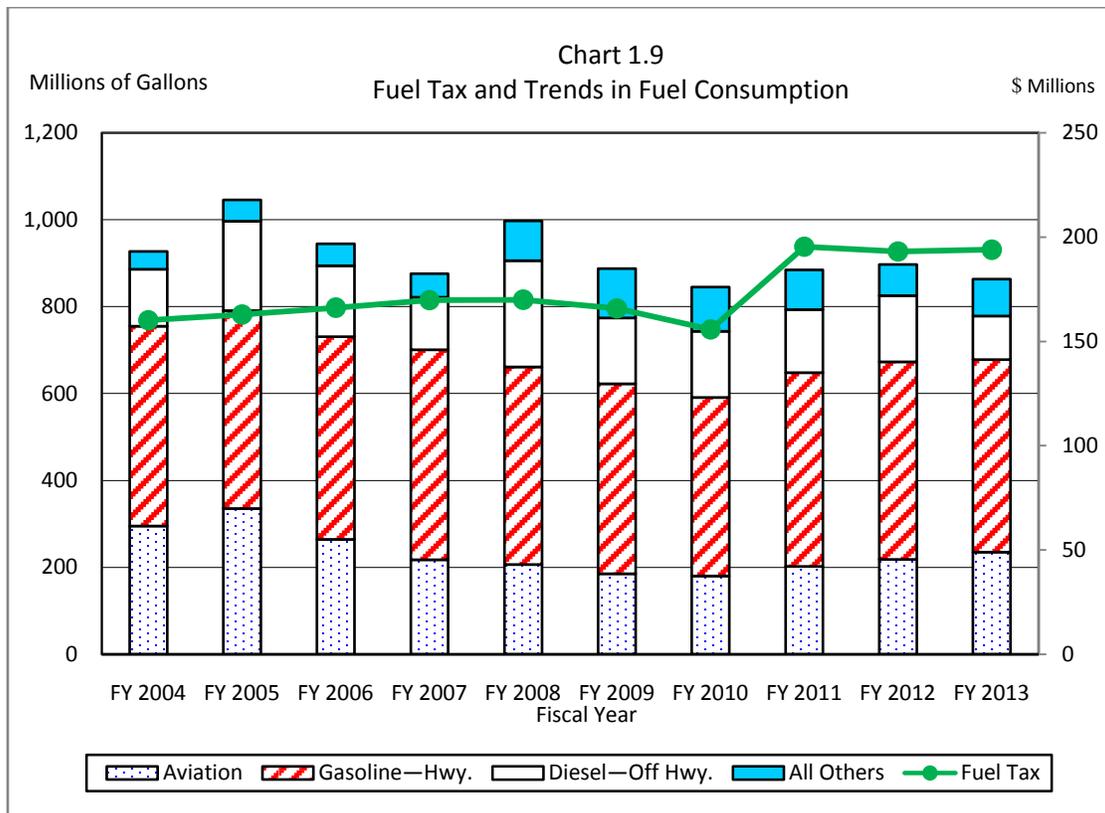


TABLE 1.5 – TAXABLE GALLONS OF FUEL CONSUMED
(In thousands of gallons)

	FY 2013	FY 2012	Difference	
			Amount	%
Gasoline	443,138	454,555	(11,417)	(2.5)
Diesel Oil – Nonhighway	100,087	151,635	(51,548)	(34.0)
Diesel Oil – Highway	51,613	41,679	9,934	23.8
Liq. Pet. Gas – Highway	26	44	(18)	(41.3)
Small Boats – Gasoline	1,170	1,148	22	1.9
Small Boats - Diesel Oil	511	425	86	20.2
Aviation Fuel	235,350	217,656	17,694	8.1
Other Fuel 1/	31,000	29,030	1,970	6.8
TOTAL-GALLONS	862,894	896,173	(33,279)	(3.7)
Environmental Tax (Barrel)	25,895	26,294	(399)	(1.5)

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

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

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. Remaining revenues from the State fuel taxes are deposited into the State Highway Fund, whereas remaining revenues from county fuel taxes are deposited into the counties' highway funds.

Revenues from the Environmental Response Tax were distributed as follows in FY 2013: For each barrel taxed at \$1.05, 5 cents went to the Environmental Response Revolving Fund administered by the Department of Health for oil spill prevention and remediation programs; 25 cents went to the Energy Security and Energy Systems Development Special Funds administered by the Department of Business, Economic Development, and Tourism to support the Hawaii clean energy initiative program; 15 cents went 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; and the remainder (60 cents per barrel) went to the General Fund.

Table 1.6 shows how the fuel taxes and the Environmental Response Tax were allocated in FY's 2012 and 2013. The table also shows allocations of the motor vehicle taxes and fees to the State Highway Fund.

TABLE 1.6 - ALLOCATION OF FUEL TAXES
(In thousands of dollars)

	FY 2013	FY 2012	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Fuel	\$86,025	\$87,230	(\$1,205)	(1.4)
Motor Vehicle Tax/Fees	171,776	150,312	21,464	14.3
TOTAL	\$257,801	\$237,542	\$20,259	8.5
COUNTY HIGHWAY FUNDS:				
City & County of Honolulu	\$53,825	\$49,220	\$4,605	9.4
County of Maui	10,617	10,438	179	1.7
County of Hawaii	6,035	8,691	(2,656)	(30.6)
County of Kauai	3,930	3,949	(19)	(0.5)
TOTAL	\$74,407	\$72,297	\$2,110	2.9
BOATING SPECIAL FUND	\$1,621	\$1,611	\$10	0.6
STATE AIRPORT FUND:				
Aviation Fuel	\$4,707	\$4,353	\$354	8.1
ENVIRONMENTAL TAX FUND	\$1,295	\$1,315	(\$20)	(1.5)
ENERGY SECURITY FUND	\$3,884	\$3,944	(\$60)	(1.5)
ENERGY SYSTEMS DEVELOPMENT FUND	\$2,590	\$2,629	(\$39)	(1.5)
AGRICULTURAL DEVELOPMENT & FOOD SECURITY FUND	\$3,884	\$3,944	(\$60)	(1.5)
GENERAL FUND	\$15,537	\$15,777	(\$240)	(1.5)

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

1.7 MOTOR VEHICLE TAXES AND FEES

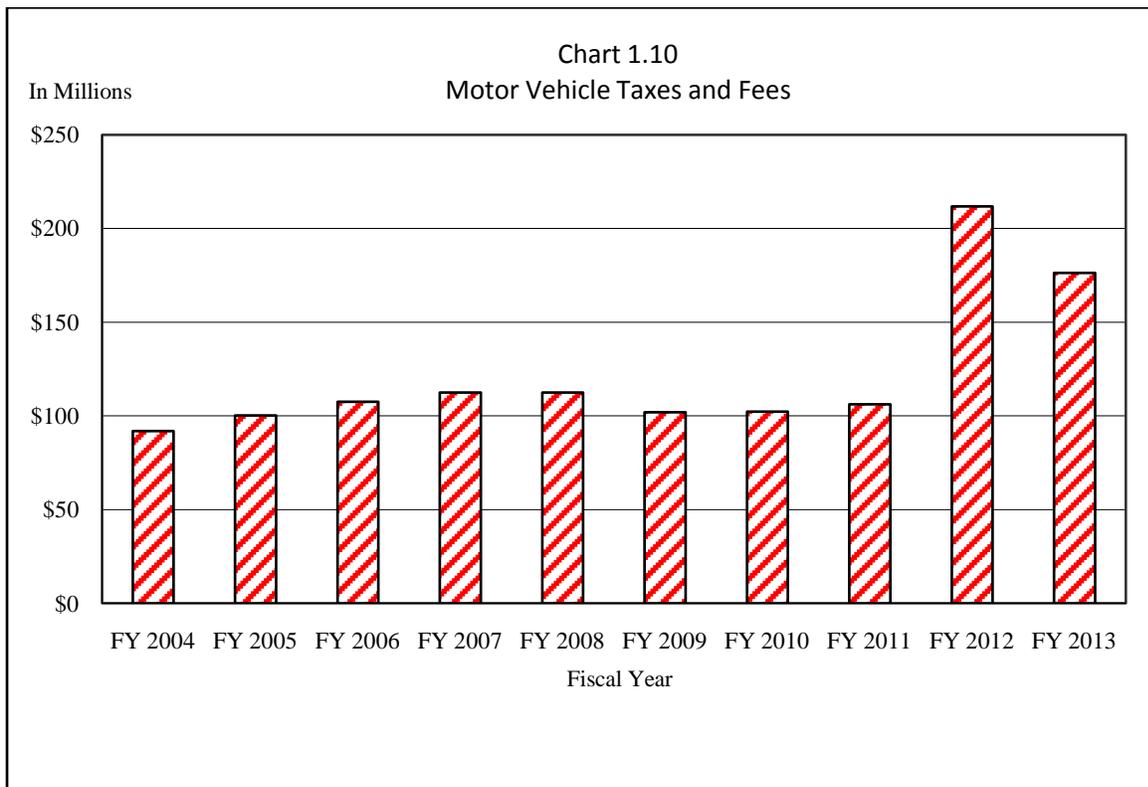
1.7.1 Overview

The State levies an annual registration fee per vehicle and a tax based on vehicle weight. The State also levies the Rental Motor Vehicle Surcharge (RMVS) tax for motor vehicles that are rented or leased. The tax is imposed on the lessor. The rate of the RMVS tax was \$7.50 per day for the period from July 1, 2011 to June 30, 2012, and \$3.00 per day beginning July 1, 2012. 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 for those subject to the taxes on rental or tour vehicles.

1.7.2 Revenue

For FY 2013, the State's motor vehicle taxes and fees (including the RMVS) totaled \$176.3 million, compared to \$211.7 million in FY 2012, a decline of 16.7%. The decline was caused mainly by the reduction in the RMVS tax rate from \$7.50 per day to \$3.00 per day that took effect July 1, 2012. In FY 2013, \$4.5 million of the RMVS tax was allocated to the General Fund and the remainder of the motor vehicle taxes and fees (\$171.8 million) went to the State Highway Fund. Chart 1.10 shows the total motor vehicle taxes and fees for FY's 2004 through 2013.



1.8 CIGARETTE AND TOBACCO TAX

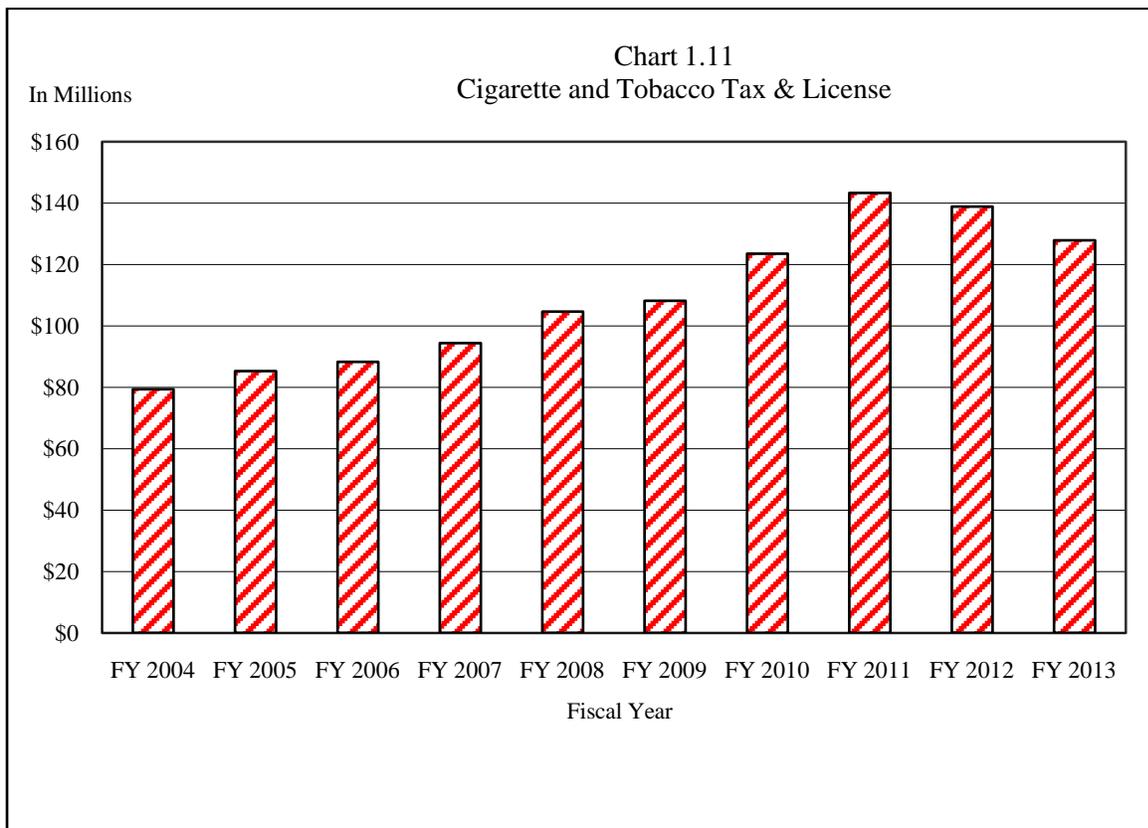
1.8.1 Overview

Wholesalers and dealers, as those terms are defined in section 245-1, HRS, must pay an excise tax on the sale or use of tobacco products and on each cigarette or little cigar sold, used, or possessed. The tax per cigarette or little cigar was increased to 16 cents for sales on and after July 1, 2011. The excise tax on large cigars is 50% of the wholesale price and the excise tax on all other tobacco products (tobacco in any form except cigarettes, little cigars or large cigars) is 70% of the wholesale price. A \$2.50 tobacco tax license is required and must be renewed before

July 1 each year. Cigarette wholesalers and dealers are required to affix a stamp to each individual cigarette package as proof that the tax has been paid. 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 1 each year.

1.8.2 Revenue

During FY 2013, collections of the Cigarette and Tobacco Tax (including tobacco licenses) totaled \$127.9 million, compared to \$138.8 million in FY 2012, a decrease of 7.9%. Chart 1.11 shows the total collections of the tax for FY's 2004 through 2013.



The 16 cent tax per cigarette was distributed as follows in FY 2013: 2.0 cents per cigarette went to the Hawaii Cancer Research Special Fund, 0.75 cents per cigarette went to the Trauma System Special Fund, 0.75 cents per cigarette went to the Community Health Centers Special Fund, and 0.50 cents went to the Emergency Medical Services Special Fund. The remainder of the Cigarette and Tobacco Tax went to the General Fund. Table 1.7 shows collections of the tobacco taxes and how the revenues were allocated in FY's 2012 and 2013.

TABLE 1.7 - CIGARETTE AND TOBACCO TAX
(In thousands of dollars)

	FY 2013	FY 2012	Difference	
			Amount	%
COLLECTION				
Cigarette and Tobacco Tax & License	\$127,881	\$138,798	(\$10,917)	(7.9)
DISTRIBUTION*				
Hawaii Cancer Research Special Fund	\$15,777	\$16,828	(\$1,051)	(6.2)
Trauma System Special Fund	5,919	6,312	(393)	(6.2)
Emergency Medical Service Special Fund	3,938	4,203	(265)	(6.3)
Community Health Centers Special Fund	5,919	6,312	(393)	(6.2)
Cigarette Stamp Administrative & Enforcement Funds	2,148	2,290	(142)	(6.2)
General Fund	94,180	102,853	(8,673)	(8.4)
TOTAL	\$127,881	\$138,798	(\$10,917)	(7.9)

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

* Details on distributions of the revenues are given in section 245-15, HRS.

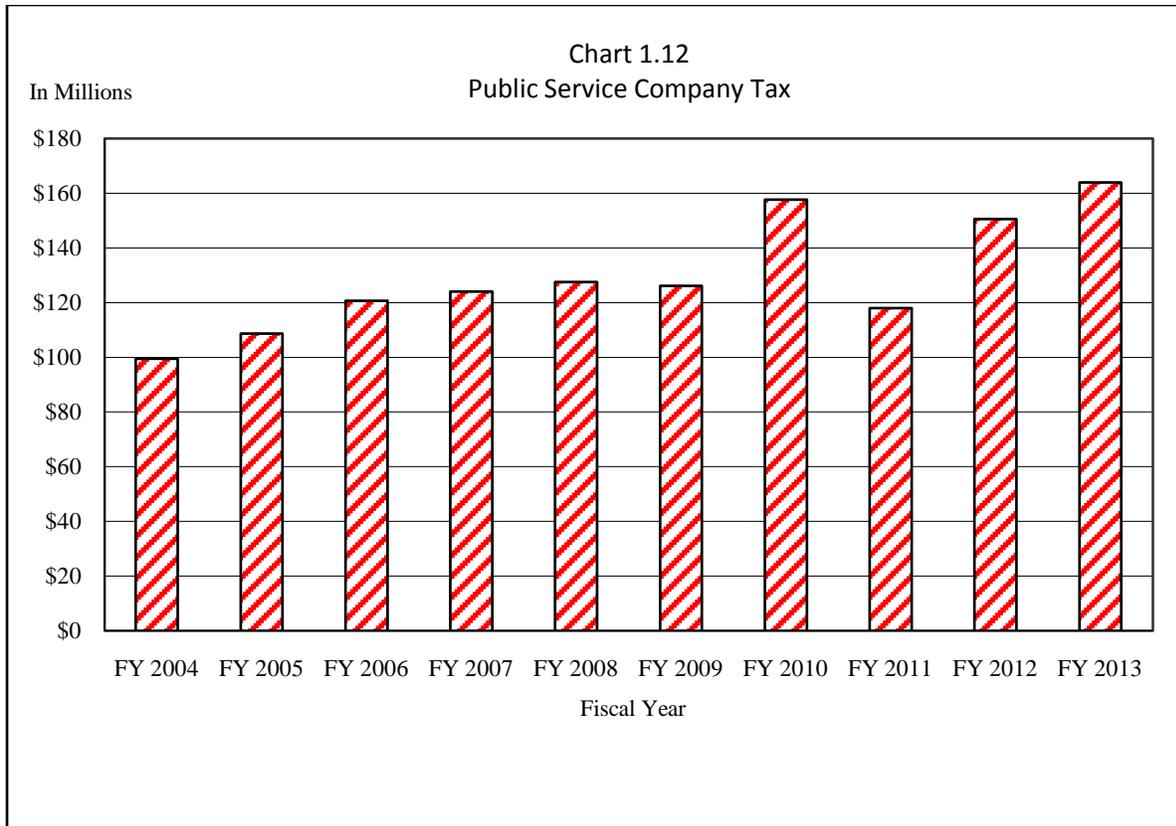
1.9 PUBLIC SERVICE COMPANY TAX

1.9.1 Overview

The Public Service Company (PSC) Tax is levied on public utility businesses in lieu of all taxes except income taxes, vehicular taxes imposed under chapter 249, HRS, the franchise tax on public utilities imposed under chapter 240, HRS, and the Use Tax imposed under chapter 238, HRS. Generally, the tax is applied to gross income from the business of public utilities for the preceding calendar year. The tax rates on the PSC's range from 0.5% (levied on sales for resale) to 8.2%. For a public utility, only the first 4% is a realization of the State, and any excess over 4% is distributed to counties that provide a real property tax exemption for property used by the public utility in its business. For a carrier of passengers by land between points on a scheduled route, the gross income from passenger fares is taxed at 5.35%, all of which is realized by the State.

1.9.2 Revenue

The PSC Tax yielded \$163.9 million in tax, penalty, and interest in FY 2013, compared to \$150.5 million in FY 2012, an increase of 8.9%. All of the revenues from the PSC Tax are allocated to the General Fund. Chart 1.12 shows the total collections of the tax for FY's 2004 through 2013.



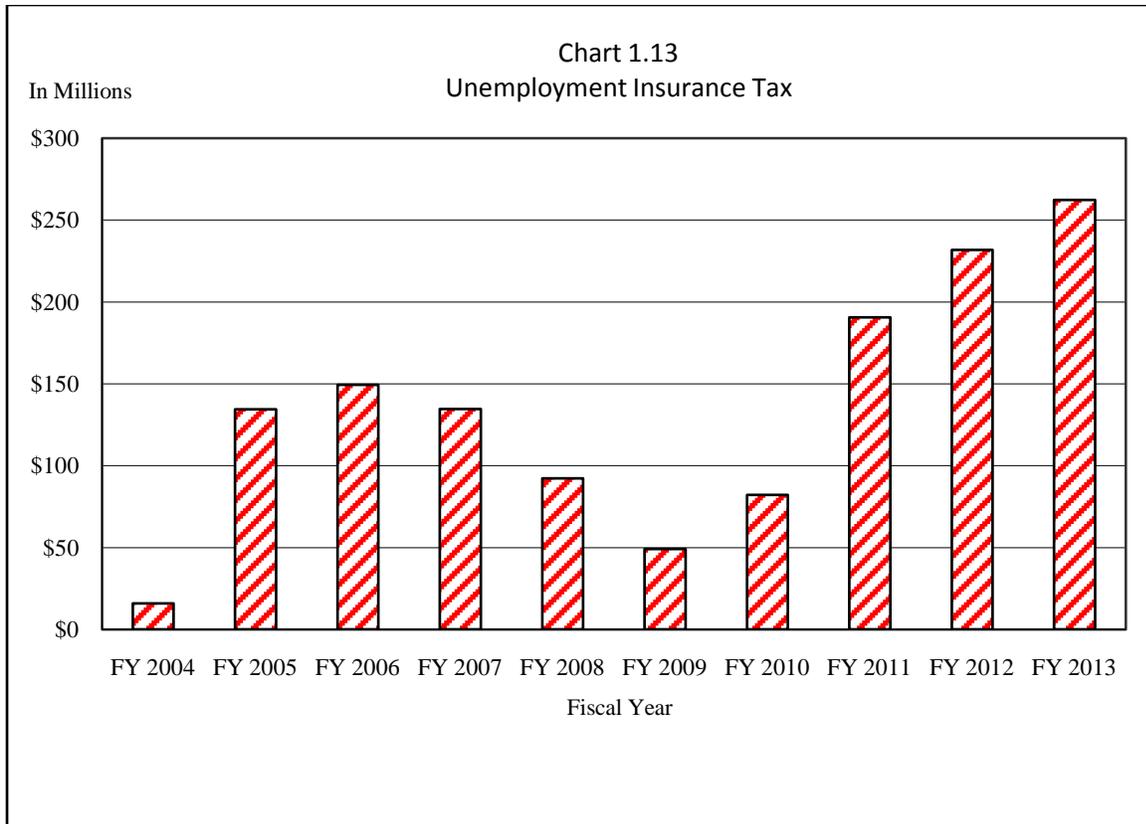
1.10 UNEMPLOYMENT INSURANCE TAX

1.10.1 Overview

The Unemployment Insurance (UI) Tax (officially called "Employment Security Contributions") is imposed on wages paid by employers with one or more employees, with certain exemptions. The UI tax rate for each year depends on the financial condition of the UI Trust Fund. An employer's contribution rate cannot be less than 0.0% or greater than 5.4%. There is also an additional employment and training fund assessment applicable to all employers. The tax is levied on wages paid to an employee, up to a limit called the "tax base." The tax base represents the state's average annual wages reported by employers contributing to the unemployment trust fund. For 2013, the tax base was set at \$39,600. Revenues from the tax go to the Unemployment Security Fund. The Department of Labor and Industrial Relations administers the UI Tax and the Department of Taxation collects the tax.

1.10.2 Revenue

For FY 2013, revenue from the UI Tax totaled \$262.3 million, compared to \$231.7 million in FY 2012, an increase of 13.2%. Chart 1.13 shows collections of the UI Tax for FY's 2004 through 2013.



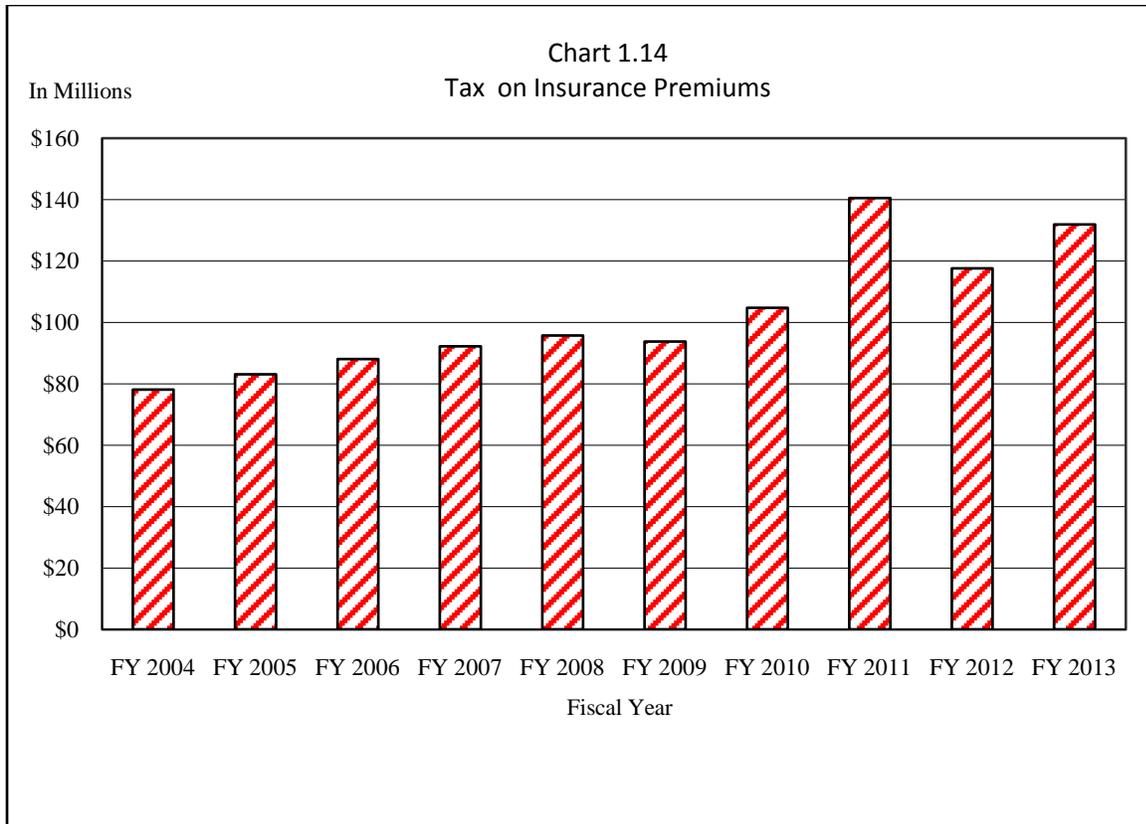
1.11 INSURANCE PREMIUM TAX

1.11.1 Overview

The tax on insurance premiums 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, 0.8775% on gross underwriting profit; and (4) Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. The tax is administered and collected by the Insurance Commissioner, who is required to report to the Director of Taxation the amounts of all taxes collected under chapter 431, HRS.

1.11.2 Revenue

During FY 2013, the tax on insurance premiums totaled \$131.9 million, compared to \$117.6 million in FY 2012, an increase of 12.1%. Chart 1.14 shows collections of the tax for FY's 2004 through 2013.



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. All of the insurance fees have been deemed to be non-tax revenues, so they are excluded from the total tax collections and from the General Fund tax revenues.³

1.12 LIQUOR TAX

1.12.1 Overview

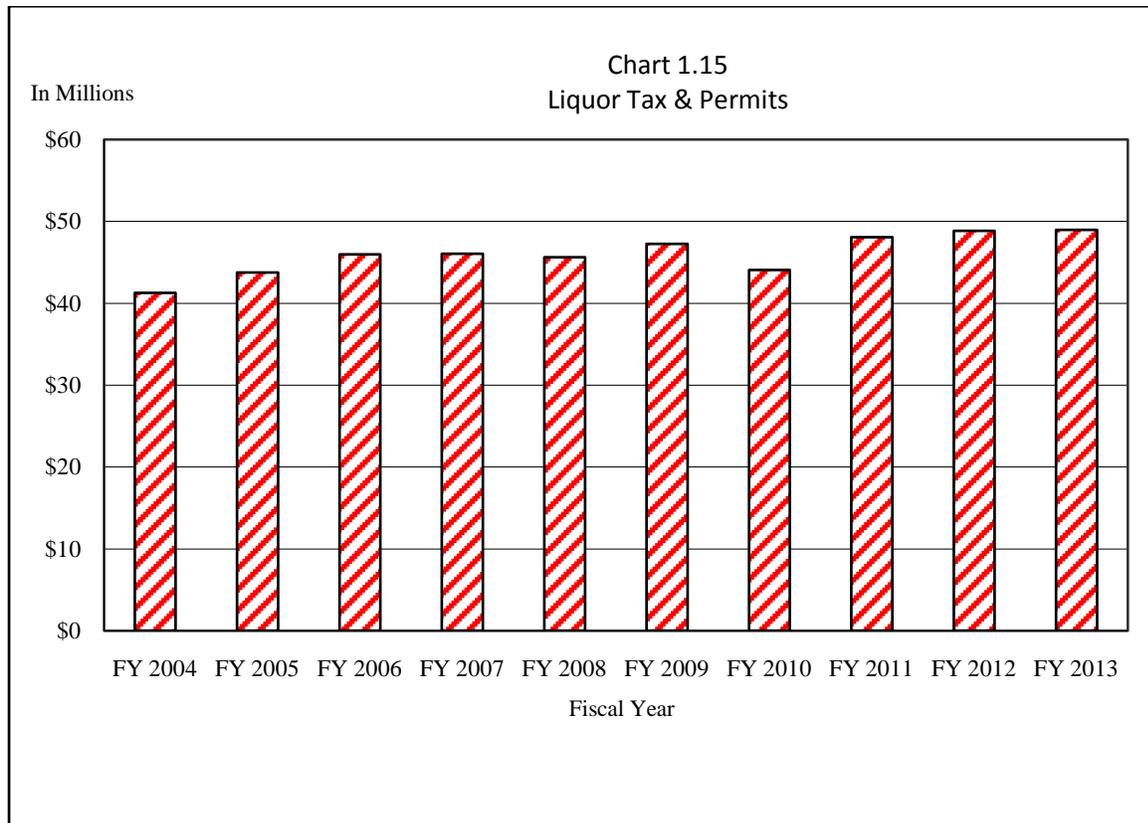
The Liquor Tax is a gallonage tax imposed upon "dealers" as defined in section 244D-1, HRS, and upon certain others who sell or use liquor. A \$2.50 Liquor Tax permit is required and must be renewed before July 1 each year. See section 244D-4, HRS, for exemptions from the tax.

³ Beginning with the reports for July of 2013, the Office of Tax Research and Planning excludes the insurance fees from the total tax collections and from General Fund tax revenues. Prior to the July reports, the fees dedicated to the General Fund were included in the totals for both the tax collections and the General Fund tax revenues.

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 2013, the Liquor Tax and permit fees totaled \$49.0 million, a small increase over the \$48.9 million collected in FY 2012. Chart 1.15 shows collections of the Liquor Tax and permit fees for FY's 2004 through 2013.



1.13 CONVEYANCE TAX

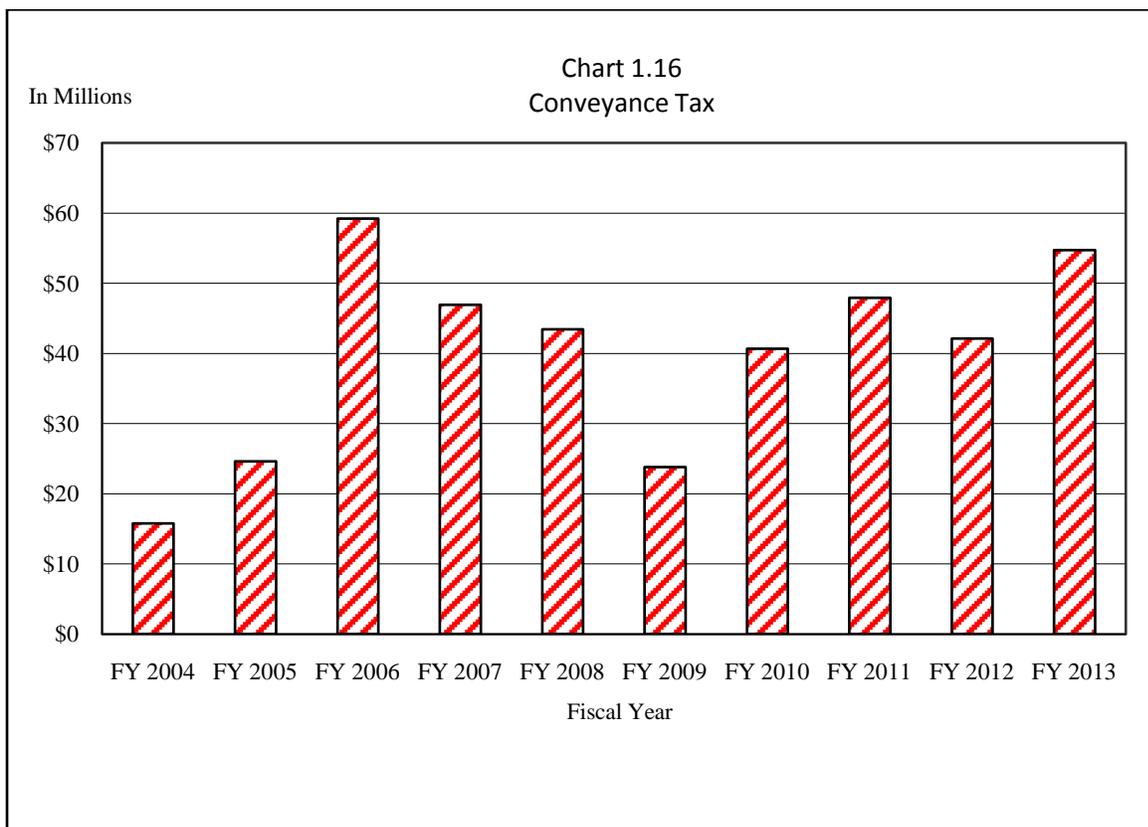
1.13.1 Overview

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. For a sale of a condominium or single family residence, the rate of the Conveyance Tax depends on whether the purchaser is eligible for a county homeowners' exemption from the real property tax. If the purchaser is eligible for the exemption, or if the sale is of real property other than a condominium or single family residence, then the 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. If the purchaser is ineligible for the exemption, the tax rate for a sale of a condominium or single family residence 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 more. The Conveyance Tax is administered by the Department of Taxation, but it is collected by the Bureau of Conveyances in the Department of Land and Natural Resources.

1.13.2 Revenue

For FY 2013, revenue from the Conveyance Tax totaled \$54.7 million, compared to \$42.1 million in FY 2012, an increase of 29.9%. The revenues for FY 2013 were distributed as follows: 10% went to the Land Conservation Fund, 30% went to the Rental Housing Trust Fund, 25% went to the Natural Area Reserve Fund and the remaining 35% went to the General Fund. Chart 1.16 shows collections of the Conveyance Tax for FY's 2004 through 2013.



1.14 BANK AND OTHER FINANCIAL CORPORATIONS TAX

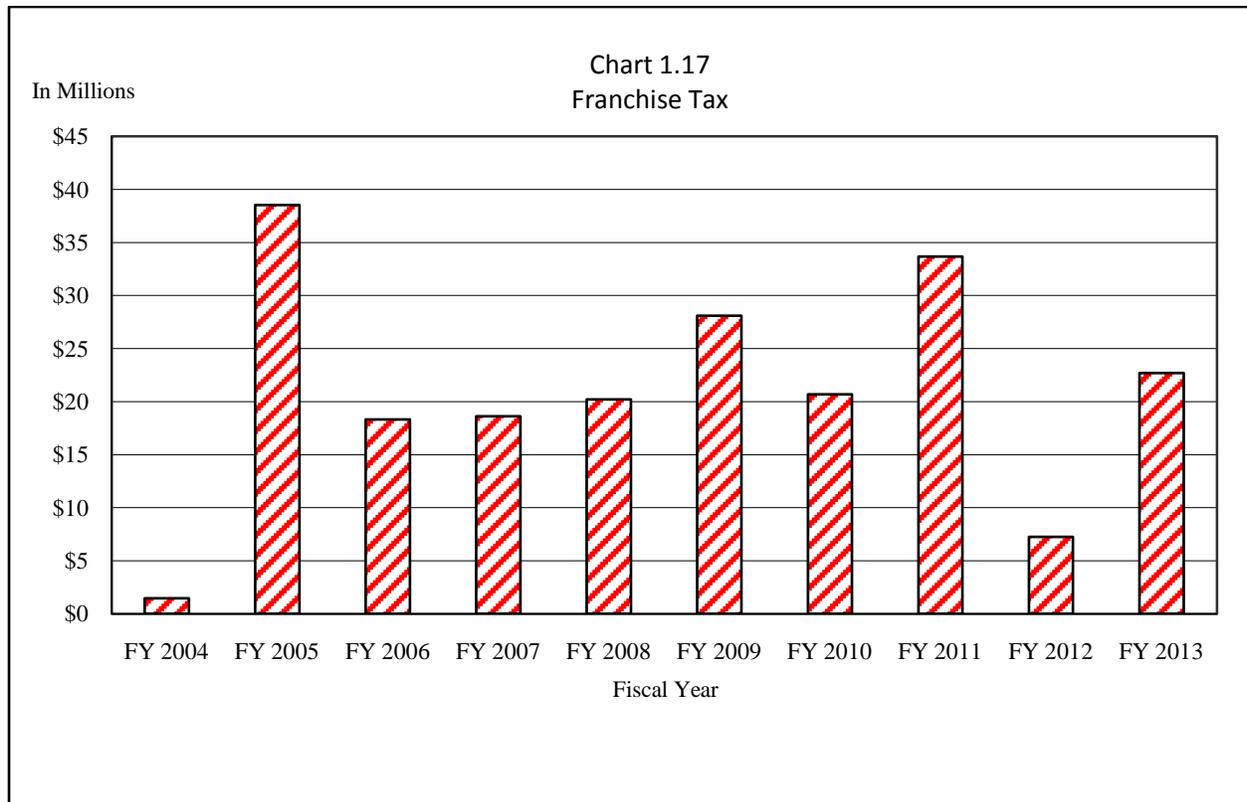
1.14.1 Overview

The tax on banks and other financial corporations (the Franchise Tax) is levied on net income of 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, and subsidiaries not subject to the tax imposed by chapter 235, HRS. The tax is in lieu of the net income tax in chapter 235, HRS and of the

GET, but it uses the definition of net income from chapter 235, with modifications. The tax is levied on net income at the rate of 7.92%. The assessment date is January 1 of each year.

1.14.2 Revenue

During FY 2013, Franchise Tax collections totaled \$22.7 million, compared to \$7.2 million in FY 2012, an increase of 213.6%. Collections of the tax were low in FY 2012, due partly to a one-time transfer of \$16.5 million to the Litigated Claims Fund. Chart 1.17 shows collections of the Franchise Tax for FY's 2004 through 2013.



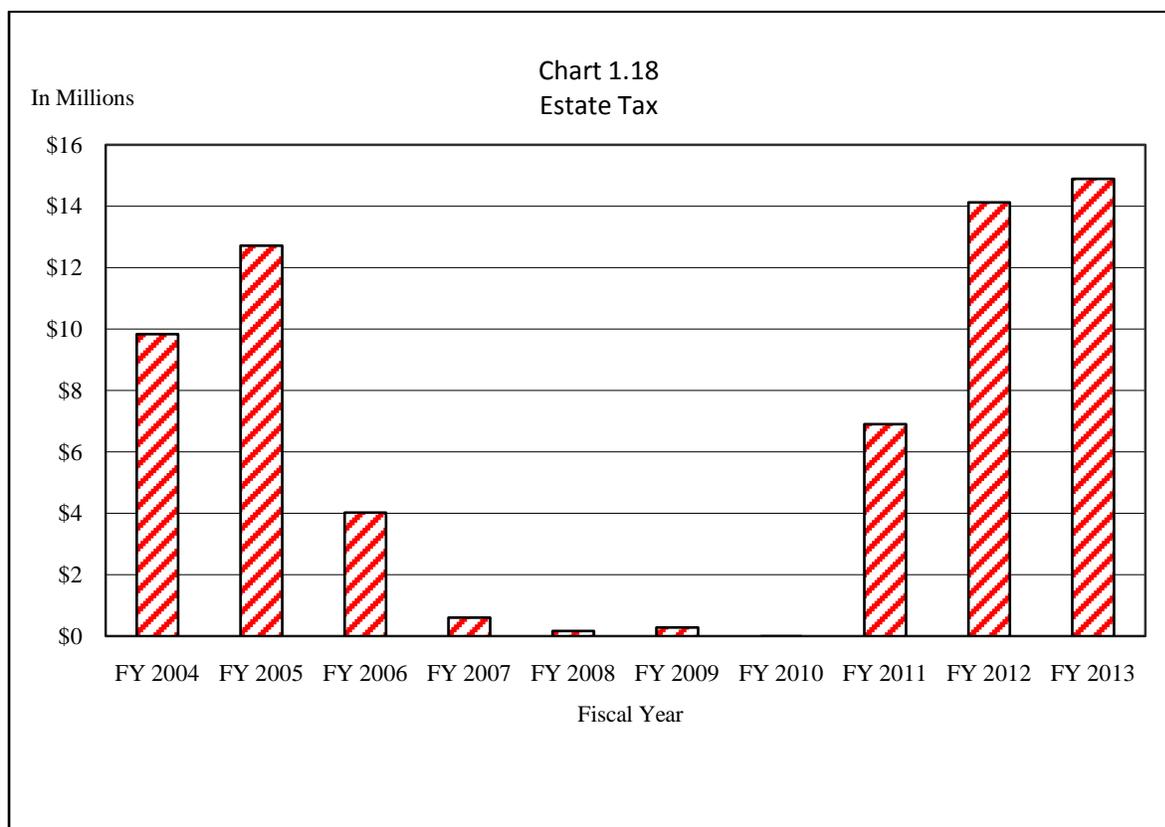
1.15 ESTATE AND TRANSFER TAX

1.15.1 Overview

Hawaii's Estate and Transfer Tax is levied on the transfer of a taxable estate. The taxable estate is based on the federal definition (with adjustments for nonresidents), but the State has its own tax rate schedule, with tax rates varying from 10.0% to 15.7%. The generation skipping tax is also based on the federal taxable transfer, but has its own tax rate (currently 2.25%).

1.15.2 Revenue

During FY 2013, estate tax collections totaled \$14.9 million, compared to \$14.1 million in FY 2012, an increase of 5.4%. Chart 1.18 shows collections of the Estate and Transfer Tax for FY's 2004 through 2013.



1.15.3 Recent Legislation⁴

The federal Economic Growth and Tax Relief Reconciliation Act of 2001 gradually phased out the federal 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 Internal Revenue Code (IRC) operative for purposes of the estate and transfer tax as of December 31, 2009. However, IRC section 2011 (federal estate tax credit for state death taxes paid) and IRC section 2604 (federal credit for state generation-skipping transfer taxes paid), which are used to define the Hawaii estate tax base, 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 to its present form, for decedents dying after January 25, 2012.

⁴ See also Act 1, SLH 2011, described on page 8.

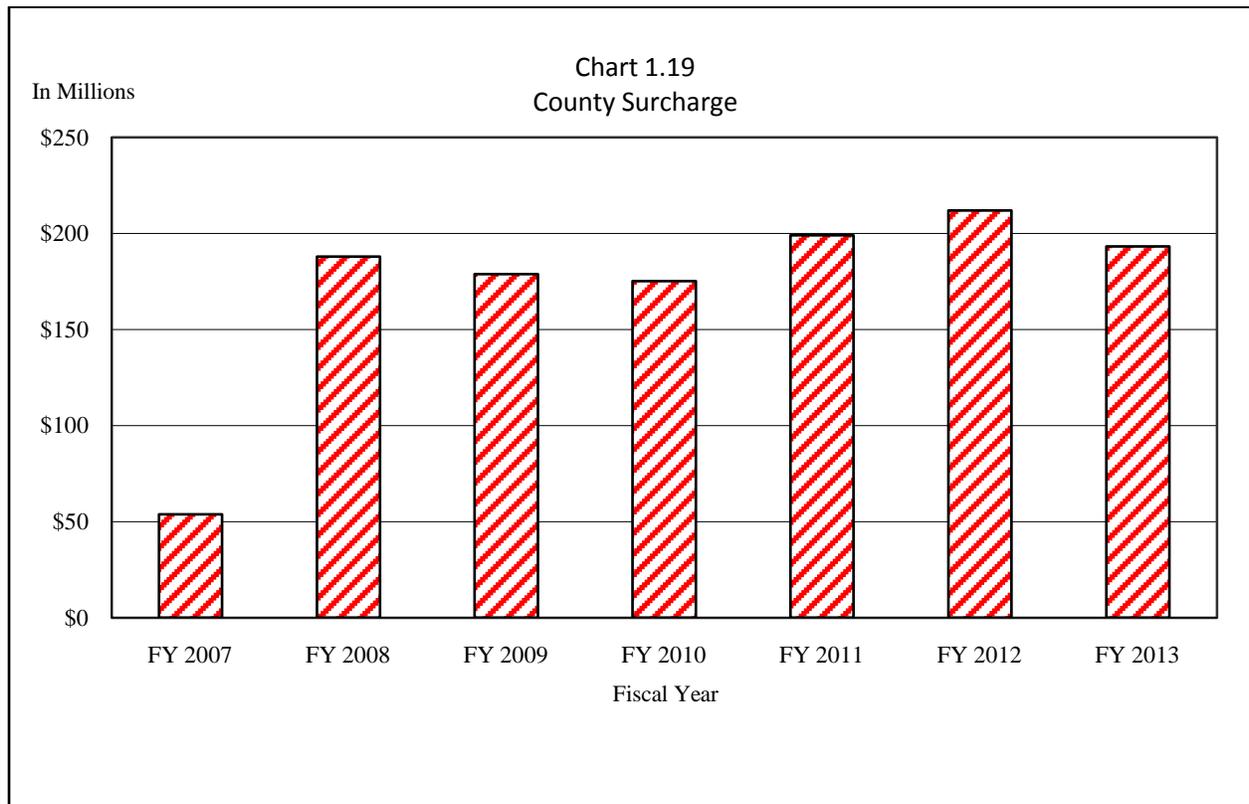
1.16 CITY AND COUNTY OF HONOLULU SURCHARGE TAX

1.16.1 Overview

Act 247, SLH 2005, granted counties the authority to impose a County Surcharge of no more than 0.5% on gross income that is subject to the State's GET at the rate of 4% to fund county public transportation systems. The Act specified that the surcharge be levied no earlier than January 1, 2007 and that it be automatically repealed on December 31, 2022. The Department of Taxation is required to administer and collect the surcharge for the counties. The City and County of Honolulu was the only county to adopt the surcharge, which took effect on January 1, 2007. The State retains 10% of the collections from the County Surcharge as administrative costs, and Honolulu County receives the remaining 90% of the collections.

1.16.2 Revenue

In FY 2013, collections of Honolulu's County Surcharge totaled \$193.1 million, a decline of 8.8% from the \$211.9 million collected in FY 2012. The reason for the decline was an adjustment of \$9.9 million of the tax collected in FY 2012 to be reported in the State's General Fund in FY 2013. (Without the transfer, the County Surcharge collections would have grown slightly from FY 2012 to FY 2013.) Chart 1.19 shows collections of the County Surcharge for FY's 2004 through 2013.



1.17 TOTAL TAX COLLECTIONS

Total tax collections in FY 2013 amounted to \$6.54 billion, or about 8.9% more than the \$6.00 billion collected in FY 2012. The Department collected the great majority of the total taxes (\$6.23 billion), but the counties collected \$124.2 million in State motor vehicle weight taxes and registration fees, the Insurance Commissioner (in the Department of Commerce and Consumer Affairs) collected \$131.9 million in insurance premium taxes, and the Bureau of Conveyances (in the Department of Land and Natural Resources) collected \$54.7 million in Conveyance Tax. The total collections are shown in Table 1.8.

TABLE 1.8 - TAX COLLECTIONS
(In thousands of dollars)

SOURCE OF REVENUE	FY 2013		FY 2012	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$22,673	0.35	\$7,229	0.12
Conveyance	54,686	0.84	42,106	0.70
Employment Security Contributions	262,290	4.01	231,669	3.86
Fuel	193,949	2.96	193,101	3.22
General Excise & Use	2,944,487	45.01	2,697,951	44.93
Honolulu County Surcharge	193,136	2.95	211,850	3.53
Income – Corporations	100,988	1.54	73,027	1.22
Income – Individuals	1,736,007	26.54	1,541,050	25.67
Inheritance and Estate	14,886	0.23	14,125	0.24
Insurance Premiums 1/	131,906	2.02	117,617	1.96
Liquor & Permits	48,962	0.75	48,854	0.81
Motor Vehicle Tax 2/	176,295	2.70	211,742	3.53
Public Service Companies	163,930	2.51	150,528	2.51
Tobacco & Licenses	127,881	1.95	138,798	2.31
Trans. Accom. Fees	20	0.00	11	0.00
Trans. Accom. Tax	368,556	5.63	323,940	5.40
All Others 3/	648	0.01	672	0.01
TOTAL	\$6,541,300	100.00	\$6,004,268	100.00

1/ Excludes insurance fees dedicated to the General Fund.

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

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

1.18 DISTRIBUTION OF TAXES

Of the \$6.54 billion in total tax collections in FY 2013, \$5.47 billion or 83.6% was deposited into the State's General Fund. The four counties received \$167.4 million or 2.6% of the tax collections, which came from county fuel taxes and the TAT. In addition, \$193.1 million of County Surcharge was collected for the City and County of Honolulu (before deducting the 10% administrative fee imposed by the State). The remaining tax revenues not deposited into the General Fund or transferred to the counties were distributed among several State special funds. The State Highway Fund received the largest portion, \$257.8 million. All of the Unemployment Insurance Tax (the Employment Security Contributions) went into the Unemployment Trust Fund for unemployment benefits. Portions of the TAT went to the next two largest special funds: \$71.0 million went to the Tourism Special Fund and \$33.0 million went to the Convention Center Fund.

Table 1.9 shows allocations of taxes to the State's General Fund in FY's 2012 and 2013. The distributions of the total tax collections among all funds in FY's 2012 and 2013 are shown in Table 1.10.

TABLE 1.9 - STATE GENERAL FUND
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2013		FY 2012	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$20,673	0.38	\$5,229	0.11
Conveyance	19,132	0.35	18,917	0.38
General Excise & Use	2,944,487	53.86	2,697,951	54.24
Income – Corporations	100,988	1.85	73,027	1.47
Income – Individuals	1,735,499	31.75	1,540,604	30.97
Inheritance & Estate	14,886	0.27	14,125	0.28
Insurance Premiums 1/	131,906	2.41	117,617	2.36
Liquor & Licenses	48,962	0.90	48,854	0.98
Public Service Companies	163,930	3.00	150,528	3.03
Tobacco & Licenses	94,180	1.72	102,853	2.07
Trans. Accom. Tax	171,556	3.14	126,302	2.54
All Others 2/	20,725	0.38	77,888	1.57
TOTAL	\$5,466,924	100.00	\$4,973,895	100.00

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

1/ Excludes insurance fees that go to the General Fund.

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

TABLE 1.10—DISTRIBUTION OF COLLECTIONS
(In Thousands of Dollars)

	FY 2013		FY 2012	
	Amount Distributed	% of Total	Amount Distributed	% of Total
STATE FUNDS:				
State General	\$5,466,923	83.58	\$4,973,895	82.84
State Highway	257,801	3.94	237,542	3.96
State Airport	4,707	0.07	4,353	0.07
Boating Special Fund	1,621	0.02	1,611	0.03
Environmental Fund	1,295	0.02	1,315	0.02
Cigarette Stamp Admin/Enf. Fund	2,148	0.03	2,290	0.04
Compliance Resolution Fund	2,000	0.03	2,000	0.03
Unemployment Trust	262,290	4.01	231,669	3.86
Election Campaign Fund	219	0.00	141	0.00
Tourism Special Fund	71,000	1.09	69,000	1.15
Rental Housing Fund	16,409	0.25	10,540	0.18
Land Conservation Fund	5,470	0.08	4,216	0.07
Natural Area Reserve Fund	13,675	0.21	8,432	0.14
Convention Center Fund	33,000	0.50	35,637	0.59
Public Libraries Fund	68	0.00	73	0.00
Domestic Violence/Child Abuse	147	0.00	154	0.00
School Repair & Maintenance Fund	74	0.00	77	0.00
Cancer Research Fund	15,777	0.24	16,828	0.28
Trauma System Fund	5,919	0.09	6,312	0.11
Emergency Medical Service Fund	3,938	0.06	4,203	0.07
Community Health Centers Fund	5,919	0.09	6,312	0.11
Energy Security Fund	3,884	0.06	3,944	0.07
Energy Systems Development Fund	2,590	0.04	2,629	0.04
Agricultural Dev. & Food Security Fund	3,884	0.06	3,944	0.07
Subtotal – State	\$6,180,756	94.49	\$5,627,120	93.72
HONOLULU COUNTY SURCHARGE:	\$193,136	2.95	\$211,850	3.53
REVENUES TRANSFERRED TO COUNTIES:				
Other County Revenues				
Fuel	\$74,407	1.14	\$72,297	1.20
Trans. Accom. Tax	93,000	1.42	93,000	1.55
Subtotal – Counties	\$167,407	2.56	\$165,297	2.75
TOTAL	\$6,541,300	100.00	\$6,004,268	100.00

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

1.19 TRENDS IN TAX COLLECTIONS

Table 1.11 provides data on total tax collections for FY's 2004 through 2013.

TABLE 1.11 - HISTORICAL COLLECTIONS FOR SELECTED TAXES
(In Thousands of Dollars)

SOURCE OF REVENUE	Fiscal Year				
	2004	2005	2006	2007	2008
General Excise and Use	\$1,900,377	\$2,136,603	\$2,355,316	\$2,555,762	\$2,618,787
Income – Individuals	1,168,953	1,381,480	1,550,596	1,560,286	1,544,835
Transient Accom. Tax & Fees	181,860	198,784	217,008	224,942	229,388
Unemployment Insurance	15,828	134,459	149,388	134,612	92,279
Motor Vehicle Tax 1/	91,957	100,278	107,527	112,412	112,448
Fuel	160,127	162,873	166,138	169,712	169,927
Public Service Companies	99,505	108,686	120,679	124,017	127,481
Tobacco and Licenses	79,387	85,245	88,261	94,387	104,624
Insurance Premiums 2/	78,142	83,077	88,068	92,196	95,742
Income – Corporations	56,653	85,605	130,010	81,834	85,081
Liquor and Permits	41,250	43,737	45,955	46,034	45,620
Conveyance	15,767	24,583	59,201	46,887	43,421
Banks-Financial Corporations	1,466	38,520	18,324	18,599	20,212
Total Collections 3/	\$4,044,223	\$4,597,415	\$5,101,011	\$5,316,593	\$5,478,491

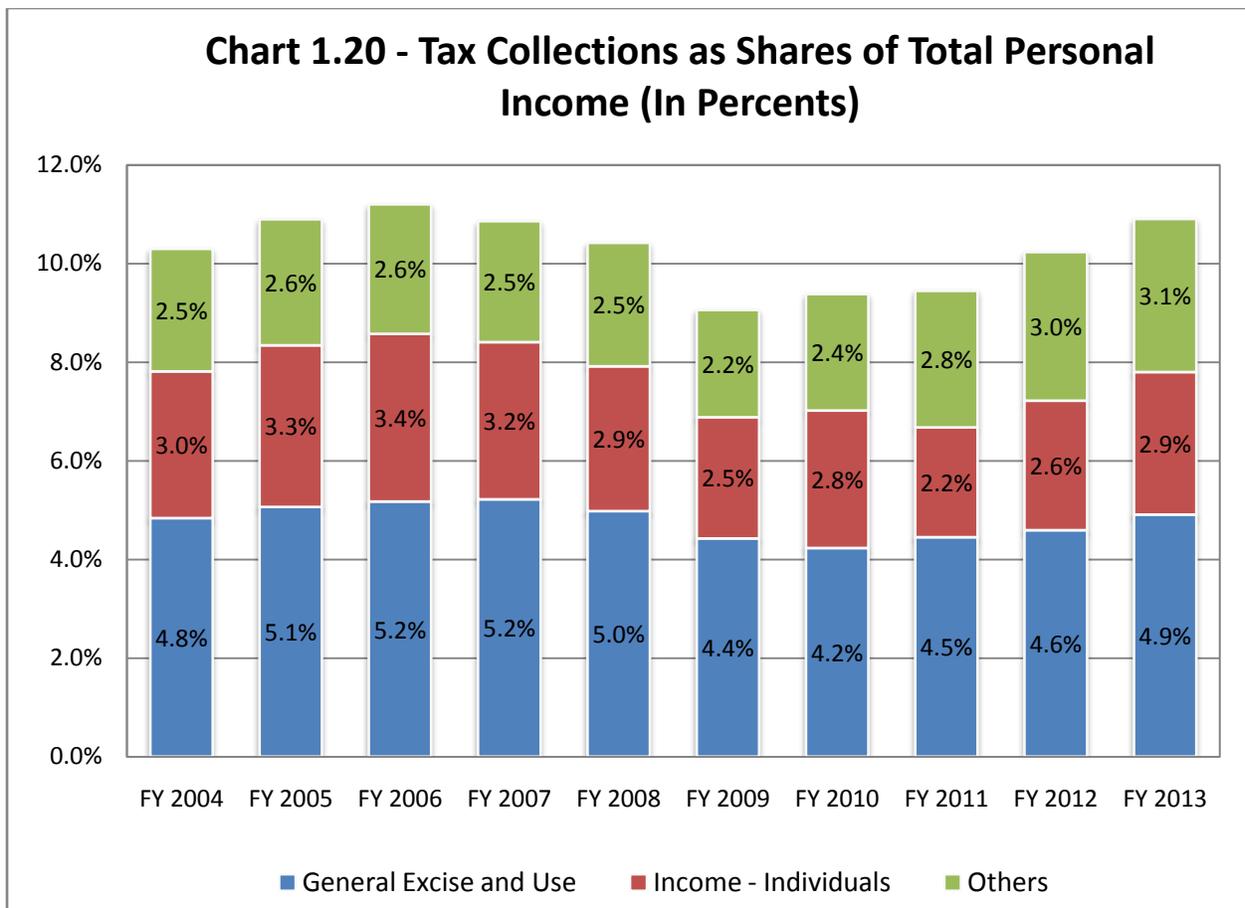
SOURCE OF REVENUE	Fiscal Year				
	2009	2010	2011	2012	2013
General Excise and Use	\$2,417,580	\$2,316,434	\$2,495,807	\$2,697,951	\$2,944,487
Income – Individuals	1,339,056	1,528,110	1,247,153	1,541,051	\$1,736,007
Transient Accom. Tax & Fees	210,622	224,252	284,472	323,951	\$368,576
Unemployment Insurance	49,071	82,017	190,511	231,669	\$262,290
Motor Vehicle Tax 1/	101,991	102,319	106,166	211,742	\$176,295
Fuel	165,717	155,703	195,336	193,101	\$193,949
Public Service Companies	126,069	157,661	117,940	150,528	\$163,930
Tobacco and Licenses	108,164	123,489	143,293	138,798	\$127,881
Insurance Premiums 2/	93,720	104,721	140,456	117,617	\$131,906
Income – Corporations	53,522	59,186	34,573	73,026	\$100,988
Liquor and Permits	47,242	44,074	48,054	48,854	\$48,962
Conveyance	23,772	40,634	47,906	42,106	\$54,686
Banks-Financial Corporations	28,075	20,666	33,677	7,229	\$22,673
Total Collections 3/	\$4,944,133	\$5,134,807	\$5,292,193	\$6,004,268	\$6,541,300

1/ 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.

2/ Excludes Insurance Fees allocated to the General Fund, which were included in previous reports.

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

Chart 1.20 shows total tax collections relative to total personal income (TPI) in the State for FY's 2004 through 2013.⁵ From FY 2004 to FY 2006, the ratio of tax collections to TPI increased steadily, but from FY 2006 to FY 2009, the ratio declined, with big declines in collections of both the GET and the IIT relative to TPI. The ratio has grown each year from FY 2009 to FY 2013.



⁵ The chart uses the most recent figures from the Bureau of Economic Analysis (BEA) for TPI. The Bureau periodically updates TPI figures and the updates often extend back for a number of years.

2.0 TAX ADMINISTRATION

2.1 OVERALL PERFORMANCE

The Department of Taxation consists of two divisions, four staff offices, a public information officer, a taxpayer advocate, an appeals officer, and the System Administration Section. The two divisions are the Tax Services and Processing Division and the Compliance Division. The four staff offices are the Administrative Services Office, the Rules Office, the Tax Research and Planning Office, and the Information Technology Services Office.

The total number of authorized permanent positions in the Department increased from 373 positions in FY 2012 to 383 positions in FY 2013. The Department's operating budget is a small fraction of total tax revenue. In FY 2013, the Department's operating expenses were \$18 million, which continues a downward trend in operating expenses that started in FY 2009, when they were \$25.5 million. The Department collected \$6.23 billion in taxes in FY 2013, so the cost of collecting each \$100 dollars of taxes was about 29 cents.

The Department has continued to encourage taxpayers to use electronic transmissions rather than paper returns. Changes in electronic filing by the Internal Revenue Service resulted in electronic filings of Hawaii's Individual Income Tax to decline slightly from FY 2012 to FY 2013, but the share of total payments for all taxes from electronic sources grew, from 69.5% in FY 2012 to 72.3% in FY 2013. The Department will continue in its efforts to modernize its processing of tax returns.

The total number of audit cases completed by the Compliance Division (the Office Audit Branch and Field Audit Branch combined) declined from 9,826 cases in FY 2012 to 7,701 cases in FY 2013, a decrease of 21.6%. However, total assessments increased by 12%, from \$77.7 million in FY 2012 to \$87.1 million in FY 2013. In addition, our auditors recommended assessments against On-line Travel Companies (OTC) totaling \$817.7 million including taxes, penalties and interest. The OTCs have appealed the cases to the Tax Appeal Court. The Criminal Investigation section collected a total of \$1.0 million in unpaid taxes, interest and penalties in FY 2013, down from the \$1.4 million collected in FY 2012, but since the main function of the Section is to deter tax evasion, its collections are not a good measure of the success of its operations.

2.2 TAX SERVICES AND PROCESSING DIVISION

2.2.1 Overview

The Tax Services and Processing (TSP) Division consists of three branches: (1) Document Processing, (2) Taxpayer Services, and (3) Revenue Accounting. The Division performs the following functions: 1) centralized processing, editing, and controlling of tax information received from paper documents or electronic data, and receiving, securing, depositing, and accounting for tax payments; 2) functions relating to account management, licensing, and providing taxpayer services to the public; and 3) maintaining revenue control and reconciliation

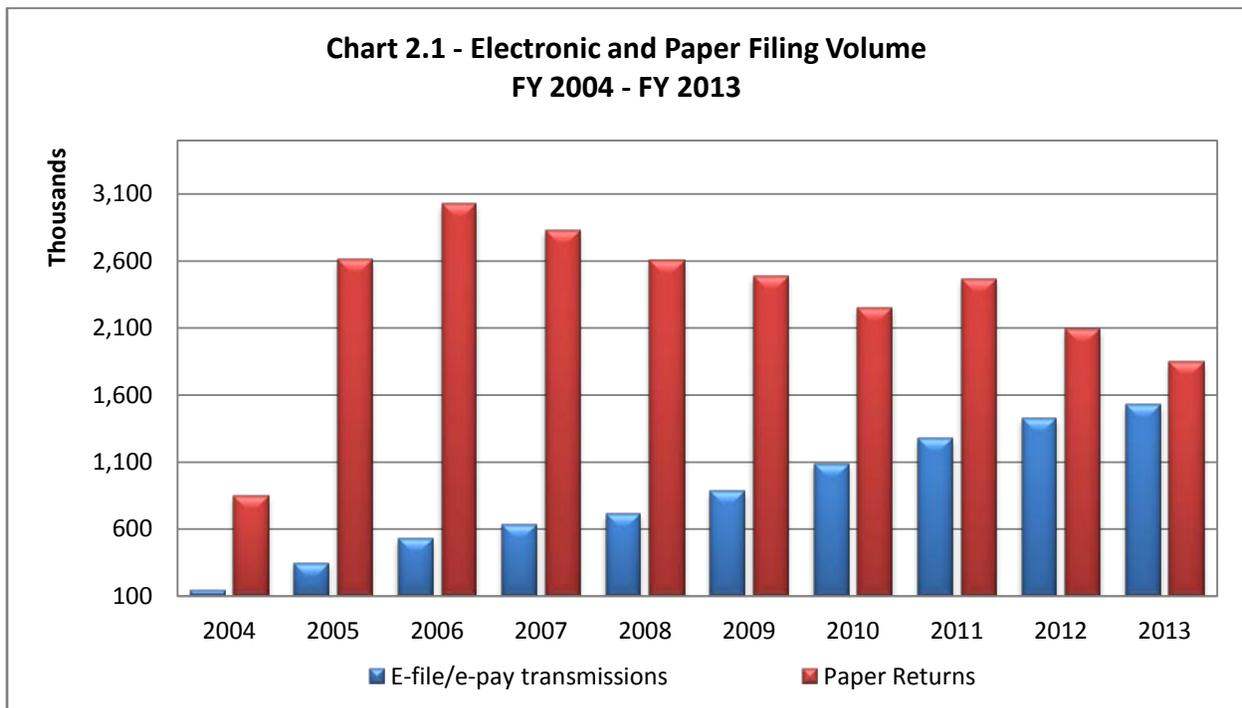
functions for all State tax revenues, including the preparation of the Preliminary Report, the Statement of Tax Operations (STO), and other revenue-related reports.

The Division is planning for a future in which taxpayers will have more options for filing their state tax returns and other documents with the Department, and where the Department will rely more heavily on electronic filings and financial transactions instead of paper returns and check remittances. Moreover, as electronic transactions allow data to be processed with less manual work, processing will become more efficient and the need for staff will be reduced. With the Department's Tax System Modernization Project on the horizon, the TSP Division looks forward to utilizing technology to improve processing and customer service.

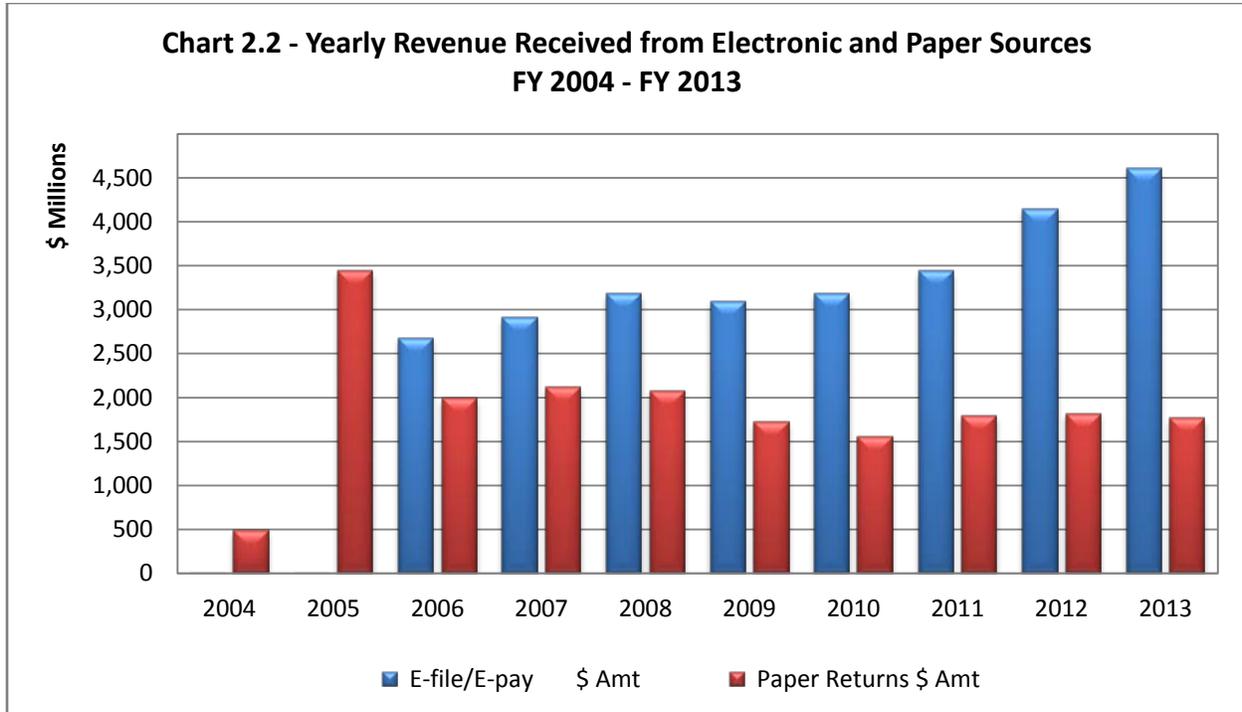
2.2.2 Document Processing Branch

The main function of the Document Processing (DP) Branch is to quickly and efficiently process all tax returns and documents; to receive, secure, deposit, and account for tax payments; to ensure proper storage and retrieval of documents; and to perform various functions relating to electronic filing. The branch has the following six sections: Receiving and Sorting, Data Preparation, Imaging and Data Entry, Monetary Control, File Maintenance, and Electronic Processing.

During FY 2013, the DP Branch processed approximately 3,700,000 returns of various tax types. Of these returns, 1,530,000 (41%) were electronically transmitted, an increase of 101,000 over FY 2012. The upward trend in electronic filings and payments over the past eight years indicates that the Department has been successful in increasing public interest and participation in electronic filing. Chart 2.1 shows the gradual increase in electronic filing by Hawaii taxpayers, from 140,000 electronic filings in FY 2004 to 1,530,000 in FY 2013:



The DP Branch also processed approximately 1,857,422 million payments totaling close to \$6.37 billion during FY 2013, nearly \$408 million more than in FY 2012. Chart 2.2 shows the upward trend in taxpayer remittances of electronic payments versus paper payments since FY 2006:



In February 2013 the Internal Revenue Service discontinued the Joint Electronic Filing Program ("JELF") and transitioned to the Modernized e-Filing ("MeF") Program. As of the end of June 2013, the total number of Hawaii returns filed electronically through MeF decreased by 3% from 404,804 last year to 392,450 this year, and the total number of returns filed by paper increased by 4% from 234,869 last year to 244,524 this year.

2.2.3 Revenue Accounting Branch

The main function of the Revenue Accounting ("RA") Branch is to maintain accounting records for all tax revenues, refunds (including cashier refunds) and adjustments, district transfers and closing adjustments, and other adjustments, including preparation of all Journal Vouchers and Summary Warrant Vouchers. The RA Branch controls, and is responsible for, all adjustment, error resolution, accounting, and reconciliation functions for all State tax revenues. Specific tasks include the preparation of the Preliminary Report, the Statement of Tax Operations (STO), the Daily Cash Collection Report (Oahu District), the Monthly Segregation of Taxes Reports for Miscellaneous Taxes.

The Preliminary Report is a monthly, statewide summary of all revenues received by the Department, less the amount of tax refunds. The STO is a formal, detailed report of State revenues that is based on the Preliminary Report.

The RA Branch also performs manual accounting activities for all miscellaneous tax collections, except the estate and transfer tax; controls and accounts for all State tax refunds resulting from either overpayments or adjustments; maintains the statewide accounting records and prepares journal entries associated with the various administratively-established trust accounts and for other mandated purposes; maintains the manual accounting system for all protested payments and tax appeals; provides allocation reports (in addition to the STO) to the Department of Accounting and General Services (DAGS) and the Department of Budget and Finance (B&F); and handles all State refund exception activities, such as returned checks, tracers, or forgeries.

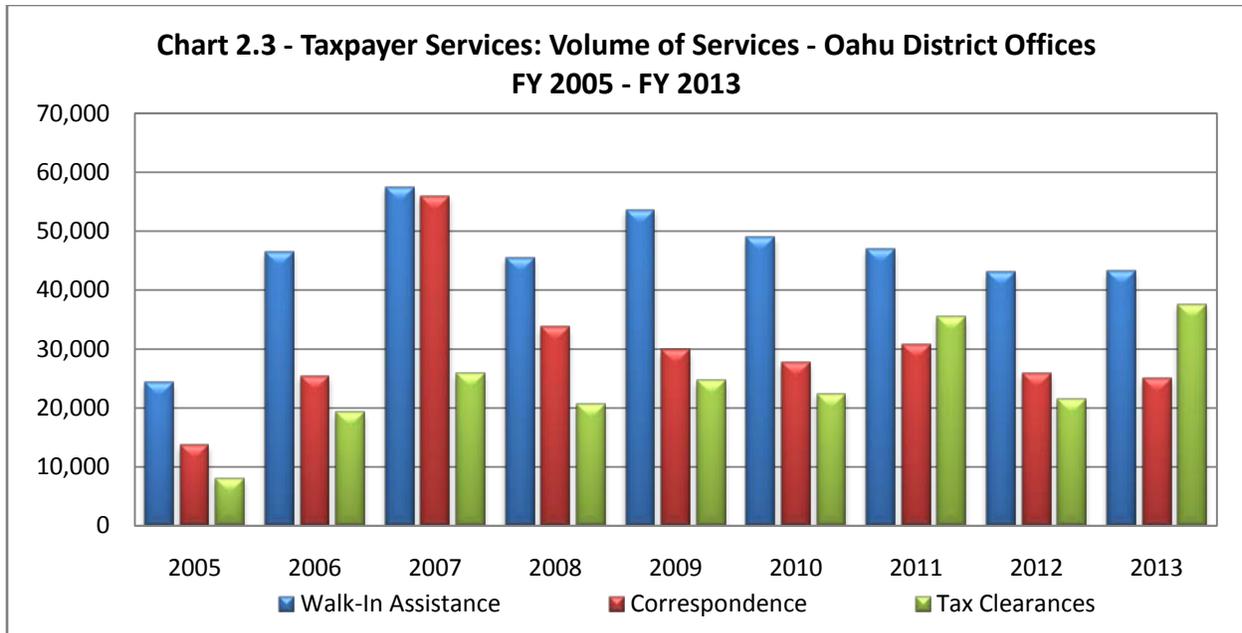
2.2.4 Taxpayer Services Branch

The Taxpayer Services (TPS) Branch has three main functions: (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 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 2013, Customer Inquiry continued to service taxpayer requests for assistance through the Call Center, at the counters, and via paper and electronic mail, with a total of 299,749 taxpayers serviced. The following are the FY 2013 production statistics for Customer Inquiry:

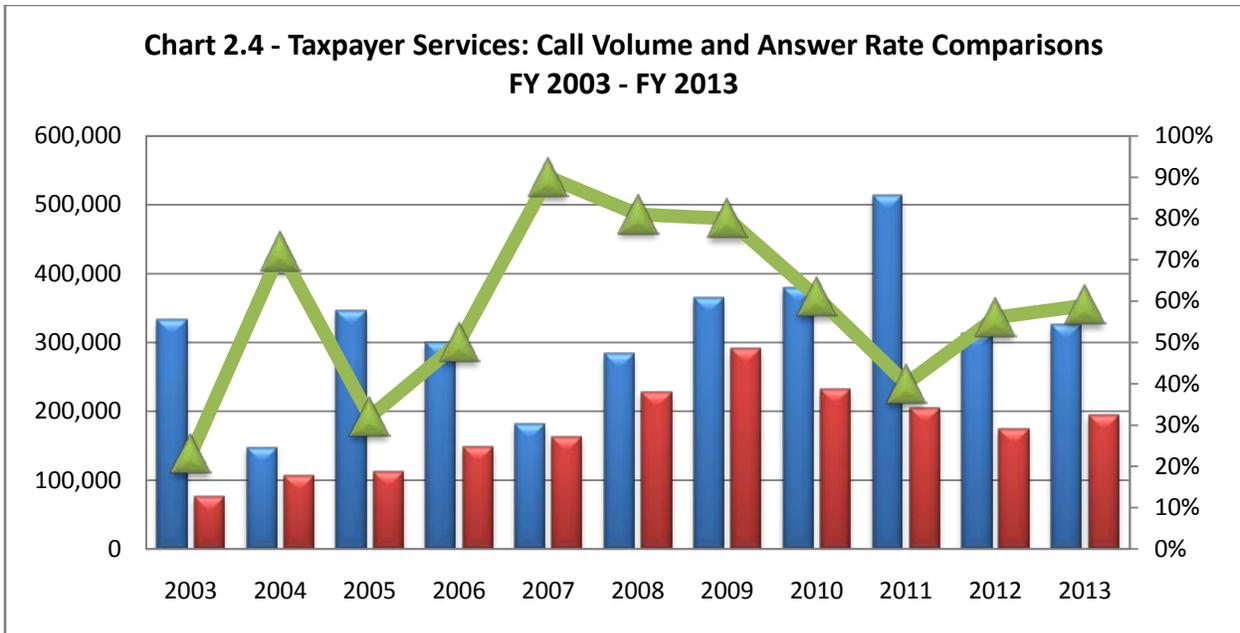
Total number of taxpayers serviced at the counter:	43,221
Total number of taxpayers serviced through the Call Center:	193,988
Total number of tax clearances processed:	37,519
Total number of paper and email responses:	<u>25,021</u>
Total number of taxpayers serviced:	299,749

The Chart 2.3 provides statistics on the above categories of customer contact (except Call Center statistics, which are shown on a separate chart), from FY 2005 through FY 2013:

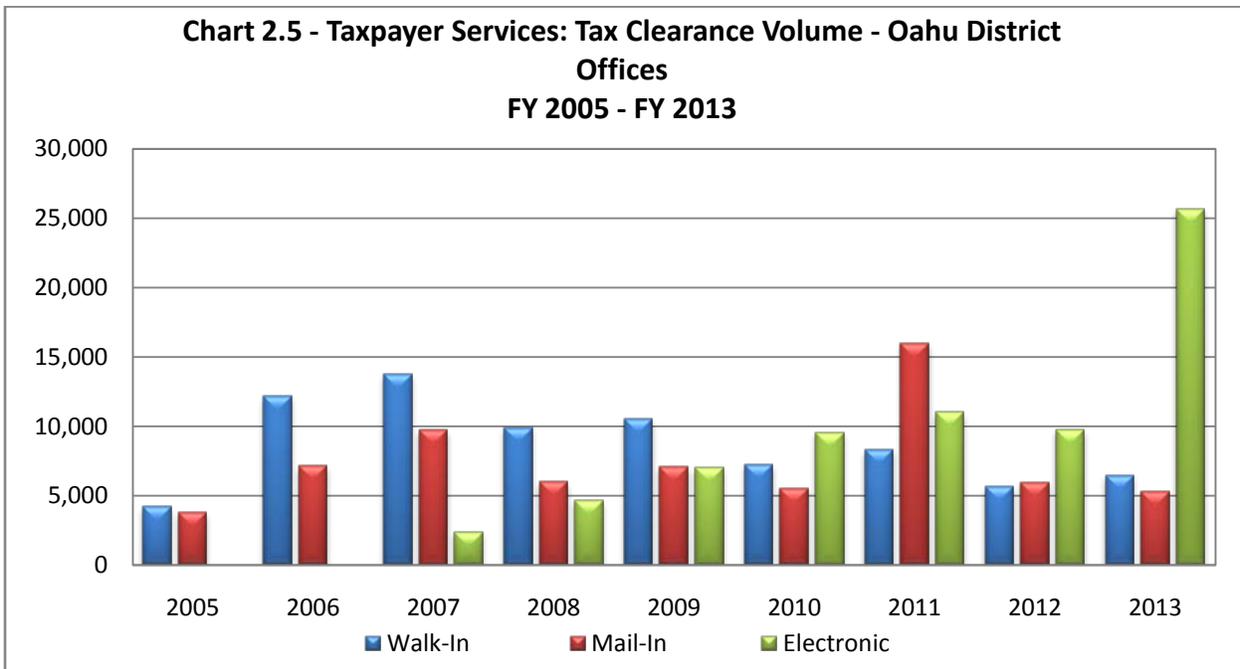


With no major initiatives affecting Taxpayer Services, the call pickup rate continued to improve from 40% in FY 2011 to 57% in FY 2012 and to 59% in FY 2013. The call statistics for FY's 2009 through 2013 are reported below. Chart 2.4 compares the statistics from FY 2003 through FY 2013.

<u>FY</u>	<u>Total Incoming Calls</u>	<u>Total Calls Answered</u>	<u>Overall Call Answer Rate</u>
2013	328,793	193,988	59%
2012	312,441	177,367	57%
2011	513,503	205,383	40%
2010	380,142	232,471	61%
2009	364,804	291,228	80%



With the enactment of Act 190, SLH 2011, which took effect July 1, 2011, the dollar threshold for Hawaii Compliance Express for vendors doing business with the State and county agencies was lowered from \$15,000 to \$2,500. This change also required vendors to provide Certificates of Compliance via the Hawaii Compliance Express instead of paper clearances. The change caused a dramatic increase in electronic processing of tax clearances (25,691 electronic clearances were processed in FY 2013, compared to 9,777 in FY 2012), as shown in Chart 2.5:



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.

In FY 2013, Account Management faced major challenges in accomplishing its tasks during the tax season as a result of processing delays. Although there were no major technical problems, the worklist inventory was consistently high during the tax season, and especially before the end of the fiscal year when there is a rush to clear the refund returns off the worklist to avoid accruing interest payable. However, the work group successfully managed to clear nearly all of the refund returns on their worklist before the July 20 deadline.

Licensing processed 8,411 cancellations in FY 2013, a 15% decline from FY 2012 when 9,850 cancellations were processed. The total number of license applications processed in FY 2013 was 31,003, a 39% increase from FY 2012 when 22,271 applications were processed. Overall, Licensing did not experience any unusual events that would have increased its workload in FY 2013. For FY 2014, in line with the Department's goal of expanding the use of electronic channels to do business in Hawaii, one of the goals for Licensing is to increase the options available to taxpayers applying for business licenses via the Hawaii Business Express, the Department's online business license application channel.

2.3 COMPLIANCE DIVISION

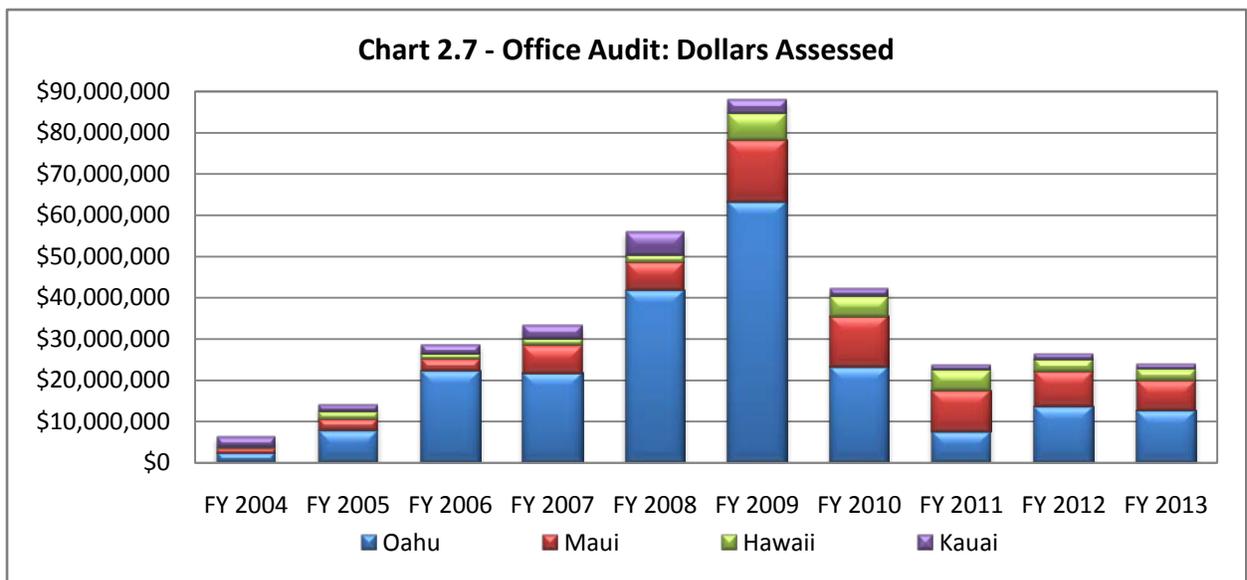
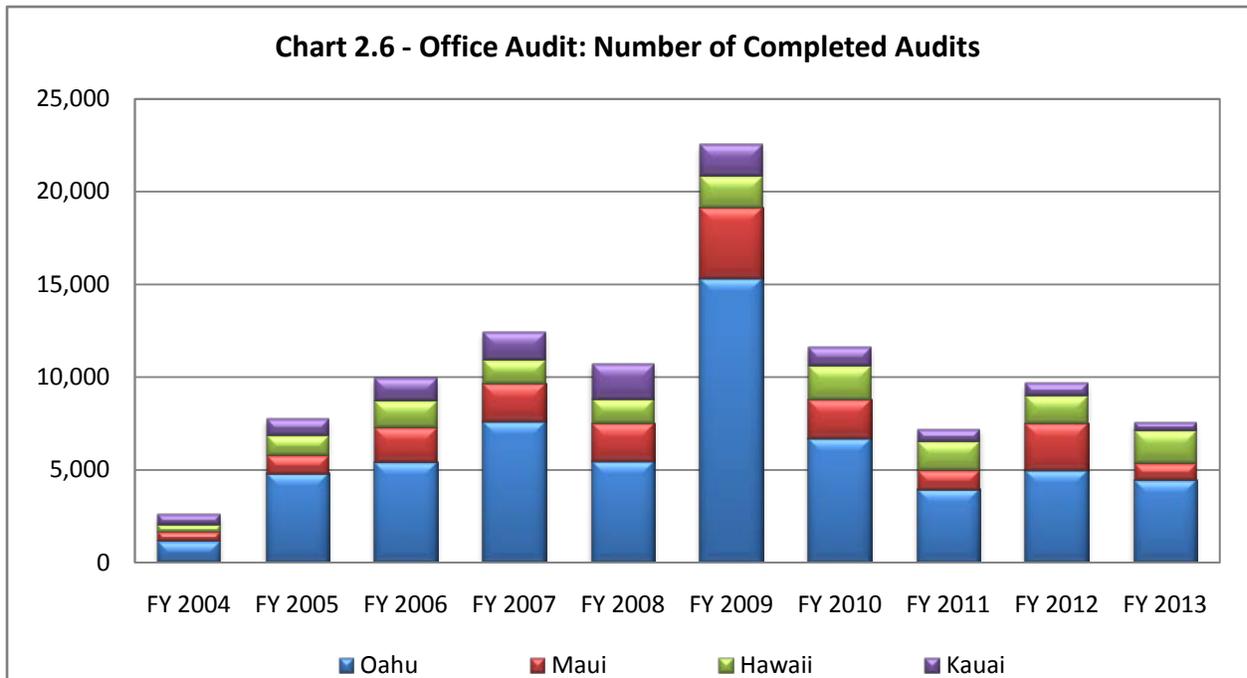
2.3.1 Overview

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, the Oahu Field Audit Branch, the Oahu Collections Branch, Returns Classification, 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 tax system: (1) auditing/examination, (2) collection, and (3) taxpayer assistance/education.

2.3.2 Office Audit Branch

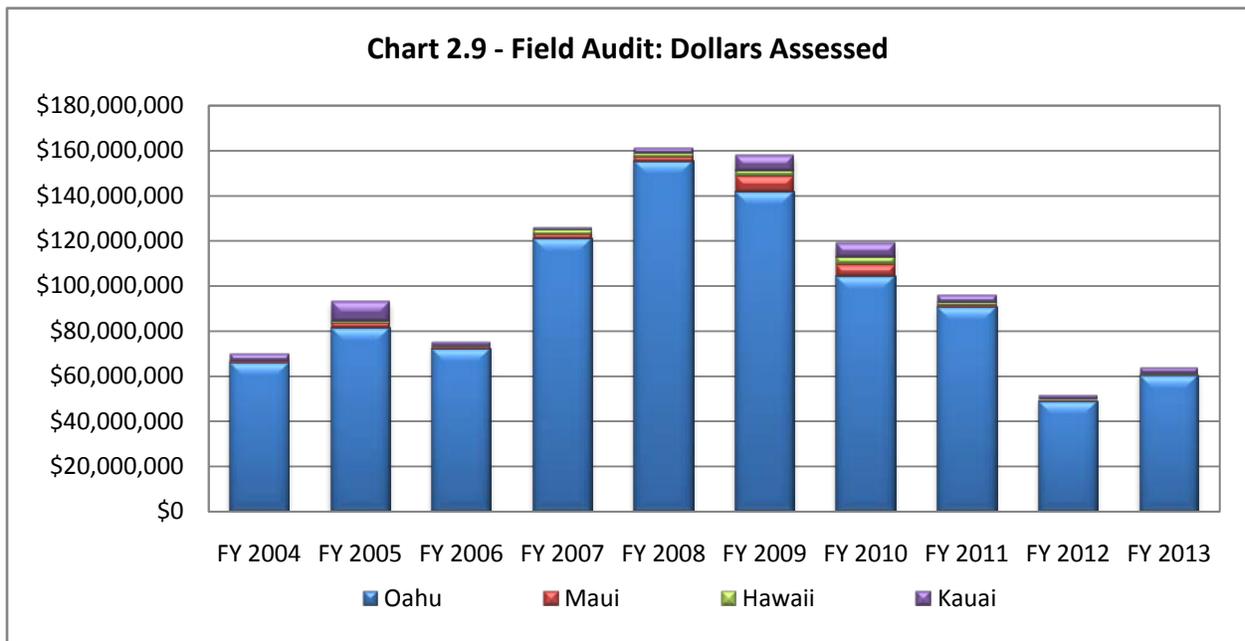
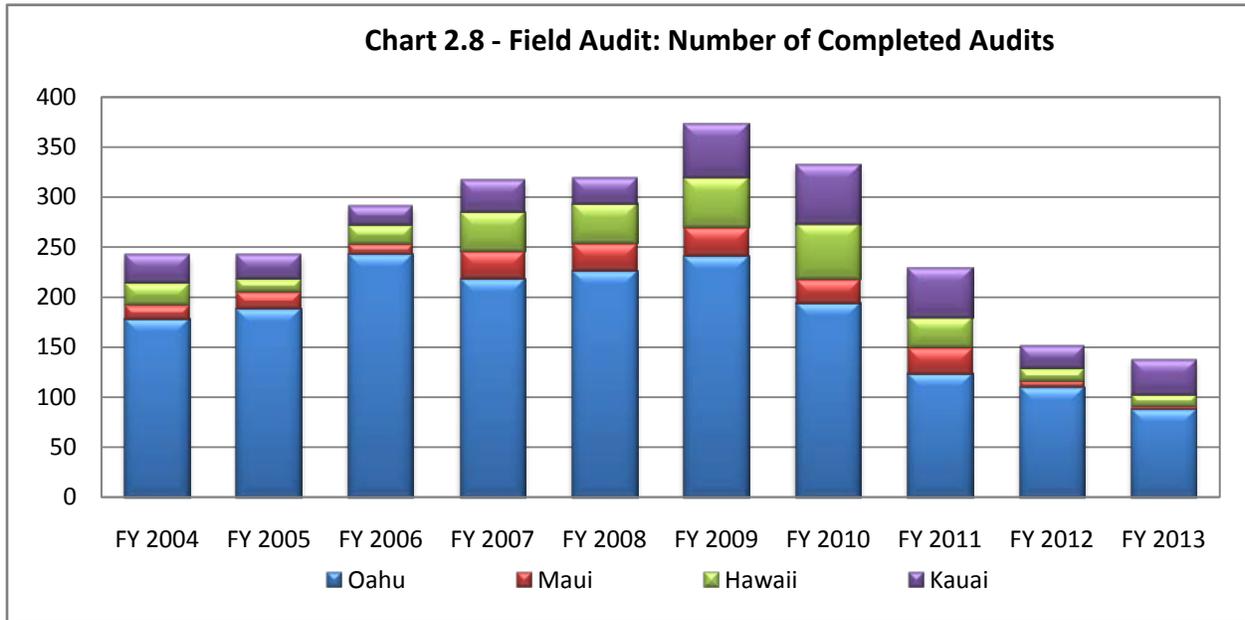
The Office Audit Branch performed examinations and audits to enhance voluntary compliance. In FY 2013, the number of audits completed by the Office Audit Branch was 7,563 cases, a decrease of 21.8% (2,112 cases) compared to FY 2012, and the total dollars assessed was \$23.8 million, a decrease of 10.3% (\$2.7 million) compared to FY 2012. Similar to Field Audit, the reduction in available staff hours has impacted on the number of cases completed and assessed. The majority of the audits were performed by Oahu Office Audit Branch, followed closely by the Hawaii District Office. In FY 2013, the Office Audit section handled the processing of the Estate and Transfer Tax returns and collected \$4.9 million for estate tax returns. Chart 2.6 shows the number of audits completed and Chart 2.7 shows dollars assessed by Office Audit for FY 2004 through FY 2013.



2.3.3 Field Audit Branch

Similar to the Office Audit Branch, the Field Audit Branch performed examinations and audits to enhance voluntary compliance. The Field Audit Branch handled audits involving intricate auditing procedures. In FY 2013, the number of audits completed by the Field Audit Branch was 138 cases, a decrease of 8.6% (13 cases) compared to FY 2012, and the total dollars assessed was \$63.3 million, an increase of 23.6% (\$12.1 million). The decline in the number of audit cases in the Field Audit Branch was attributable to budget restrictions and cuts, employee hiring freezes, additional time off with the 5% pay cuts, and the assignment of staff to work on special projects. The majority of the audits were performed by Oahu Field Audit Branch. Charts 2.8

and 2.9 show the number of audits completed and the dollars assessed by Field Audit for FY2004 through FY 2013.



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 decreased from \$55.7 million in FY 2012 to \$23.4 million in FY 2013.⁶ The figure for

⁶ Dollars assessed are assessments generated during the 2013 fiscal year. The dollar amount collected is for collections during the 2013 fiscal year and may include assessments and settlements from prior fiscal years.

FY 2013 represents a collection rate of 26.8%. Chart 2.10 summarizes the amounts collected from assessments made by the Office and Field Audit Branches for FY 2005 through FY 2013. Table 2.1 shows the amounts assessed for FY 2013.

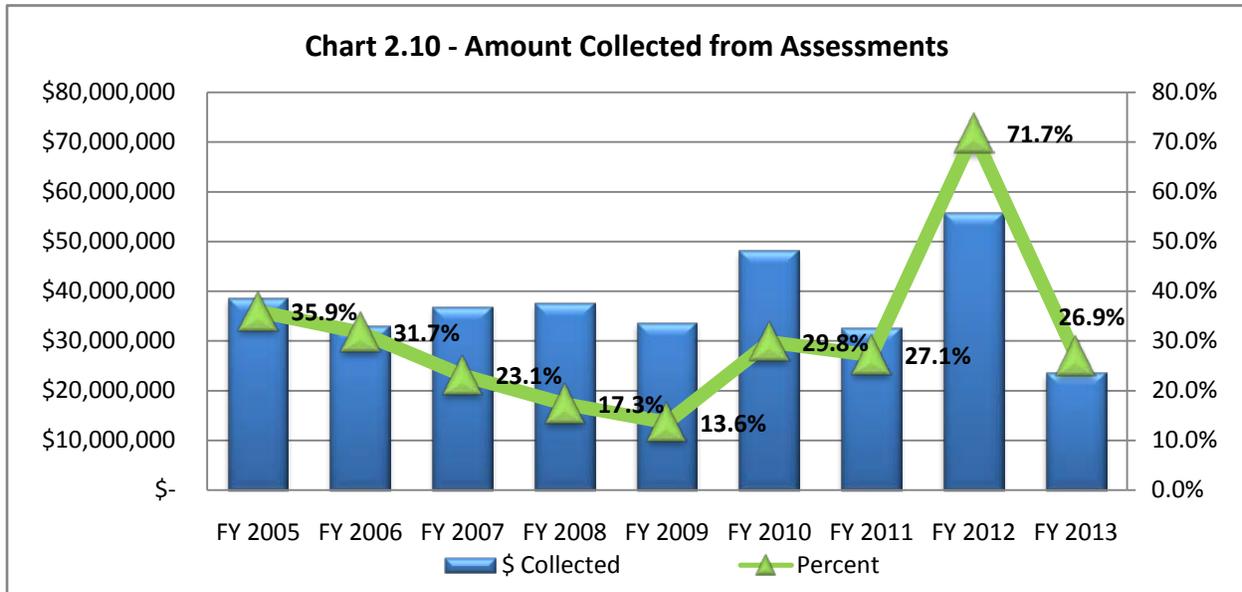


TABLE 2.1 - AMOUNTS ASSESSED FOR FY 2013

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits	Dollars Assessed	Number of Audits	Dollars Assessed
Oahu	4,436	\$ 12,592,356	88	\$ 60,412,852
Maui	902	\$ 7,350,683	3	\$ 40,205
Hawaii	1,774	\$ 2,765,091	11	\$ 504,174
Kauai	451	\$ 1,053,980	36	\$ 2,350,449
Total FY 2013	7,563	\$ 23,762,110	138	\$ 63,307,680
Total FY 2012	9,675	\$ 26,477,420	151	\$ 51,232,533
Difference	-2,112	\$ (2,715,310)	-13	\$ 12,075,147

2.3.5

Special Projects

The Oahu Office Audit Branch conducted a new project during the fiscal year:

- Renewable Energy Tax Credit: The review of the credits claimed resulted in \$755,323 in assessments.

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. Four audits were completed and resulted in \$2.9 million in assessments.
- Referral Cases from Criminal Investigation Unit: Seventeen cases that were either originally considered for possible criminal prosecution or that arose pursuant to a criminal investigation were completed, resulting in \$2.9 million in assessments.
- Research Tax Credit: Three audit cases involving the research tax credit were completed, resulting in \$0.8 million in assessments.
- Online Travel Companies: The Field Audit Branch assisted the Attorney General's office and issued additional assessments to 10 on-line travel companies. The additional assessments (for 2012) totaled \$113.1 million. The proposed assessments to date total \$817.7 million including taxes, penalties and interest. 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 – Oahu in the previous section.

2.3.6 Taxpayer Assistance Provided

During FY 2013, the personnel in neighbor island district tax offices 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 Taxpayer Services Branch when requested. Table 2.2 summarizes the volume of taxpayer inquires provided by the Maui, Hawaii, and Kauai District Tax Offices:

TABLE 2.2 - TAXPAYER ASSISTANCE PROVIDED BY THE MAUI, HAWAII AND KAUAI DISTRICT OFFICES

	FY 2013	FY 2012	Difference	
			Amount	Percentage
Counter	69,804	75,024	-5,220	-7.0
Phone Services	54,508	53,758	750	1.4
Tax Clearances	6,241	4,934	1,307	26.5
Correspondence	12,157	17,643	-5,486	-31.1

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 filing, to forms design, and to mail processes.

The change in the volume of the taxpayer assistance activities in the neighbor island district tax offices is attributable to the Department's cost cutting in response to the decline in the State's economy, unfilled vacant positions, changes in the tax law, electronic filings, an increase in the activities handled by the Honolulu office, and other factors.

The increase in the number of tax clearances occurred because contractors' biennial license renewals are required in September of even numbered years, and because taxpayers with City, County or State government contracts are now required to apply online with the Hawaii Compliance Express in accordance with Act 190, SLH 2011.

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

2.3.7 Collection Branch

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

Collections of delinquent taxes totaled \$192.7 million for FY 2013, a decrease of 6.4% compared to the \$205.9 million in delinquent tax collections in FY 2012. The decline was attributable to budget restrictions, hiring freezes, retirements and resignations. Moreover, the current computer system transfers assessments from ITPS and incorrectly reports these as collection accounts. The error was caused by the delay in posting of timely payments to the account, causing a tax delinquency notice, most likely inflating the amounts reported as "collected" for delinquent collection accounts. We will correct this processing error in our new computer system. Chart 2.11 shows delinquent collections and working inventory for FY 2004 through FY 2013.

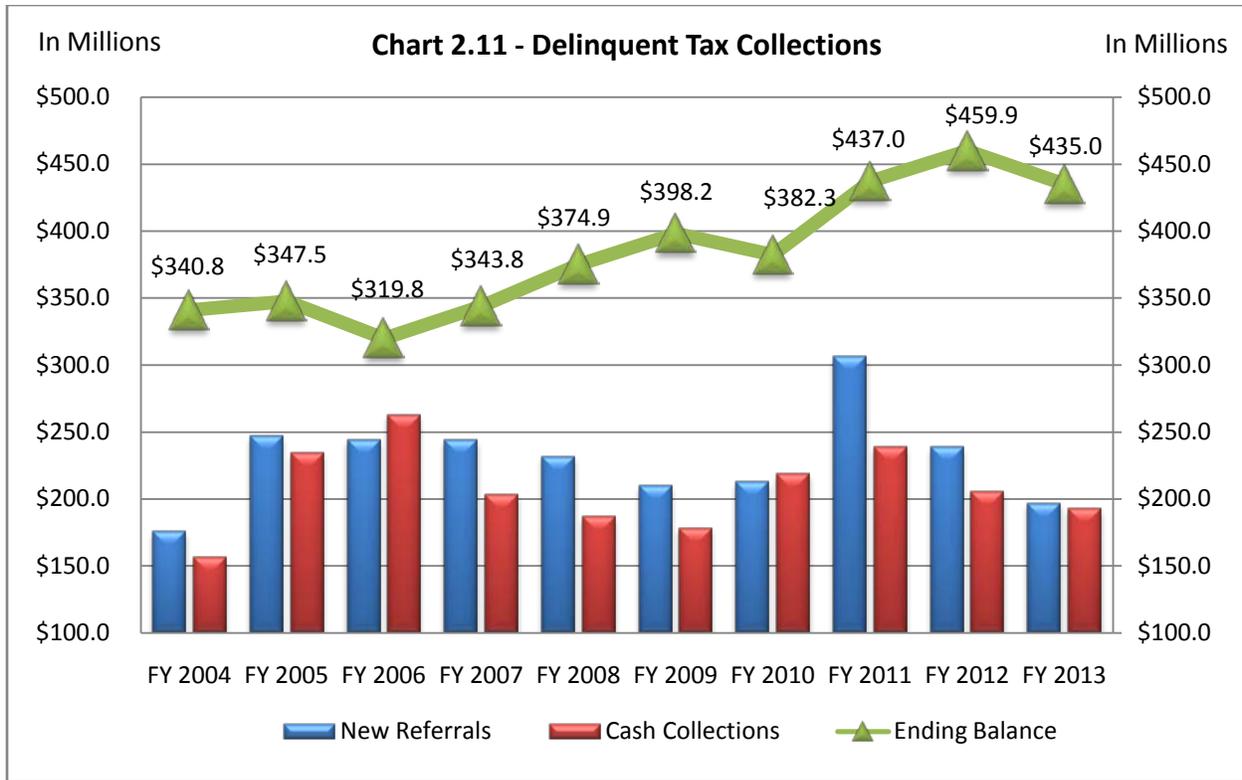


Table 2.3 shows major performance measures for FY 2012 and FY 2013.

TABLE 2.3 - MAJOR PERFORMANCE MEASURES FOR FY 2012 AND FY 2013

Measure	FY 2013	FY 2012	Difference	
			Amount	Percentage
Total Delinquent Tax Balance (\$ Millions)	\$434.9	\$460.0	(25.1)	(5.4)
Total New Delinquent Referrals (\$ Millions)	\$196.9	\$239.0	(42.1)	(17.6)
Total Cash Collected (\$ Millions)	\$192.7	\$205.9	(13.2)	(6.4)
Uncollectible Tax Write-Offs (\$ Millions)	\$29.1	\$10.2	18.9	185
Payment Plans Initiated	21,624	30,658	(9,034)	(29.4)
Tax Liens Filed	3,399	5,022	(1,623)	(32.3)
Levies Served	20,690	20,700	(10)	0

2.3.8 Criminal Investigation Section

During FY 2013, the Criminal Justice Division of the Department of the Attorney General filed complaints or indictments against seven taxpayers for violating Hawaii State tax laws as set out in Hawaii Revised Statutes §§ 231-34, 231-35 and 231-36. The complaints and indictments

accounted for over \$799,000 in unpaid taxes, excluding civil assessments, penalties and interest. A Plea of guilty or no contest was entered in all cases.

Including those mentioned above, eight cases were adjudicated in FY 2013 that accounted for over \$8.6 million in unreported income and over \$344,509 in unpaid taxes. The courts imposed criminal fines of \$4,500 and 1,150 hours of community service. One taxpayer was sent to prison when his case was under appeal in March 2013 and the judge ruled in favor of the State of Hawaii. The original sentence, issued in July of 2010, was upheld and the taxpayer was ordered back to prison to serve the remaining 11 months of his one-year jail term. In another case, a taxpayer failed to make an appearance at his May 2013 hearing and a bench warrant was issued for his arrest. The taxpayer was arrested in June 2013 and released after posting bail of \$94,187.⁷

A total of \$1,035,908 in unpaid taxes, penalties and interest was collected during FY 2013 by the Criminal Investigations Section.

Cases Worthy of Note:

The owner of a bridal establishment was charged with failing to file her company's annual general excise tax returns for tax years 2003 through 2008. As the person responsible for the tax filings of the corporation, she failed to report more than \$3 million dollars in gross income received during the years in question. A separate complaint was also filed against the corporation for the same violations. The owner pled guilty to all counts on behalf of the corporation as well as herself and was ordered to perform 150 hours of community service work in lieu of a fine. Restitution for \$137,590 was also ordered with payments to be made jointly and severally between both parties.

An attorney in private practice and his law firm were charged with failing to file the general excise, net income and withholding tax returns of his law corporation for tax years 2004 through 2008. As the person responsible for filing the tax returns, he failed to report more than \$1.5 million dollars in gross income that his firm received during the years in question. Pursuant to a plea agreement, the attorney pled guilty to all charges on behalf of himself and his law corporation and both parties were ordered to pay restitution jointly and severally in the amount of \$123,595. The attorney also agreed to perform 600 hours of community service work in lieu of a fine.

The Criminal Investigations Section receives numerous referrals and reports of potential cases, from both internal and external sources. The Section's successful prosecution of tax offenders and the media exposure it provides are important parts of the efforts of the Department's Compliance Division.

2.3.9 Special Enforcement Section

⁷ The bail amount was converted to restitution and paid over to the Tax Department in July 2013. The case will be recorded in next year's report.

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 2013, SES was staffed with only two investigators while the third investigator was acting supervisor. In the prior year, the unit was staffed with three investigators and a supervisor from another section was assigned to assist investigators on SES cases. Despite the staff shortage, SES produced the following results in FY 2013:

Complaints Filed	136
Vendors Educated	885
Site Visitations	54
Investigations Completed	12
Investigations Sent to Audit	10
Total Dollars Assessed	\$512,055
Total Dollars Secured Returns	\$1,496,206
Total Dollars Collected	\$679,570

2.4 STAFF OFFICES

2.4.1 Administrative Services Office

2.4.1.1 Fiscal Office

The Administrative Services Office submitted the biennium budget for FY 2014-2015 to the 2013 Legislature. The Legislature appropriated \$23.5 million from the General Fund for the Department of Taxation in FY 2014 and \$26.1 million for FY 2015. It also appropriated \$16.0 million in Capital Improvement Project funds for both FY 2014 and FY 2015 for the design and construction of a new computer system to replace the Department's current system.

The increases in General Fund appropriations of \$1.8 million for FY 2014 and \$4.4 million for FY 2015 were primarily for the Tax System Modernization project, which was budgeted for \$1.6 million in FY 2014 and \$3.9 million in FY 2015.

For fiscal year 2013, \$21.7 million was appropriated for the Department. In discharging its duties and responsibilities, the Department incurred operating expenses of \$18.0 million for FY 2013. Net collections of taxes by the Department totaled \$6.23 billion in the fiscal year, so the cost to collect \$100.00 of taxes was about \$0.29.

2.4.1.2 Personnel Management

The Department had 383 authorized permanent positions for FY 2013, which was an increase of 10 positions from FY 2012. Employees were geographically distributed as follows: Oahu, 316;

Hawaii, 27; Maui/Molokai, 24; and Kauai, 16. For FY 2014, the Department has 382 authorized permanent positions distributed as follows: Oahu, 315; Hawaii, 27; Maui/Molokai, 24; and Kauai, 16.

The following personnel actions were completed during the year: 6 new exempt hires, 39 new civil service hires, 58 temporary tax season hires, 36 promotions, 3 transfers, 12 retirements, and 20 resignations. Other personnel actions included temporary assignments of employees to higher levels. Table 2.4 shows the staffing patterns for FY 2010 through FY 2014.

TABLE 2.4 - STAFFING PATTERNS
(Number of Authorized Permanent Positions)

<u>Organization/Operating Program</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Headquarters Administration	75.0	72.0	72.0	63.0	67.0	74.0
Tax Services and Processing Division	118.0	122.0	122.0	122.0	137.0	138.0
Compliance Division	<u>189.0</u>	<u>189.0</u>	<u>179.0</u>	<u>179.0</u>	<u>187.5</u>	<u>195.5</u>
TOTAL	382.0	383.0	373.0	364.0	391.5	407.5

2.4.2 Rules Office

The Rules Office is comprised of the Rules staff and the Technical Section. The function of the Rules Office is to serve as a resource for complex policy recommendations and complex internal support. The Rules Office also assists in the Department's implementation of new legislation and creation and maintenance of the Department's tax forms.

2.4.2.1 Rules Staff

The Rules staff serves as the Department's internal advisory arm to the Director of Taxation on tax policy and advises the Director's Office and the Department on legislative and tax policy issues. Litigation and other external legal matters are handled exclusively by the Tax Division of the Department of the Attorney General.

In addition, the Rules staff 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 Review. The Rules staff also assisted the Tax Division of the Department of the Attorney General with the Department's tax cases that are being litigated.

The Rules staff also testified at legislative hearings on behalf of the Director, provided training for Department personnel, and spoke at several workshops for tax practitioners. For the 2013 legislative session, the Rules staff drafted and submitted twenty-two 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 the bills introduced to the 2013 Legislature, the Director's Office and the Rules staff determined there were approximately 400 measures proposing tax law changes and analyzed them in depth. The measures were tracked throughout the legislative session and written testimonies were prepared each time a tax measure was heard by the Legislature. In addition, the Rules staff drafted letters to legislative committee chairs to respond to specific questions raised during hearings or to address specific concerns of committee members.

During the fiscal year, the Rules staff prepared Tax Announcements, Tax Information Releases, letter rulings, Administrative Directives, and other publications. During FY 2013, two official Tax Information Releases and nineteen Tax Announcements were issued. Since 2009, when it became the Department's policy to publicly release taxpayer letter rulings in redacted form, 60 redacted letter rulings have been released.

In FY 2013, the Department issued temporary administrative rules relating to the renewable energy technologies income tax credit provided under section 235-12.5, Hawaii Revised Statutes. The new rules went into effect on November 16, 2012 and apply to systems placed into service on or after January 1, 2013. Before the new rules were issued, the determination of what constituted a renewable energy "system" was based on several Tax Information Releases (TIRs) that basically stated that the number of independent connections to a project site's electrical system was equal to the number of systems that were deemed to be installed and placed into service. The guidance from the TIRs proved to be confusing for taxpayers and created an uneven playing field amongst the renewable energy system sellers. The temporary rules remedied these problems by providing a mathematical, mandatory allocation method under which the number of "systems" is determined by the total output capacity (also known as nameplate capacity) of the equipment installed.

The Rules staff also reviewed and certified 559 requests for the high technology business investment tax credit and 37 requests for the credit for research activities in accordance with Act 215, Session Laws of Hawaii 2004.

2.4.2.2 Technical Section

The Technical Section is tasked with varying responsibilities to carry out the Department's projects, goals and initiatives, and to support the Department's operational needs. Specifically, the Technical Section assists and advises all divisions within the Department, as well as outside parties such as individual and corporate taxpayers and tax professionals, on complex areas of state tax. For FY 2013, the Technical Section responded to over 1,250 email inquiries and to over 6,500 telephone inquiries. It also responded to 81 formal requests, including requests for letter rulings or information letters, for determinations of tax status (such as for eligibility for the general excise tax exemptions for air-pollution control facilities), for multi-level marketing agreements, and for tax surveys and questionnaires from other government agencies, educational institutions, and major tax service product providers.

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 or creating the State's tax forms and instructions, incorporating all applicable federal and state tax law changes. For FY 2013, the Technical Section reviewed 303 tax forms and 54 tax form instructions. It also developed two new tax forms and two new tax form instructions, and it terminated 10 tax forms and two instructions that were determined to be obsolete.

Other duties of the Technical Section include analyzing and reviewing certain applications for tax exemptions. In FY 2013, 202 applications for an exemption from the general excise tax were received, 290 applications were reviewed and processed, and 166 applications are pending further action. In addition, 3,573 applications for conveyance tax exemptions were reviewed 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 Tax Revenues*.

In fiscal year 2013, the TRP Office worked on the Department of Taxation's *Annual Report: 2011–2012*, which was completed and published in April of 2013. 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 2013 Legislative session, TRP staff reviewed and tracked tax-related legislative bills and resolutions, and prepared more than 400 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.

An important function 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 2013 was produced on May 28, 2013. The forecast called for tax collections dedicated to the Fund to grow by 6.7% over fiscal year 2012. The actual growth rate was 9.9%, as General Fund collections rose from \$4.97 billion in fiscal year 2012 to \$5.47 billion in fiscal year 2013. The Council's last forecast for total personal income for calendar year 2012 was produced on October 30, 2012 and called for growth of 4.4% over calendar year 2011. The actual growth was 3.9%, from \$59.0 billion in 2011 to \$61.3 billion in 2012.

The TRP Office updated 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 provides the results of a single-equation regression to predict General Fund tax revenues.

2.4.4 Information Technology Services Office

The Information Technology Services (ITS) Office is responsible for providing technical support for the Departments' computerized tax systems and applications, for its local area network, and for networking-related components and infrastructures.

During FY 2013, the ITS Office continued to focus on managing, administering, and maintaining the Integrated Tax Information Management System (ITIMS), the local area network, and the associated components and infrastructures.

Key initiatives continued or accomplished during FY 2013 include the following:

- In accordance with Act 104, Session Laws of Hawaii 2011, system modifications were made change the Rental Motor Vehicle and Tour Vehicle Surcharge Tax rate from \$7.50 back to \$3.00 per day. System modifications were implemented in October, 2012.
- Through team efforts, the migration from the Joint Electronic Filing program (JELF) to the Modernized Electronic Filing (MEF) program, as mandated by the Internal Revenue Service, was completed and implemented in February, 2013. The change to the MEF program resulted in the following benefits: 1) taxpayers can submit payments via the

ACH Debit method; 2) attachments can be sent that are not supported by JELF; 3) taxpayers can file returns year round; 4) the Department can provide faster acknowledgement of taxpayer filings; 5) it is easier to resolve problems and to provide more descriptive messages when problems are encountered; and 6) images of returns are available directly online for departmental staff via the main Integrated Tax Processing System (ITPS) application.

- The upgrade of the Bulk Filing website was completed in November 2012. In addition to replacing the aging infrastructure of the old website, bulk filers are now able to upload payments via the ACH Debit method. As with the MEF program, images of the returns are available directly online for departmental staff via the main ITPS application.
- System modifications were implemented in 2013 to change processing for all first-time filers from direct deposits to paper refunds when the taxpayer files an annual tax return. The change was made, because numerous fraudulent returns were being filed to claim refunds using stolen social security numbers. Since the change was implemented, 562 fraudulent returns were caught that saved the State \$1,170,369.
- System modifications were implemented to automatically generate taxpayer notification correspondence as well as to automatically post tax return information for taxpayers who fail to attach and submit Form W-2 with their tax return. Prior to this change, the correspondence was manually generated and the tax returns were manually posted to the system.
- The transmission process with First Data Corporation to receive ACH debit payments was upgraded from a modem connection to a more secure File Transfer Protocol connection.
- The processing of electronic payments through the Hawaiian Information Consortium (HIC) was changed to deposit the payments directly to the State's account at First Hawaiian Bank, rather than to HIC's account at Central Pacific Bank. The change ensures that the State receives funds as quickly as possible, and reduces the float period involved.
- Departmental computers, printers, network routers, and switches were upgraded to resolve end-of-life, technical support, reliability, and security issues.

Items that will most likely continue into the next reporting period include the following: 1) the Tax System Modernization Project; 2) annual Tax Law Changes; 3) the redesign of the departmental website based on new standards established by the Office of Information Management and Technology; 4) the upgrade of the Tax Refund Search and Tax License Search websites so that they can be accessed by mobile devices; 5) active participation in the state-wide Enterprise Resources Planning Project; 6) further strengthening of the security for ITIMS applications, as well as providing support for network and database infrastructures.

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 2013 the following changes were initiated or completed.

Major System Enhancements

- Automatic processing of returns with missing Forms W-2 – Due to the high volume of returns received without a W-2, the previous manual process (which was time consuming and inefficient) was replaced with an automated process that requires little manual handling. The change helps fulfill the Department's goal of improving processing of tax returns.
- First Time Filer enhancement – Converts direct deposit refunds to paper refunds for first-time filers. The change was implemented to deter fraudulent claims for refunds and to discourage identity theft.

Modernized Electronic Filing (MeF)

The Modernized Electronic Filing (MeF) program allows electronic filing of federal and state returns through the Internal Revenue Service. The program was implemented in January 2013. The Department processed almost 400,000 Individual Income returns via MeF during the first six months after implementation. Taking into consideration all the challenges of deploying the new MeF e-file system, the first year of processing Individual Income returns through the new program was impressive. The benefits from processing via MeF 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 adapt other returns to the program.

Bulk Filing Application Upgrade

The Department partnered with Hawaii Information Consortium to implement a Bulk Filing website in September 2012. The upgraded Bulk Filing application replaced an antiquated system and allows the upload of files to allow en masse filing of returns and payments. 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, thereby reducing processing of paper returns. The Periodic Withholding Tax return (HW-14) was the initial tax return supported on the website.

487J Social Security Number Protection

Section 487 of the Hawaii Revised Statutes places limitations on the use of Social Security Numbers in correspondence or other communications with the taxpayer that may be inadvertently misdirected. The required modifications to correspondence templates are nearly complete.

2.5 MANAGEMENT PERSONNEL

As of June 30, 2013

OFFICE OF THE DIRECTOR

Director of Taxation..... Frederick D. Pablo
Deputy Director of Taxation..... Joshua A. Wisch

STAFF OFFICES

Public Information Officer..... Mallory Fujitani
Rules Officer..... Ted Shiraishi
 Acting Technical Section Supervisor..... Adriane N. Aarona
Tax Research & Planning Officer..... Donald Rousslang
 Senior Economist..... Yvonne Chow
Information Technology Services Officer..... Robert Su
Administrative Services Officer..... Lloyd R. Cereleja
 Personnel Officer..... Sharon Iwamura
Taxpayer Advocate..... Vacant

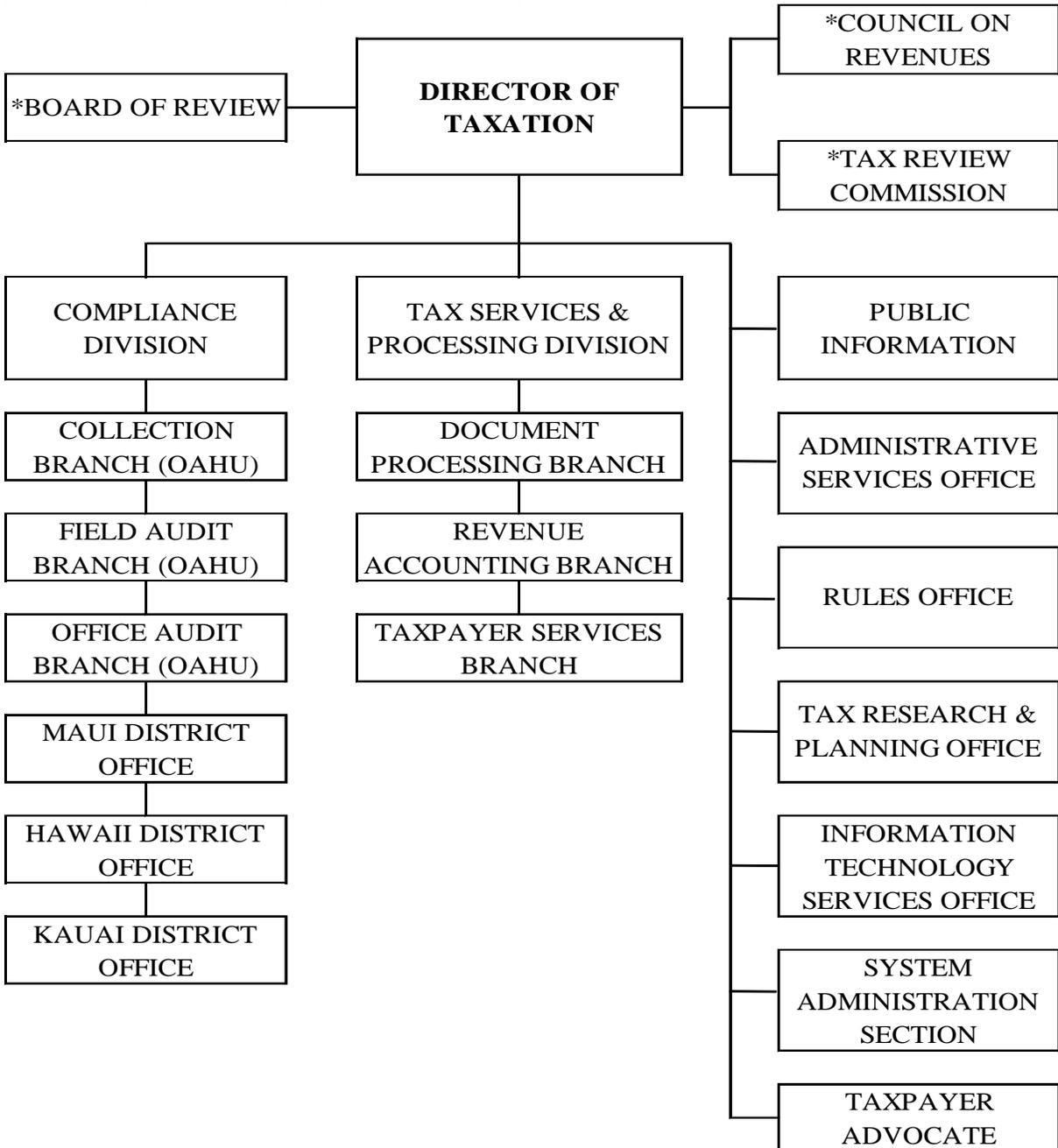
OPERATIONS STAFF

Compliance Division Chief..... Kevin Wakayama
 Acting Compliance Coordinator..... Valerie Iinuma
 Oahu Field Audit Branch Chief..... Madelaina Lai
 Oahu Office Audit Branch Chief..... Donald Kuriki
 Oahu Collection Branch Chief..... William Deeley
 Maui District Tax Manager..... Kathleen Uehara
 Hawaii District Tax Manager..... Duquesne Hulihee
 Kauai District Tax Manager..... Dulcie Yano

Acting Tax Services and Processing Division Chief..... Annette Yamanuha
 Acting Taxpayer Services Branch Chief..... John Pacheco
 Acting Document Processing Branch Chief..... Donna Botelho
 Acting Revenue Accounting Branch Chief..... Lemy B. Balais

2.6 ORGANIZATION CHART

Department of Taxation
State of Hawaii



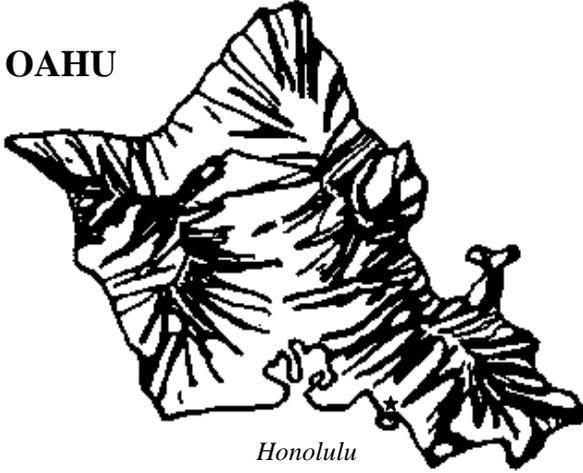
*For Administrative Purposes

2.7 DISTRICT OFFICES

FIRST TAXATION DISTRICT

City & County of Honolulu

OAHU



Oahu Office
830 Punchbowl Street
Honolulu, Hawaii 96813

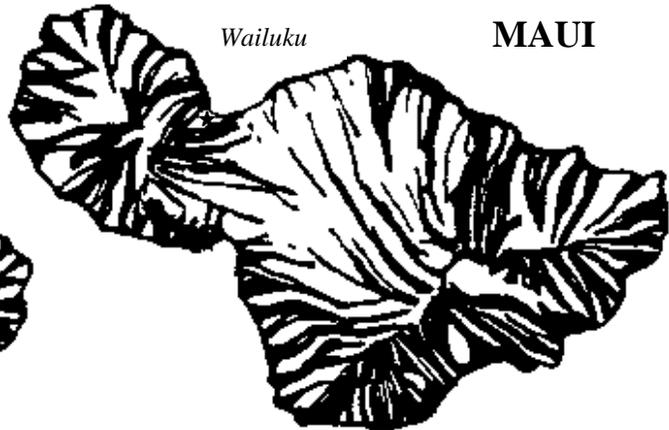
SECOND TAXATION DISTRICT

Counties of Maui and Kalawao



Kaunakakai

MOLOKAI



Wailuku

MAUI

LANAI



KAHOOLAWE

Maui Office
54 South High Street
Wailuku, Hawaii 96793

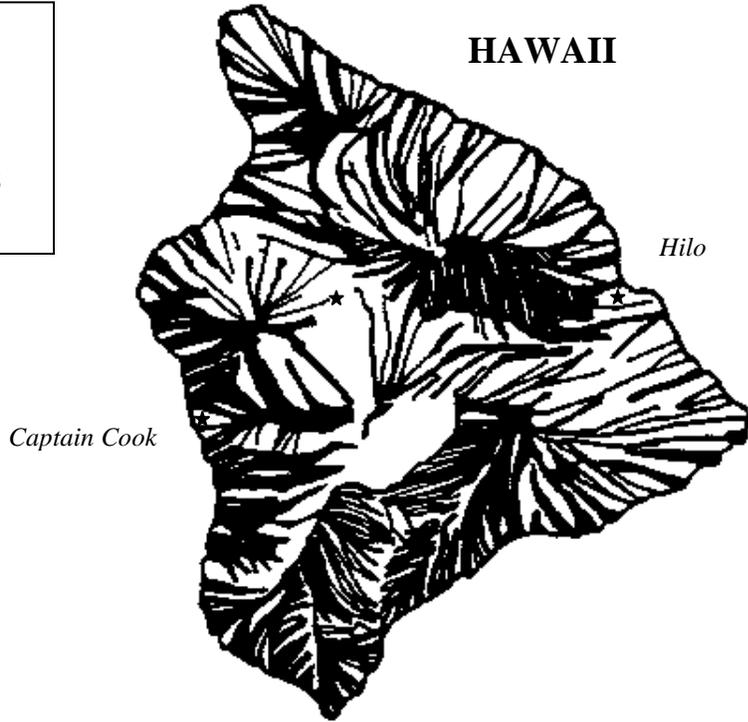
Molokai Office
35 Ala Malama Street #101
Kaunakakai, Hawaii 96748

THIRD TAXATION DISTRICT

County of Hawaii

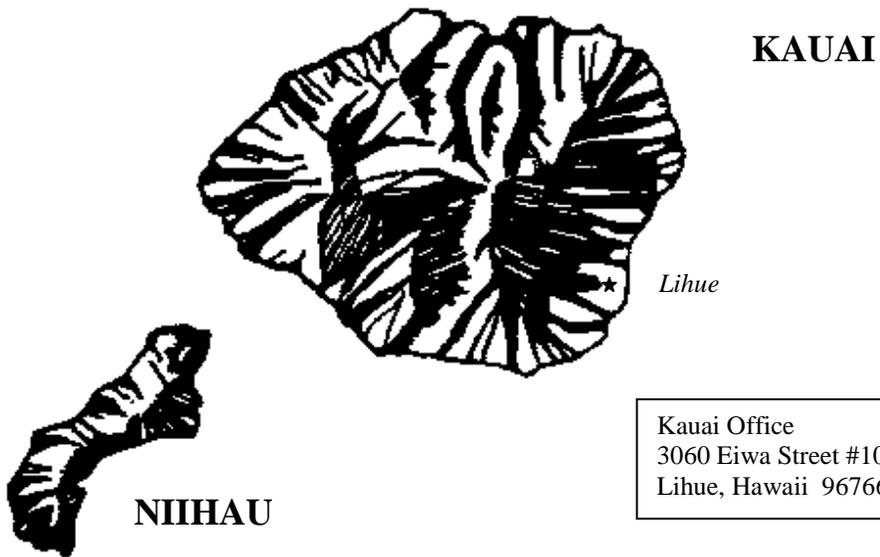
Hilo Office
75 Aupuni Street
Hilo, Hawaii 96720

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



FOURTH TAXATION DISTRICT

County of Kauai



Kauai Office
3060 Eiwa Street #105
Lihue, Hawaii 96766

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 121 pending tax appeals. During FY 2013, 42 new appeals were filed, 17 appeals withdrawn, and 14 appeals settled; a total of 132 appeals to the Boards of Taxation Review were pending at the end of the fiscal year.

Table 3.1 shows details on appeals to the Boards of Taxation Review by taxation district:

TABLE 3.1 - APPEALS TO THE BOARD OF TAXATION REVIEW

<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)	92	6	1	17	5	121
New Appeals	11	19	2	2	8	42
Appeals Withdrawn	9	2	0	1	5	17
Appeals Settled	4	6	1	0	3	14
Appeals Pending (Ending)	90	17	2	18	5	132

3.2 CIVIL DECISIONS, SETTLEMENTS, AND OTHER LEGAL MATTERS

During the last fiscal year, the Tax & Charities Division ("Division") closed 749 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 the myriad of charitable oversight, charity registration and charitable solicitation or charitable trust related matters the Division routinely handles. Table 3.2 shows "matters closed" and amounts collected in FY 2013.

TABLE 3.2 - MATTERS CLOSED AND AMOUNTS COLLECTED

<u>Matters Closed</u>		<u>Amounts Collected⁸</u>	
Appeals	30	Tax Appeals	\$820,957.87
Bankruptcies	427	Foreclosures	\$112,828.17
Contracts	8	Bankruptcies	\$1,483,305.11
Foreclosures	152	Trusts	\$79,280.67
Legislation (None closed yet)		Miscellaneous	\$203,604.16
Miscellaneous	104	TOTAL	\$2,699,975.91
Opinions	5		
Quiet Title	2		
Subpoenas	21		

⁸ The Division also secured the dismissal of several 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 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. The matter was settled and the case was dismissed.

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 were amounts owed by the owners to the Association of Apartment Owners ("AOAO"). Taxpayer asserted that the amounts were exempt under the reimbursement exemption and because it acted as a true agent for the AOAO. The matter was settled and the case was dismissed.

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. The matter was settled and the case was dismissed.

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. This case was settled.

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

Taxpayer filed an appeal based on the denial of its request for an exemption on the conveyance tax for property conveyed in the Third Taxation District. The amount in controversy was \$78,626.90. The matter was settled and the case was dismissed.

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

Taxpayer challenged the Department's assessments that reclassified and recalculated his general tax liability for services from wholesaling to contracting. Taxpayer also challenged the assessment as being untimely based on the statute of limitations. The matter was settled and the case was dismissed.

3.2.2 Court Decisions

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 did not apply because the Department never issued an assessment and that the alleged assessment was Taxpayer's general excise tax return that he signed and dated. The Intermediate Court of Appeals on February 21, 2013 affirmed the decision of the Tax Appeal Court.

Tax Appeal Court

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

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 granted the Department of Taxation's motion to dismiss the appeal for lack of subject matter jurisdiction by order filed February 29, 2012; however, the Court granted Taxpayer's motion for reconsideration of the dismissal. The Department's motion for summary judgment is scheduled for hearing on October 14, 2013.

In the Matter of the Tax Appeal of Steven Booth Songstad, T.A. No. 13-1-0226, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from final assessments totaling \$76,854.05 from general excise and income taxes. The court granted by order filed August 8, 2013 the Department of Taxation's motion to dismiss the appeal for lack of subject matter jurisdiction for untimely filing Notice of Appeal and failing to properly serve the Director of Taxation with the Notice of Appeal.

3.2.3 Pending Appeals

Intermediate Court of Appeals

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

After a trial, the Tax Appeal Court determined that the Department's general excise tax assessment for tax year 1992 was proper. The Tax Appeal Court found that Taxpayer did not file a general excise tax return to start the statute of limitations and as a result of this finding, the court determined that that the Department properly issued the assessment.

In the Matter of the Travelocity.Com, LLC, Case No. 11-1-0020, Tax Appeal Court, State of Hawaii (Consolidated Cases).

Travelocity.com LP, Site 59.com LLC, Expedia, Inc., Hotwire, Inc., Hotels.com, L.P., Orbitz, LLC, Internetnetwork Publishing Corp. (d/b/a Lodging.com), Trip Network, Inc. (d/b/a CheapTickets.com), priceline.com Inc., and Travelweb LLC filed separate Notices of Appeal to the Tax Appeal Court of the State of Hawaii, timely appealing final notices of assessments of general excise tax and transient accommodations tax for the period 1999 through 2011. By orders filed on February 8, 2012 the Court granted the Department's motions for summary judgment on the general excise tax assessments and denied the Department's assessments of transient accommodations taxes. On August 15, 2013, the Tax Appeal Court entered a final judgment in favor of the State on the general excise tax assessments and against the State on the transient accommodations tax assessments. The amount of general excise tax, penalties and interest owed as of the date of the final judgment is \$246.8 million. On August 19, 2013 the State filed a notice of appeal from the adverse ruling on the transient accommodations tax assessments. The OTCs are expected to cross-appeal.

Tax Appeal Court

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 had, among other things, not made an "investment" as required by § 235-110.9, HRS, to claim this credit. Trial is set for January 13, 2014.

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

Taxpayer was assessed additional general excise taxes for amounts it received for condominium maintenance fees that it collected on behalf of its members and paid to the One Napili Way AOA. Taxpayer asserted the fees it collected were not income for purposes of chapter 237, HRS, and, alternatively, that the amounts were exempt reimbursements under § 237-20, HRS. Trial is set for March 10, 2014.

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 09-0089, 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 7, 2014.

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 May 19, 2014.

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. The parties have filed a stipulation for partial dismissal of the case. In the appeal that remains, Taxpayer argues 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 October 14, 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 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 February 10, 2014.

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 February 10, 2014.

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 February 10, 2014.

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 is set for February 3, 2014.

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 is set for February 3, 2014.

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 is set for February 3, 2014.

In the Matter of the Tax Appeal of JN Group, Inc., Case No. 10-1-1808, 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 2, 2014.

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 October 6, 2014.

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 October 6, 2014.

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 sec. 238-1, HRS 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 September 15, 2014.

In the Matter of Taxpayer Appeal of Stephen A. Cipres, Case Nos. 11-1-0084, 12-1-0436, 12-1-0437, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's general excise tax assessments on the basis that the Department incorrectly increased his commissions for certain years and misinterpreted and misapplied the penalty provisions in the HRS. Trial is set for October 28, 2013.

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

Taxpayers appealed income tax assessments for tax years 2005, 2006, and 2007. Taxpayers claimed that the assessments improperly denied their carryover residential construction and remodeling tax credit under sec. 235-110.45, HRS, and their pass-through capital goods excise tax credit. Taxpayers also claimed that they were not required under sec. 235-110.45, HRS, to attach Form N-332 to their 2005 and 2006 Form

N-11s to claim properly and timely the tax credit for those years. They further claimed that the assessments and the decision of the board of review violated Hawaii law, due process, the commerce and/or equal protection clauses of the United States constitution and the Constitutions of the State of Hawaii and the State of Hawaii and the Department of Taxation Taxpayer's Bill of Rights. Trial is set for January 13, 2014.

In the Matter of the Tax Appeal of Kamaaina's Food Service, Inc., Case Nos. 12-1-0237 and 12-1-0244, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed for general excise tax and county surcharge when applicable, for unreported services income for tax years 1987 through 1992, 1994, 1995, 1997, 1998, and 2000 through 2009 and/or imposed a 25% penalty for failure to file and a 25% penalty due to negligence or intentional disregard of rules. Taxpayer was assessed for general excise tax for unreported services income for tax years 1993, 1996, and 1999; The Department imposed a 25% penalty for failure to file and a 25% penalty due to negligence or intentional disregard of rules. Taxpayer disputes the assessments, arguing that the imposition of both penalties is not authorized by statute. Trial is set for November 18, 2013.

In the Matter of the Tax Appeal of CompUSA Inc., T.A. Nos. 12-1-0264, 12-1-0265, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the disallowance of a use tax refund request for use taxes paid for 2006, 2007, and 2008. Taxpayer is arguing that under the commerce clause and equal protection clauses of the United States Constitution the imposition of Hawaii's use tax is unconstitutional. Trial is set for February 24, 2014.

In the Matter of the Tax Appeal of Alex Ou, Case Nos. 12-1-269; 12-1-304, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise, transient accommodations, and county surcharge taxes for rental income from tax years 1997 through 2010, inclusive. Taxpayer argues that his management company was obligated to pay the taxes and file the appropriate tax returns and that he was unaware that it was not doing so. Trial is set for February 17, 2014.

In the Matter of the Tax Appeal of JTSI, Inc., Case No. 1TX-12-1-0276, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and county surcharge taxes on sales of services to government instrumentalities. Taxpayer argues that it primarily sold tangible personal property to the federal government that is exempt from general excise taxes. Trial is set for January 13, 2014.

In the Matter of the Tax Appeal of Omega & Beyond, Inc., Case No. 12-1-277; 12-1-278; 12-1-279; 12-1-280; 12-1-281; 12-1-282, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes for tax years 2005 and 2006 and general excise and county surcharge taxes for tax years 2007 through 2010, inclusive, for underreported services including professional income. Taxpayer claims that the income

arising out of a federal contract is exempt from general excise tax because the services were performed, used, and consumed out of the state. Trial is set for November 18, 2013.

In the Matter of the Tax Appeal of Barbara Gilliss, Case No. 12-1-0303, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and county surcharge taxes, when applicable, for rental income in tax years 2002 through 2011. Taxpayer argues that the penalties and interest should be waived. Trial is set for January 27, 2014.

In the Matter of the Tax Appeal of Safeway Inc., Case No. 12-1-0385, Tax Appeal Court, State of Hawaii.

Taxpayer's claim for refund of use taxes was denied. Taxpayer argues that it should not have paid use taxes on amounts paid to a licensed shipper. The Department asserts use tax is calculated on the landed value of the imported item, including shipping. Trial is set for April 14, 2014.

In the Matter of the Tax Appeal of Julie A. Dunham, Case No. 12-1-0390, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and income taxes on non-filed returns for 1999 through 2010. Taxpayer argues that the Department's income figures are incorrect. Trial is set for September 29, 2014.

In the Matter of the Tax Appeal of Ronald Au, Case No. 1TX 12-1-0393, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing the Department's income tax assessments on unreported income received for tax years 2008 and 2009. Trial is not set.

In the Matter of the Tax Appeal of Zephyr Insurance Company, Inc., Case Nos. 1TX 13-1-0223, 1TX 13-1-0227, 1TX 13-0229, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing the Insurance Commissioner's tax assessment that disallowed its claim to the Qualified High Technology Business ("QHTB") tax credit pursuant to § 235-110.9, HRS. The disallowance was based on the Department determination letter to the Insurance Commissioner that ruled that Taxpayer was not entitled to claim the QHTB. Trial is not set.

In the Matter of the Tax Appeal of William A. Bartenstein, Case No. 13-1-0228, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise and/or use taxes, penalties and interest on goods imported for resale. Taxpayer argues that the Department's income figures are incorrect and the stacking of the negligence and underpayment penalties is erroneous. Trial is set for September 29, 2014.

In the Matter of the Tax Appeal of Peter Whiting, Case Nos. 1TX 1-13-0232, 1TX 1-13-0233, 1TX 1-13-0234, 1TX 1-13-0235, 1TX 1-13-0236, 1TX 1-13-0237, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing the Department's general excise tax assessments on unreported income received from his personal business tax years 2004, 2005, 2006, 2008, 2009, 2010, and 2011. Taxpayer did not file any general excise tax returns for these years. Trial is not set.

In the Matter of the Tax Appeal of Peter Whiting and Shanna Whiting, Case Nos. 1TX 1-13-0238, 1TX 1-13-0239, 1TX 1-13-0240, 1TX 1-13-0241, 1TX 1-13-0242, 1TX 1-13-0243, 1TX 1-13-0244, 1TX 1-13-0245, 1TX 1-13-0246, 1TX 1-13-0247, 1TX 1-13-0248, 1TX 1-13-0249, 1TX 1-13-0250, 1TX 1-13-0251, 1TX 1-13-0252, 1TX 1-13-0253, Tax Appeal Court, State of Hawaii.

Taxpayers are appealing the Department's general excise and transient accommodations tax assessments on unreported rental income received for tax years 2004, 2005, 2006, 2008, 2009, 2010, and 2011. Taxpayers did not file any general excise or transient accommodations tax returns for these years. Trial is not set.

In the Matter of the Tax Appeal of Kauai Development LLC, Case No. 13-1-0255, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise on imputed interest. Taxpayer argues that the statute of limitations has run and that general excise taxes are not applicable to imputed interest. Trial has not been set.

In the Matter of the Tax Appeal of Analytical Services Inc., Case Nos. 13-1-0258 and 13-1-0278, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes for 2003 through 2009. On Taxpayer's 2009 general excise annual return, Taxpayer requested a refund, that the Department denied. Taxpayer claims that it is not subject to the general excise tax on services provided to the military because its software applications are not limited to Hawaii military users. Trial has not been set.

Frederick D. Pablo, Director of Taxation, State of Hawaii vs. Sandra K. Whang, Case No. 13-1-0259, Tax Appeal Court, State of Hawaii.

The Director of Taxation appealed the board of review's decision that Taxpayer's income as process server was exempt from general excise tax under equitable estoppel grounds. Trial is not set.

Trip Network, Inc. v. State of Hawaii, Case No. 13-1-0261, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer's Internet site. Trial is not set.

Orbitz, LLC v. State of Hawaii, Case No. 13-1-000262, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Internetwork Publishing Co. v. State of Hawaii, Case No. 13-1-000263, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Travelweb, LLC v. State of Hawaii, Case No. 13-1-000264, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Expedia, Inc. v. State of Hawaii, Case No. 13-1-000265, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Hotwire, Inc. v. State of Hawaii, Case No. 13-1-000266, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Hotels.com LLP v. State of Hawaii, Case No. 13-1-000267, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Site59.com v. State of Hawaii, Case No. 13-1-000268, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Priceline.com, Incorporated v. State of Hawaii, Case No. 13-1-000269, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer' s Internet site. Trial is not set.

Travelocity.com LLP v. State of Hawaii, Case No. 13-1-000270, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing from the assessment of general excise and transient accommodations taxes for tax year 2012 resulting from the online sale of hotel rooms via Taxpayer's Internet site. Trial is not set.

3.2.4 Criminal Investigations/Enforcement Actions

During fiscal year 2012-2013, the Criminal Justice Division of the Department of the Attorney General filed complaints or indictments against seven taxpayers for violating Hawaii state tax laws as set out in sections. 231-34, 231-35, and 231-36, HRS. The complaints and indictments filed against the seven taxpayers accounted for over \$799,000.00 in unpaid taxes (excluding civil assessments, penalties, and interest). Pleas of guilty or no contest was entered in all cases.

Including the cases referenced above, there were eight cases that were adjudicated in fiscal year 2013 that accounted for over \$8.6 million in unreported income and over \$344,509.00 in unpaid taxes. The courts imposed criminal fines of \$4,500.00 and 1,150 hours of community service. One taxpayer was given terms of imprisonment. The original sentence that was issued back in July 2010 was upheld and the taxpayer was ordered back to prison to serve the remaining eleven months of his one-year jail term. In another case, a taxpayer failed to make an appearance at his May 2013 hearing and a bench warrant was issued for his arrest for \$94,187.00. The taxpayer was arrested in June 2013 and released after posting bail of \$94,187.00.⁹

A total of \$1,035,908.00 in unpaid taxes, penalties, and interest was collected during fiscal year 2012-2013 by the Criminal Investigations Section.

Cases Worthy of Note:

The owner of a bridal establishment was charged with failing to file her company's annual general excise tax returns for tax years 2003-2008. As the person responsible for the tax filings of the corporation, she failed to report more than \$3 million in gross income received during the years in question. A separate complaint was also filed against the corporation for the same violations. The owner pled guilty to all counts on behalf of the corporation as well as herself and was ordered to perform 150 hours of community service work in lieu of a fine. Restitution for \$137,590.00 was also ordered with payments to be made jointly and severally between both parties.

An attorney in private practice and his law firm were also charged with failing to file the general excise, net income, and withholding tax returns of his law corporation for tax years 2004 through 2008. As the person responsible for the filing of these tax returns, the attorney failed to report

⁹The bail amount was converted to restitution and paid over to the tax department in July 2013, as this case will be recorded on the next year's report.

more than \$1.5 million in gross income his firm received during the years in question. Pursuant to a plea agreement, the attorney pled guilty to all charges on behalf of himself and his law corporation and both parties were ordered to pay restitution jointly and severally in the amount of \$123,590.05. The attorney also agreed to perform 600 hours of community service work in lieu of a fine.

Despite the amount of complaints and indictments during this period, the Criminal Investigations Section still receives numerous referrals and reports of potential cases, from both internal and external sources.

The Criminal Investigations Section is a critical part of the Department's Compliance Division, and should continue with its efforts of deterrence through successful prosecution of tax offenders along with obtaining steady media exposure.

ADMINISTRATIVELY ATTACHED ENTITIES

As of June 30, 2013

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Jack P. Suyderhoud, Vice Chair
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Carl S. Bonham
Christopher Grandy
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Vacant

THIRD TAXATION DISTRICT

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Vacant
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