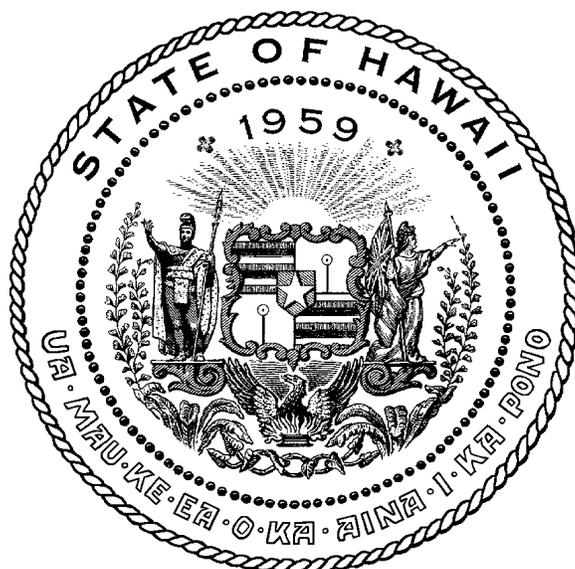


# DEPARTMENT OF TAXATION STATE OF HAWAII



## ANNUAL REPORT 1995-1996

November 15, 1996

The Honorable Benjamin J. Cayetano  
Governor  
State of Hawaii

Dear Governor Cayetano:

I am pleased to present you with this annual report summarizing the activities of the Department of Taxation for the fiscal year ending June 30, 1996.

In our first full fiscal year under your administration, the Department has many accomplishments to be proud of in all departmental line functions-- tax compliance, tax processing, and taxpayer services.

Tax compliance has taken on a new meaning under your administration. Enforced collection measures were aggressively pursued to bring delinquent taxpayers into compliance. Seizures, levies, and subpoenas are just some of the tools now being used successfully by the Department. Tighter deadlines are now required of our collectors, with increased severity of collection actions being implemented faster. Field work is now mandatory for our collectors. This no-nonsense approach to delinquent tax collections has had the desired effect--taxpayers think twice before putting the Department second to other creditors. We exceeded by \$8 million the delinquent tax collections over the previous fiscal year. The Department's collections initiatives were recognized by the selection of Pauline Fukumura, our Delinquent Tax Administrator for the Governor's Award for State Manager of the Year.

Our collection and audit functions have worked successfully on joint non-filer compliance projects designed to complement their roles and, where possible, to let computers do most of the work. By having the Internal Revenue Service match our data bases, we were able to verify general excise tax filings against our net income tax returns, and to verify state employees' filing of their Hawaii income tax returns. Other projects involved the survey of four condominium rental projects for verification of general excise tax filings by absentee owners renting their units. On the problematic matter of out-of-state federal contractors, the Department joined forces with other departments and our Congressional offices to obtain the cooperation of the military procurement agencies in helping to enforce our tax laws on a pre-award basis.

A new criminal program was initiated and, in just a few months' time, cases involving the failure to file general excise tax returns were investigated, resulting in criminal charges being brought against several taxpayers. Convictions for the failure to file general excise tax returns were obtained against two attorneys, one large retailer, and a real estate brokerage company. The deterrence effect of the criminal program is undeniable, and has resulted in many non-filers coming forward voluntarily to file their tax returns.

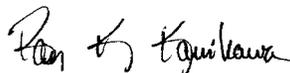
The filing of tax returns was made much easier with the design and implementation of the new Form N-11, our single-page individual income tax return. Due to the similarity of our income tax system and the federal scheme, the N-11 starts with federal adjusted gross income instead of requiring duplicate entries of gross income items. The schedules A through F were dispensed with, saving costs in paper, processing, microfilming, storage and postage.

Electronic funds transfer procedures were implemented in April for large general excise taxpayers, resulting in immediate bank-to-bank transfers of hundreds millions of tax dollars electronically. This means more money in the general fund earlier with more interest earned on these funds.

Taxpayer services has leaped forward technologically. All of the department's forms and publications are now available on the Internet. During the 1996 filing season, the Department provided tax return filing tips and instructions through Olelo television and public service radio spots. More information is being disseminated to the public with a new Tax Facts publication which describes our tax laws and rules in a simplified, plain language format. For the first time, workshops were held for practitioners and government employees on different subject areas of interest.

Legislation to modernize and integrate our computer system through performance-based contracting procedures will allow the Department to integrate our tax systems, provide better services to the legislature and executive, enhance revenue collections, and provide for more security. New legislation also requires that all bidders on public contracts obtain tax clearances before being permitted to do business with the State and counties.

Respectfully Submitted,



RAY K. KAMIKAWA  
Director of Taxation

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## **THE YEAR IN REVIEW**

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

The multiple objectives of the division are achieved by its three branches, the Documents Processing Branch, the Revenue Accounting Branch, and the Taxpayer Services Branch.

Efficient tax processing of all incoming tax documents is the function of the Documents Processing Branch. This unit processed nearly 102,000 pounds or 2.7 million pieces of incoming mail, including about 1.4 million payment transactions. Act 121, SLH 1995, resulted in the development of a new program designed to expedite processing of tax payments. The process became operational in March, 1996, and satisfies the legislative requirement that every person whose tax liability for any one year exceeds \$100,000 and who files a tax return for any tax to remit payment by means of electronic funds transfer (EFT).

Maintenance of accurate accounting records was achieved by the Revenue Accounting Branch through controlling and accounting for all tax collections and refunds and preparing timely accounting reports.

Providing service and disseminating pertinent information to taxpayers are the primary objectives of the Taxpayer Services Branch. Relevant information on tax topics of general interest is now provided in plain language through the publication of "Tax Facts". Details on general excise, use, and transient accommodation taxes, Form N-11, and new tax clearance procedures have been discussed in this publication.

In its ongoing efforts to simplify the filing of income tax returns, the Department designed and distributed a single page Form N-11 Resident Individual Income Tax Return for filing 1995 tax returns. Starting with federal adjusted gross income, the simplified returns will not only make filing easier for taxpayers, the new form should result in significant savings in printing, postage and other costs. Workshops for tax practitioners, announcements through the news media, and two 15-minute segments on the 'Olelo community television were developed in anticipation of the deluge of inquiries the new form would generate.

The Director of Taxation recorded short public service announcements offering tax filing and information tips for airing on radio stations during the tax filing season. Effective use of the media assisted in educating the public and promoting voluntary compliance with State tax laws.

Through Act 314, SLH 1996, businesses bidding on state and/or county contracts must first secure tax clearance certificates from both the Department and the Internal Revenue Service. Public agency workshops were conducted about this new requirement which became effective July 3, 1996.

### **AUDIT DIVISION**

To achieve its objective of maximizing taxpayer compliance with Hawaii tax laws, the Audit Division engages in tax return exception handling, auditing and information dissemination.

During the year, the Department's computerized system ascertained errors on 19% of the 899,200 net income tax documents processed and corrected the errors on-line within the prescribed clock periods. Exception handling is also performed on general excise, use, transient accommodations and other miscellaneous tax returns processed through the Audit Division.

In fiscal 1996, the Office Audit Branch conducted 6,525 audits resulting in assessments of \$10.1 million, while the Field Audit Division engaged in 426 audits yielding \$48.1 million in assessments. Field audits conducted during the year resulted in adjustments in 85% of the cases and assessments of at least \$10,000 in 74% of the cases. Because larger accounts were audited, the assessment per work hour increased from \$991.61 in fiscal 1995 to \$1,485.35.

Neighbor island district offices provided assistance to taxpayers as part of the division's emphasis on taxpayer education and problem resolution. During the year, they responded to 74,231 telephone requests and provided over-the-counter assistance to 51,715 taxpayers and answered 5,558 correspondences. Speakers were provided for tax preparation and workshops such as the Tax Counseling for the Elderly, University Extension Service, Small Business Administration and other outreach programs.

At the close of the year, the Natural Disaster Claims Commission completed processing the final of over 900 claims made by Kauai victims of the September, 1992, Hurricane Iniki. The processing of the final claim signaled the end of the Commissions' work in each district and the commissioners were released.

The Audit Division continued a joint project between the Internal Revenue Service (IRS) and the Collection Division in detecting taxpayer discrepancy between gross receipts reported on sole proprietors federal Schedule C and their Hawaii general excise tax returns. Suspect accounts were referred for possible discrepancy and collectively, the two Divisions prepared approximately \$10.4 million in assessments and collected over \$1.4 million as of the end of the fiscal year. Another IRS/State project, conducted in the Hawaii taxation district, identified State employees who failed to file their 1993 personal income tax returns. The investigation resulted in \$53,810 in additional taxes, \$21, 146 in tax collections and \$21,746 in taxpayer refunds as of the end of fiscal year 1996.

Attention was paid to use taxes reported by individuals on the island of Hawaii importing building materials, and helicopter operators on Kauai importing aircraft and parts. For the former, 75 accounts were reviewed, yielding \$206,000 in assessments. A total of 24 Kauai accounts were reviewed and \$950,357 in assessments were prepared.

In its initial year of operation, the Criminal Unit completed five prosecutions and assessed \$1.2 million, including penalty and interest, against the taxpayers. Other cases have been completed and are pending judicial disposition for failure to file general excise tax returns.

Hawaii's first felony case ended with the indictment of the corporate principals for failure to remit to the state net income tax withheld from their employees. The activities of the Criminal Unit are expected to alert taxpayers to the criminal statutes which can be applied in appropriate situations.

Division staff participated in numerous training programs developed to increase their professional skills. Training by the Attorney General's staff on matters like bulk sales reports and fraudulent transfers is expected to increase the effectiveness of the auditors and examiners. On average, the staff received 40 hours of training during the fiscal year.

## **COLLECTION DIVISION**

During fiscal year 1996, the Collection Division collected \$94.6 million in delinquent taxes, nearly 10% more than the previous year's total of \$86.1 million. This was accomplished despite a reduction in staff and a growing population of delinquent cases due to a sluggish state economy. Aggressive collection procedures resulted in the number of levies served rising from 2,781 in fiscal 1995 to 6,016 in fiscal 1996.

The Division participated in a joint endeavor with the Internal Revenue Service to investigate taxpayers reporting gross federal sole proprietorship income and no general excise tax income. This effort resulted in \$10.4 million in statewide assessments and collections of \$1.4 million at the conclusion of the fiscal year. Through another project, the Oahu Collection Branch together with the Taxpayer Services Branch of the Tax Services and Processing Division coordinated a "one-stop" tax clearance service area. This consolidation resulted in improved services to taxpayers seeking tax clearance assistance.

The Oahu Collection Branch referred 4,000 net income accounts with delinquent taxes of \$5,000 or less to private collection agencies. The contracted agencies collected over \$250,000 in back taxes, closed 232 accounts and negotiated 1,098 payment arrangements.

New procedures for licensing real estate brokers and salespersons were developed by the Department of Taxation and the Department of Commerce and Consumer Affairs which ensures that licensees are current with their tax payments before issued a renewal of their licenses.

## STAFF OFFICES

### Administrative Services Office

#### *Fiscal Office*

The Department was appropriated \$16.0 million by the 1996 legislature to cover its fiscal year 1997 operating expenses.

For fiscal year 1996, the Department incurred operating expenditures of \$16.7 million. The cost to collect \$100 of taxes dropped 11.1% from 54 cents in fiscal year 1995 to 48 cents due to increased tax collections and lower operating expenses.

#### *Personnel Management*

Authorized positions for the Department was reduced 14.5% to 349. Employees were geographically distributed as follows: Oahu, 278; Hawaii, 31; Maui/Molokai, 26; and Kauai, 14. Movements within the Department were characterized by two retirements, one new civil service hire and 119 temporary hires. Other personnel actions included the death of a permanent employee while in service and the resignation or termination of 111 temporary employees hired for the tax season.

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

<u>By Organization/Operating Program</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>	<u>1993</u>
Headquarter Administration.....	50	63	63	63
Tax Services and Processing Division.....	90	106	107	107
Audit Division.....	114	130	129	129
Collection Division.....	<u>95</u>	<u>109</u>	<u>109</u>	<u>87</u>
TOTAL.....	349	408	408	386

Employees were encouraged to participate in various training programs to expand their professional skills, thus increasing their proficiency in performing their duties. Among these programs were leadership training and computer software use.

### Systems and Procedures Office

The Systems and Procedures Office (SPO) is responsible for the development, modification and maintenance of the Department's computerized tax systems. Modifications to the General Excise, Withholding, Transient Accommodations, and Rental Vehicle/Tour Vehicle Surcharge Tax (GEW/TAT) System resulted in lowering computer programming and paper costs associated with printing tax booklets, reports and correspondence.

A major milestone was achieved when the GEW/TAT System was modified to accept electronic tax payments from the State's banking contractor. Taxpayers with tax liabilities in excess of \$100,000 for any tax year are required to remit taxes through this media. Ongoing modifications to the system will reflect the cooperative effort between the Department of Taxation and the Department of Commerce and Consumer Affairs (DCCA) to identify tax delinquencies and other problems associated with individuals licensed with the DCCA in the contracting and real estate industries.

The Comprehensive Net Income Tax System was enhanced to accept the Department's new single page resident net income tax return. Other modifications to the System included elimination of the excise and medical services excise tax credits, including an amendment to the food tax credit, and printing of a postcard label to replace the tax booklet for taxpayers using practitioners to prepare their returns.

SPO continues to prepare for the implementation of an integrated tax information management system. Each office and division statewide will eventually be connected to a local area/wide area network. Present basic services such as word processing, spreadsheet, database and printing functions will expand to include connection to the State's main computer, access and use of the planned integrated system, and CD-ROM sharing. Complementing the in-house training on the use of personal computers, basic network functions and Windows, a train-the-trainer approach will be utilized for instruction on other network software.

### **Technical Review Office**

A major task of the Technical Review Office (TRO) is to respond to legislative tax proposals. During the 1996 session, TRO reviewed and prepared testimonies on 179 tax bills, 4 resolutions, and testified at legislative committee hearings on behalf of the Director of Taxation. The Director's staff drafted tax related bills which were introduced as administration-sponsored bills and also prepared testimony on the administration measures.

TRO continues its active participation in the State Tax Printing Project. This interdepartmental project involves the printing of State tax forms and instructions by the Department of Public Safety through its Correctional Industries Program. An essential element of this project is the computerization of the tax forms and instructions.

In addition to revising numerous tax forms and instructions for clarity and to reflect legislative changes, TRO was also involved in the development of Form N-11, the new single page resident income tax return developed for income tax year 1995. This staff office also participated in putting a number of state tax forms on the Department's Internet page for wider accessibility.

A continuing responsibility of this office is to provide opinions and interpretations of the tax law. During the year, it issued 22 governor's letters, 54 director's correspondences, 482 letter rulings and general correspondences, eight Tax Information Releases, eight Department Announcements and four Administrative Rules.

Another duty of TRO is the reviewing of applications for exemptions from certain taxes. For this fiscal year, TRO processed 204 nonprofit applications, 2,495 conveyance tax exemptions and 2,105 applications for the waiver of withholding taxes by nonresidents.

TRO is also involved in developing and maintaining a professional education program for departmental employees. The office sponsored or conducted 12 training sessions which included the Sample and Bailey, CPAs 1040 Tax Seminar and informational sessions on 1995 tax law changes and new forms.

### **Tax Research & Planning**

This staff office plans, organizes, directs and coordinates a tax research and tax planning program for the Department. Statistical information and projections as to tax yields, tax impacts, and economic conditions affecting taxes are prepared and distributed to government officials and other private and public users. Among

its more important functions, Tax Research & Planning (TR&P) reviews and analyzes tax proposals as to their effect on tax revenues and provides administrative and technical support to forecast state revenues. TR&P provides an important service to the state administration through its ability to evaluate the revenue flow provided by state tax laws.

During the 1996 legislative session, this office reviewed over 300 tax proposals, of which the legislature passed 14 which became law. Significant measures enacted in 1996: a) require contractors to be current in general excise payments as a condition for license renewal, b) amend conditions upon which public works contracts are awarded, and c) conform Hawaii's laws to IRS provisions, including lowering the maximum state withholding tax rate from 10% to 8%.

TR&P provides staff services to the Council on Revenues, assisting in determining the official forecast of general fund revenues over seven fiscal years and the state total personal income for two calendar years. The Council estimated a 6.0% growth in general fund tax revenues for fiscal 1996. The final year-end results produced an actual change of 6.4%. In arriving at the projection, the Council had to consider the health of the State economy, the effect of the 1995 legislative repeal and amendment of three net income tax credits, the change in the maximum withholding tax rate, the reduction of an estimated 400 state payroll positions and the processing change resulting from electronic funds transfers of tax payments. The Council's fiscal 1996 estimates played a major role in shaping the financial administration of the state budget.

In November, 1995, TR&P published three reports. The "Hawaii Income Patterns - Individuals" provides statistical results of individual net income tax returns filed in 1994 for tax year 1993. For the first time in recent years, the change in the number of returns filed over the previous year rose a scant 0.02% to 570,190. Adjusted gross income (AGI), exclusive of losses, slipped a fraction from \$15,787 million in tax year 1992 to \$15,781 million in tax year 1993. Although salaries and wages, the largest component of AGI, rose 1.4% to \$12.9 billion, total reported income slid 0.2% from \$15.8 billion to \$15.7 billion.

The second report, "Tax Credits Claimed by Hawaii Residents" reflected a dip in total credits claimed for tax year 1993. Tax credits claimed and processed for tax year 1993 amounted to \$108.1 million, down 0.7% from \$108.8 million for 1992.

The third report, "Hawaii Income Patterns - Business", presented statistics from corporation, small business corporation, partnership, and sole proprietorship tax returns. For tax year 1992, a total of 101,638 active entities filed business net income tax returns, a 9.7% increase over the corresponding total of 92,611 in 1989.

In fiscal 1996, the TR&P staff logged a total of 291 hours of training, or an average of 42 hours per person. Training topics covered computers, research, tax laws and tax policy.

## MANAGEMENT PERSONNEL

### OFFICE OF THE DIRECTOR

Director of Taxation.....Ray K. Kamikawa  
Deputy Director of Taxation.....Susan K. Inouye

### STAFF OFFICES

Technical Review Officer.....Linn Garcia (Acting)  
Tax Research and Planning Officer.....Robert Koike  
Systems and Procedures Officer.....Norman Yoshikami  
Administrative Services Officer.....Warren Higashi  
Personnel Officer.....Stanley Onaga

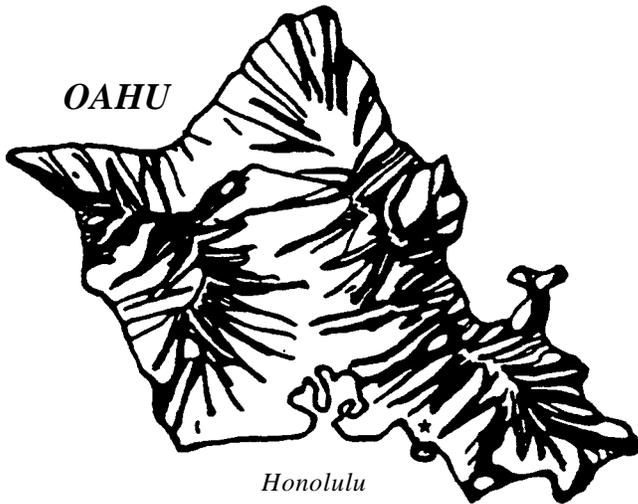
### OPERATIONS STAFF

Audit Division Chief.....Richard Chiogioji  
    1st Taxation District (Oahu)  
        Field Audit Branch.....Ronald Randall (Acting)  
        Office Audit Branch.....Ronald Randall  
    2nd Taxation District (Maui).....Janis Shinyama  
    3rd Taxation District (Haw aii).....Ronald Yabe  
    4th Taxation District (Kauai).....Ernest Balderas  
  
Collection Division Chief.....Pauline Fukumura (Acting)  
    1st Taxation District (Oahu).....Gary Fukumura  
    2nd Taxation District (Maui).....Stanley Ching  
    3rd Taxation District (Haw aii).....vacant  
    4th Taxation District (Kauai).....Randall Goto  
  
Tax Services and Processing Division Chief.....Marie Okamura  
    Taxpayer Services Branch.....June Yamamoto  
    Document Processing Branch.....Jerry Ebesu  
    Revenue Accounting Branch.....Deanne Obatake

# FIRST TAXATION DISTRICT

Island of Oahu

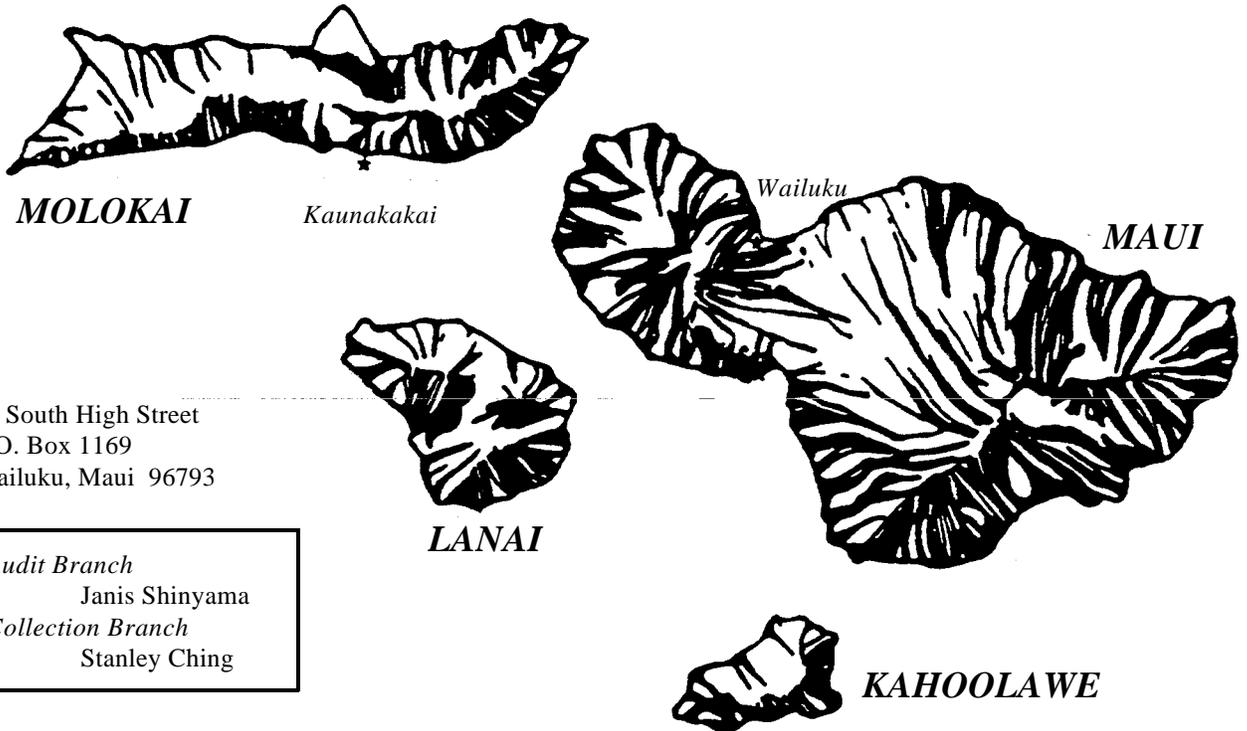
Office: 830 Punchbowl Street  
P.O. Box 259  
Honolulu, Hawaii 96809



*Audit Division Chief*  
Richard Chiogioji  
*Office Audit Branch*  
Ronald Randall  
*Field Audit Branch*  
Ronald Randall (Acting)  
*Collection Division Chief*  
Pauline Fukumura (Acting)  
*Collection Branch*  
Gary Fukumura  
*Tax Services & Processing Branch Chief*  
Marie Okamura  
*Taxpayer Services Branch*  
June Yamamoto  
*Document Processing Branch*  
Jerry Ebesu  
*Revenue Accounting Branch*

# SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



Office: 54 South High Street  
P.O. Box 1169  
Wailuku, Maui 96793

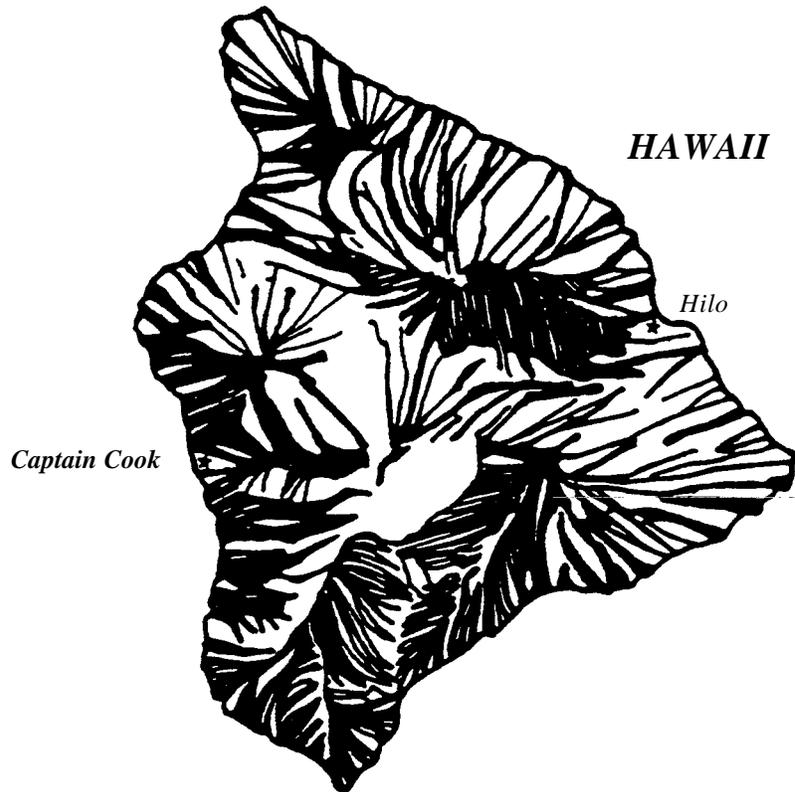
*Audit Branch*  
Janis Shinyama  
*Collection Branch*  
Stanley Ching

# THIRD TAXATION DISTRICT

Island of Hawaii

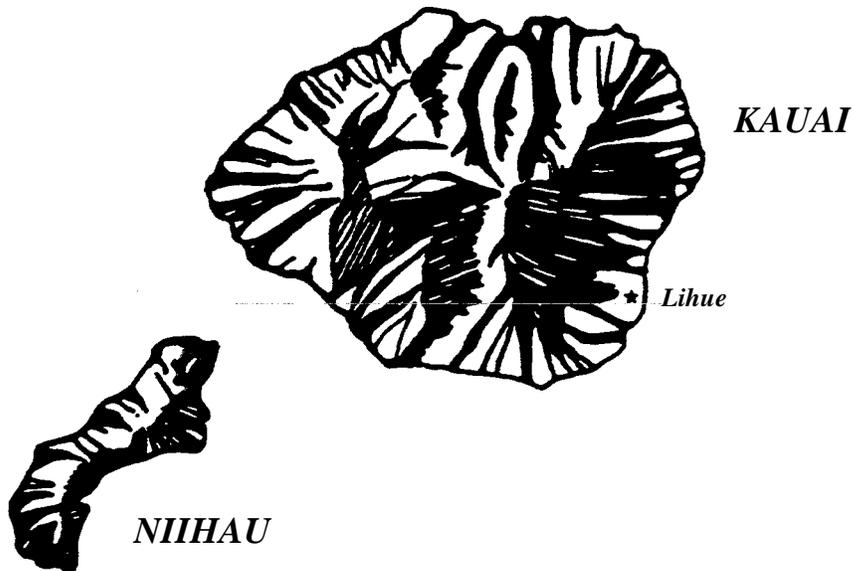
Office: 75 Aupuni Street  
P.O. Box 1377  
Hilo, Hawaii 96721

<i>Audit Branch</i> Ronald Yabe <i>Collection Branch</i> vacant
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# FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau

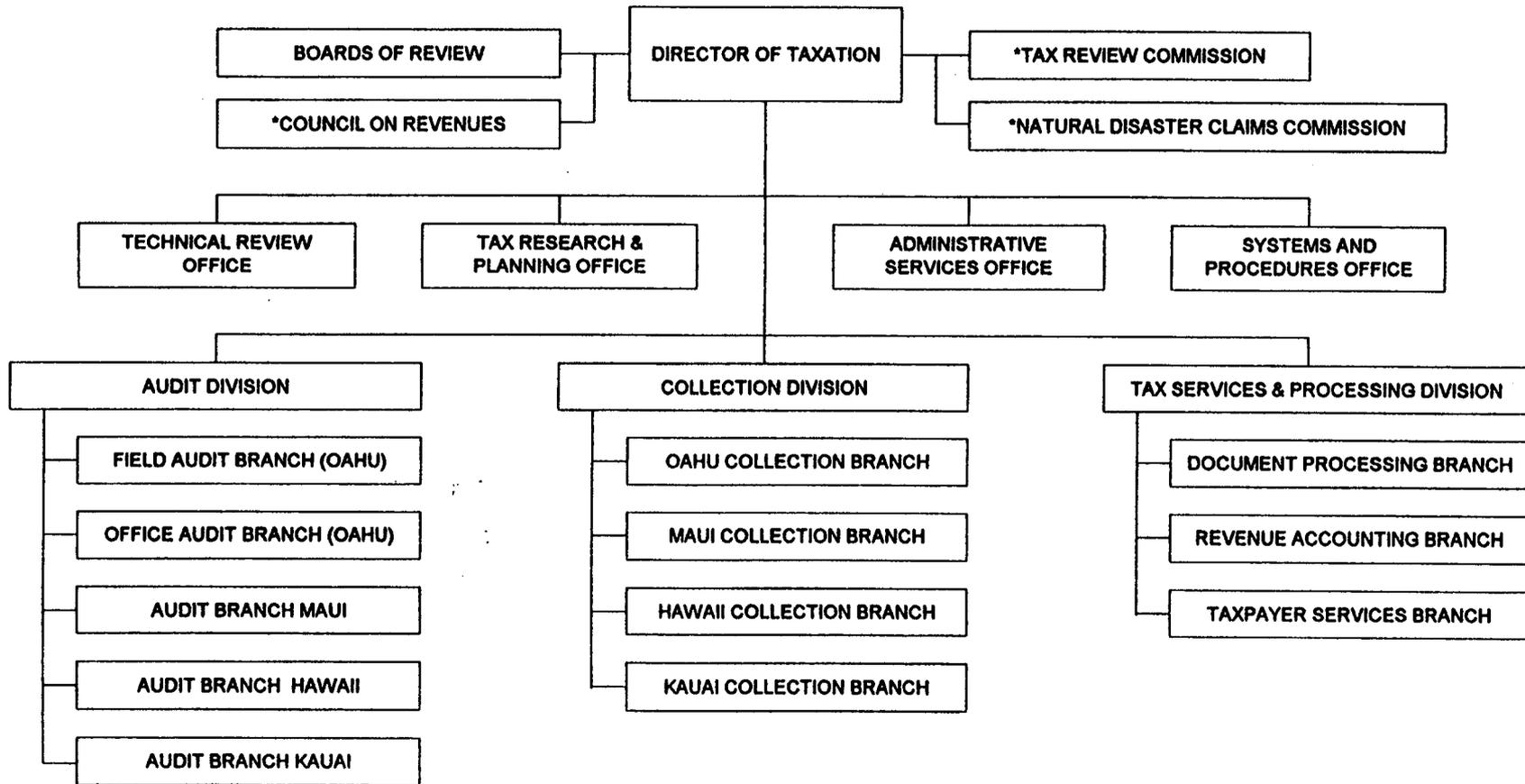


Office: 3060 Eiwa Street  
P.O. Box 1689  
Lihue, Kauai 96766

<i>Audit Branch</i> Ernest Balderas <i>Collection Branch</i> Randall Goto
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# ORGANIZATION CHART

Department of Taxation  
State of Hawaii



\*For Administrative Purposes

## TAX APPEALS AND LITIGATION

### BOARDS OF REVIEW

A Board of Review, consisting of five members, is established in each taxation district. Tax disputes that are not resolved at the district tax office level are presented to the Board of Review. Statewide, the boards began the fiscal year with 59 pending tax appeals. Although 27 appeals were settled, 31 new appeals were filed, resulting in a total of 63 appeals pending at year end. A summary of the number of appeals before the boards by tax district follows:

	<u>Oahu</u>	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals Pending - Beginning.....	41	3	13	2	59
New Appeals Filed.....	22	4	5	0	31
Appeals Settled.....	5	5	17	0	27
Appeals Pending - Ending.....	58	2	1	2	63

Of the 27 cases settled, 18 were in favor of the state involving tax liabilities of \$523.2 thousand, six were in favor of the taxpayer involving tax liabilities of \$117.3 thousand, and three were split decisions.

### COURT CASES AND LEGAL ACTIONS

A total of 24 tax appeals, in which the Department's legal counsel were involved, were closed during the year. Summarized below is a decision rendered by the Tax Appeal Court.

#### **In re Fuji Photo Film Hawaii, Inc. No. 17264 (Haw. October 9, 1995)**

The issue was whether Taxpayer's photo processing supplies (primarily paper and chemicals) were used in a manufacturing activity taxable at .5% or in a service activity taxable at 4%. The Tax Appeal Court held that the definition of manufacturing could evolve to follow modern trends as opposed to being limited by the statutory framework.

The Director appealed because the concept of tax definitions evolving to follow modern trends created the potential for tax exemptions to expand beyond what the legislature intended. The Hawaii Supreme Court agreed with the Director's position that tax exemptions are limited by the statutory framework, but held that the legislature intended to include photoprinting within the manufacturing exemption when it expanded the definition of manufacturing to include "printing".

Cases settled include:

#### **Kohala Joint Venture; Tax Appeal No. 4689**

The Department of Taxation assessed approximately \$884,000 in general excise taxes, interest, and penalties for tax years 1981 through 1993. These assessments were based on interest income received in connection with promissory notes secured by mortgages on real estate developed and sold by taxpayer in the State of Hawaii. Taxpayer argued that all mortgage activity took place outside the State of Hawaii, and alternatively, that if some activities took place in Hawaii, that apportionment was appropriate. By stipulation, the parties agreed that Taxpayer would pay \$740,000 in full payment of taxes and interest with a waiver of penalties.

#### **Bernstein Brothers; Tax Appeal No. 2530; Ray K. Kamikawa v. Bernstein Brothers, Inc.; Civil No. 94-0163-01**

The Department of Taxation audited Bernstein Brothers for unreported sales of tobacco. While the audit was pending, Taxpayer filed a tax appeal claiming that there was no taxable nexus with the State of Hawaii for tobacco sales between Taxpayer and a wholesaler. Taxpayer also claimed that it was not a wholesaler for purposes of the tobacco tax statute. The Department assessed taxes plus penalties and interest of

almost \$3 million. Since the Taxpayer had no assets, was merely maintaining a corporate shell, and was no longer doing business in the State of Hawaii, the parties settled the case for approximately \$425,000.

**Charles R. and Donna P. Broder; Tax Appeal No. 4257**

The Department of Taxation assessed general excise taxes, penalties, and interest against Taxpayers in the approximate amount of \$160,000, based on a payment Charles R. Broder received pursuant to a covenant not to compete. The Tax Appeal court in In re Keehn, T.A. No. 3045 (1994) determined that payments received pursuant to a covenant not to compete are taxable for general excise tax purposes. Moreover, the Department's TIR No. 95-1 reflected the Department's position that the grantor of a covenant not to compete is engaging in business for general excise tax purposes. Taxpayer claimed that the payment was not subject to Hawaii general excise tax, because Mr. Broder continued to serve as an employee of the business he sold, for five years after he sold the business. Payments to an employee by his employer are exempt from general excise tax under Haw. Rev. Stat. Sec. 237-24(6). Taxpayer agreed to settle the case by paying 62.5% of its tax liability, approximately \$81,000, to avoid the risk of litigation that such payment would be treated as income for general excise tax purposes.

**Osiose Wood Preserving, Inc.; Tax Appeal Nos. 3630, 4235, 4683**

On a reasonable basis assessment, the Department of Taxation assessed Taxpayer approximately \$330,000 in general excise taxes, use taxes, and interest for tax years 1988 through 1991. The Department subsequently recomputed the assessment based on additional facts. The issue in this tax appeal was whether Taxpayer's sales of its chemicals to wood treatment plants was subject to a 4% retail rate and 0.5% use tax rate as a sale to a service provider, or a 0.5% wholesale rate and exempt from use tax as a sale to a manufacturer. Taxpayer asserted that wood treatment plants were engaged in a manufacturing activity, thereby characterizing its sales at the 0.5% wholesale rate and exempt from use tax. Despite the Tax Appeal Court's previous decision of Griffin Forest Industries, T.A. No. 131 (1972), which held that wood treatment plants are not engaged in manufacturing, the Board of Appeal agreed with the Taxpayer.

By stipulated judgement, the Court affirmed its ruling in Griffin Forest Industries, affirmed the Department's methodology in the computation of the tax, ordered Taxpayer to prospectively report and pay taxes according to the Department's methodology, and ordered Taxpayer to pay \$165,000 which was essentially all taxes with forgiveness of interest.

During the fiscal year, the department's legal counsel reviewed or closed the following matters:

Tax Appeals.....	24
Bankruptcies.....	136
Foreclosures.....	87
Subpoenas.....	39
Opinions.....	39
Contracts/Bids.....	11
Legislation.....	28
Miscellaneous.....	42

Enumerated below, nearly \$5.8 million were collected from the various actions undertaken by the legal counsel:

Tax Appeals.....	\$3,182,559
Foreclosures.....	117,945
Bankruptcies.....	1,554,824
Miscellaneous.....	<u>935,559</u>
TOTAL.....	\$5,790,887

Included in the miscellaneous category are \$78,303 in taxes, penalties and interest by taxpayers after criminal charges were filed.

## LEGISLATION

During its regular session, the 1996 legislature passed 14 tax related bills, two of which were vetoed by the governor. The 12 tax related bills passed and signed into law are summarized below:

### **Act**     **Brief Description**

- 43        The contractor's board is given authority to revoke, suspend, or deny renewal of a contractor's license for failure to pay delinquent general excise taxes or to honor an installment plan for the payment therefor. Eff. 4/23/96.
- 54        Clarifies criminal tax law definition of "person" to include an officer or employee of a corporation, a partner or employee of a partnership, a trustee of a trust, a fiduciary of an estate, or a member, employee, or principal of any other entity, who as such officer, employee, partner, trustee, fiduciary, member, or principal is under a duty to perform and is principally responsible for performing the act in question. Imposes misdemeanor penalty for persons operating businesses without general excise and other licenses. Eff. 4/24/96.
- 131       Allows the recovery of fees for the reissuance of refund checks (not to exceed amount of the refund check), Department-sponsored seminars or workshops including educational materials, and research and reference materials published in machine-readable form. Allows for a hardship waiver. Fees to be determined by rules. Eff. 6/12/96.
- 132       Clarifies application of the bulk transfer law by excluding from the term "transfer" any bona fide, arm's length: (1) creation, modification or termination of a lease interest; (2) creation, modification or termination of a lien or encumbrance; or (3) transfer occurring as a result of the enforcement of a lien. Eff. 6/12/96.
- 133       Allows the Director of Taxation to require rounding of tax return items to the nearest dollar. Eff. 6/12/96.
- 157       Permits voluntary withholding of federal and state income taxes from unemployment compensation payments. The State withholding rate is 5% of the payment received. Eff. 1/1/97.
- 187       Picks up changes to the Internal Revenue Code through 12/31/95, including the self-employed health insurance deduction (retroactive). Technical changes were made in the treatment of international transactions, cooperatives, exempt organizations, and joint filers. Picks up TEFRA provisions for auditing partnership and S corporations, capital construction fund provision, and tax avoidance corporations. Requires withholding tables to be capped at 8%. Eff. 6/17/96 for taxable years beginning after December 31, 1995.
- 228       As it applies to taxes, increases preference thresholds for bidders on public works projects. State agency shall award the contract to a bidder who has filed State of Hawaii employment, general excise, and income tax returns and has paid all amounts owing on such returns for four successive years prior to submitting the bid, if the bid is for \$5 million or less, and for eight successive years if the bid is for more than \$5 million; provided that the amount of the bid is not more than 15% higher than the amount bid by any competing contractor who has not filed or paid State of Hawaii taxes. Eff. 6/18/96.
- 250       Requires the Department to continue the publication of certain reports in paper and machine-readable form. Allows the Department to charge a fee for the reports. Eff. 6/18/96.
- 273       Allows Department to enter into a performance-based contract for its systems replacement project. Eff. 6/18/96.
- 286       Expands enterprise zone eligibility to include ship or aircraft repair, education and training services, information technology design and production services, medical and health care services, and telecommunication services. Excludes businesses that act upon or process tangible personal property such as cleaning, repair, and maintenance activities. Provides exceptions to certain requirements for eligibility for agricultural producers in counties with populations of 100,000 or less (to sunset 6/30/98). Changes requirements for eligibility. Eff. 6/18/96.
- 314       Requires State and IRS tax clearances to enter into a public contract. Exceptions are made for "small purchases" of less than \$10,000 (although agencies may impose stricter requirements), emergency procurements, installment agreements, and taxes in dispute. Progress payments required to be assigned to the State and/or the IRS to satisfy delinquencies. Final payment is withheld until the tax clearances are obtained; automatic assignment of final payment to the State or IRS for failure to provide tax clearance within six months of completion date. Eff. 7/3/96, applies to contracts entered into on or after that date.

## INCOME ASSESSMENT AND AUDIT

### INDIVIDUAL INCOME TAX

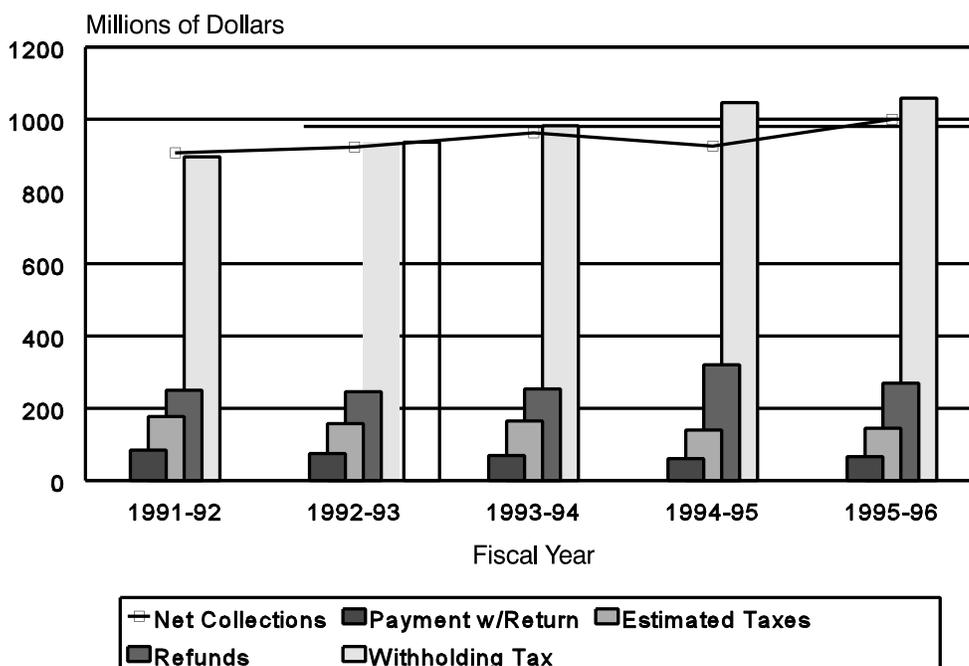
Net individual income taxes advanced 8.0% from \$925.7 million in fiscal year 1995 to \$999.9 million. Income tax collections before refunds edged upward 1.8% to \$1,269.3 million, but a 16.0% drop in refunds to \$269.3 million resulted in the 8.0% growth in individual net income tax collections.

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

	FY 1996	FY 1995	Av. Annual Change (Percent)	
			1995-96	1992-96
Declaration of Estimated Taxes	\$ 144,624	\$ 139,661	3.6	-7.3
Payment with Return	66,105	60,362	9.5	-5.3
Withholding Tax on Wages	<u>1,058,548</u>	<u>1,046,210</u>	<u>1.2</u>	<u>5.1</u>
Subtotal	\$1,269,277	\$1,246,233	1.8	2.3
Refunds	<u>269,349</u>	<u>320,529</u>	<u>-16.0</u>	<u>1.6</u>
NET	<u>\$ 999,928</u>	<u>\$ 925,704</u>	<u>8.0</u>	<u>2.8</u>

A total of 442,601 refund claims amounting to \$230.0 million was processed from January through June, 1996, for an average refund of \$519.64. Preceding year data show 484,306 refund claims totaling \$289.8 million, or an average refund of \$598.37.

### Components of the Individual Income Tax



Act 134, SLH 1995, repealed the excise tax credit, the medical services excise tax credit, and reduced the food tax credit from \$55 to \$27 per qualified individual. This legislative action contributed to the 16% drop in tax refunds.

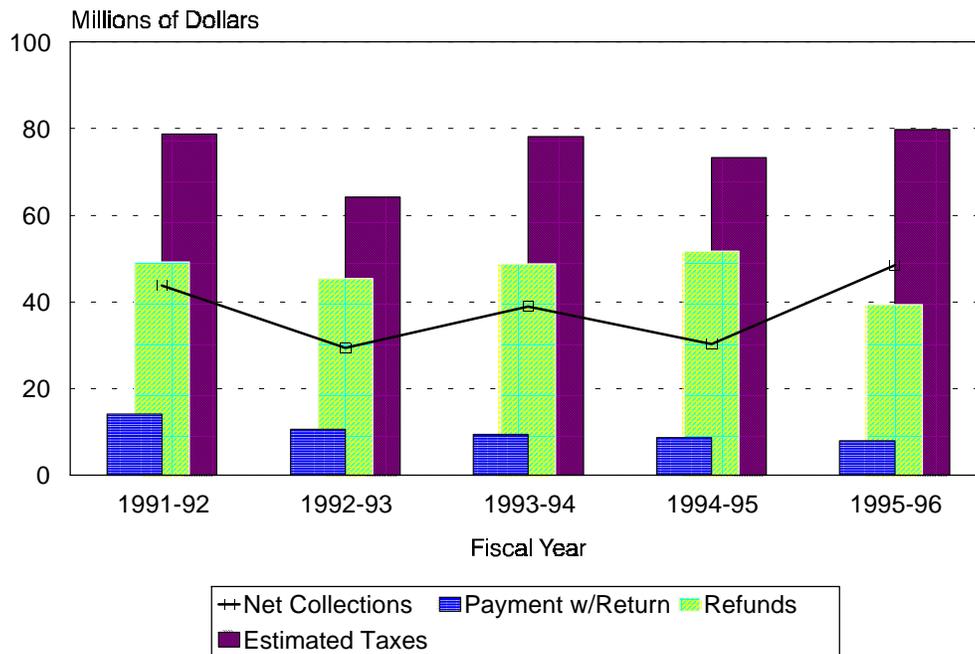
## CORPORATE INCOME TAX

Corporate income taxes escalated 60.1% from \$30.2 million in fiscal year 1995 to \$48.4 million. Bolstered by a recovering economy, estimated taxes inched upward to \$79.8 million and corporate tax refunds slipped 24% from \$51.8 million to \$39.4 million during the period.

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

	FY 1996	FY 1995	Av. Annual Change (Percent)	
			1995-96	1992-96
Declaration of Estimated Taxes	\$ 79,770	\$ 73,227	8.9	- 4.9
Payment with Return	<u>8,020</u>	<u>8,797</u>	<u>- 8.8</u>	<u>-11.4</u>
Subtotal	\$ 87,790	\$ 82,024	7.0	- 5.8
Refunds	<u>39,352</u>	<u>51,775</u>	<u>-24.0</u>	<u>7.3</u>
NET	<u>\$ 48,438</u>	<u>\$ 30,249</u>	<u>60.1</u>	<u>- 3.4</u>

## Corporate Income Tax Components



GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 1996 & 1995  
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	1996	1995	% Change
<b>TAX BASE</b>				
Retailing		\$ 15,505,222	\$ 14,701,194	5.5
Services		5,470,568	5,293,613	3.3
Contracting		3,232,815	3,194,128	1.2
Hotel Rentals		1,881,671	1,737,412	8.3
All Other Rentals		3,770,825	3,733,433	1.0
All Others (4%)		<u>2,671,641</u>	<u>2,550,490</u>	<u>4.8</u>
Subtotal		\$ 32,532,742	\$ 31,210,270	4.2
Sugar Processing		\$ 30,777	\$ 33,258	- 7.5
Pineapple Canning		6,522	6,470	0.8
Producing		475,133	449,974	5.6
Manufacturing		629,979	614,780	2.5
Wholesaling		7,817,052	7,783,924	0.4
Use (1/2%)		4,132,714	3,873,930	6.7
Intermediary Services		286,279	246,396	16.2
Insurance Commissions		<u>762,926</u>	<u>789,523</u>	<u>-3.4</u>
Subtotal		\$ 14,141,382	\$ 13,798,255	2.5
<b>TOTAL-ALL ACTIVITIES</b>		<u>\$ 46,674,124</u>	<u>\$ 45,008,525</u>	<u>3.7</u>
<b>TAX</b>				
Retailing	4%	\$ 620,209	\$ 588,048	5.5
Services	4%	218,823	211,745	3.3
Contracting	4%	129,313	127,765	1.2
Hotel Rentals	4%	75,267	69,496	8.3
All Other Rentals	4%	150,833	149,337	1.0
All Others	4%	<u>106,865</u>	<u>102,019</u>	<u>4.8</u>
Subtotal		\$ 1,301,310	\$ 1,248,410	4.2
Sugar Processing	.50%	\$ 154	\$ 166	- 7.2
Pineapple Canning	.50%	33	32	3.1
Producing	.50%	2,376	2,250	5.6
Manufacturing	.50%	3,150	3,074	2.5
Wholesaling	.50%	39,085	38,920	0.4
Use (1/2%)	.50%	20,664	19,370	6.7
Intermediary Services	.50%	1,431	1,232	16.2
Insurance Commissions	.15%	<u>1,144</u>	<u>1,184</u>	<u>- 3.4</u>
Subtotal		\$ 68,037	\$ 66,228	2.7
Unallocated*		<u>62,455</u>	<u>48,624</u>	<u>28.4</u>
<b>TOTAL-ALL ACTIVITIES</b>		<u>\$ 1,431,802</u>	<u>\$ 1,363,262</u>	<u>5.0</u>

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

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

## GENERAL EXCISE AND USE TAXES

Although slipping slightly, revenues from the general excise and use tax maintained its position as the largest producer of general fund revenues. Tax collections from this source accounted for 51.9% of the total general fund collections compared to 52.6% a year ago. The \$1,431.8 million accrued was 5.0% above fiscal year 1995 collections of \$1,363.3 million.

Tax revenues from business activities subject to the 4.0% tax rate registered an overall increase of 4.2% to \$1,301.3 million. Retailing, the largest generator of general excise and use taxes, advanced 5.5% to \$620.2 million. The state's recovering visitor industry contributed to the 8.3% rise in hotel rental tax collections. Service activities advanced 3.3% to \$218.8 million. For the first time in four years, construction activity inched upward, registering a 1.2% increase to \$129.3 million.

## TRANSIENT ACCOMMODATIONS TAX

The December 31, 1994 expiration date of transient accommodations tax (TAT) exemption for qualifying Kauai facilities, and rising tourist arrivals and average room rates contributed to the 18.1% growth of TAT collections from \$98.0 million to \$115.7 million in fiscal year 1996. As provided by law, one-sixth of the revenues collected, or \$19.3 million, was deposited into the Convention Center Fund. The counties' share, or 95% of the remaining sum, totaled \$91.6 million. Distributions into the state general fund reached \$4.8 million, up 17% from the previous year's \$4.1 million.

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

	<u>FY 1996</u>	<u>FY 1995</u>	<u>Difference</u>
Transient Accommodations Tax	\$ 115,741	\$ 98,040	\$ 17,701
Transient Accommodations Fees	<u>6</u>	<u>6</u>	<u>0</u>
SUB-TOTAL	\$ 115,747	\$ 98,046	\$ 17,701
Counties' Share	91,628	78,559	13,069
Convention Center Fund	<u>19,290</u>	<u>15,345</u>	<u>3,945</u>
Net Addition to General Fund	<u>\$ 4,829</u>	<u>\$ 4,141</u>	<u>\$ 688</u>

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

## FUEL TAXES

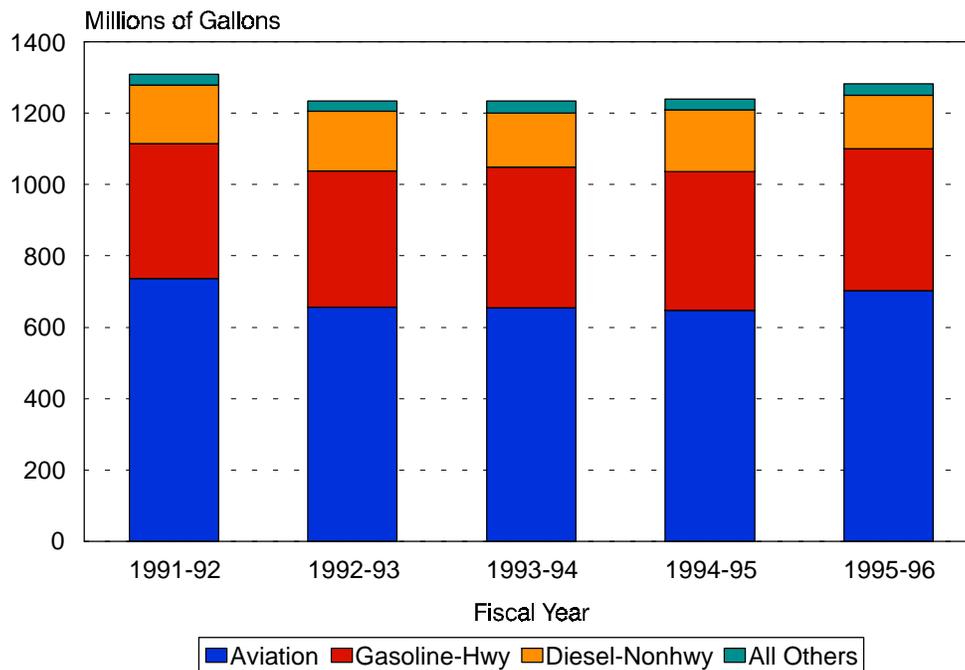
Statewide taxable fuel consumption increased 42.6 million gallons, or 3.4% over fiscal year 1995. Aviation fuel, which accounted for 54.8% of taxable fuel consumption, amounted to 703.3 million gallons, up from 646.7 million gallons a year earlier. Gasoline consumption increased a modest 2.1% but nonhighway diesel oil consumption slipped nearly 14% from 173.1 million gallons to 149.6 million gallons in fiscal year 1996.

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

	<u>FY 1996</u>	<u>FY 1995</u>	<u>Av. Annual Change</u> <u>(Percent)</u>	
			<u>1996-95</u>	<u>1992-96</u>
Gasoline	397,078	389,029	2.1	1.2
Diesel Oil - Non-highway	149,568	173,111	-13.6	- 0.4
Diesel Oil - Highway	28,315	27,262	3.9	2.9
Liq. Pet. Gas - Off Highway	3,218	2,836	13.5	- 0.1
Liq. Pet. Gas - Highway	447	528	-15.3	-11.1
Small Boats - Gasoline	51	51	0.5	2.5
Small Boats - Diesel Oil	356	252	41.2	- 0.7
Aviation Fuel	<u>703,326</u>	<u>646,676</u>	<u>8.8</u>	<u>-0.1</u>
<b>TOTAL-GALLONS</b>	<u><b>1,282,359</b></u>	<u><b>1,239,744</b></u>	<u><b>3.4</b></u>	<u><b>-0.2</b></u>
Environmental Tax (Barrel)	33,387	39,056	-14.5	NA

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

### Trends in Fuel Consumption



Fuel taxes collected by the Department are revenue sources for both the state and counties and are designated for special uses; i.e., for the construction and maintenance of highways, roads and airports. An environmental response tax of 5¢ on each barrel of petroleum product sold by a distributor to any retail dealer or end user, other than a refiner of petroleum products, is deposited into the environmental response revolving fund. This special fund is administered by the Department of Health for its oil spill prevention and remediation programs. State fuel tax rates are set by the state legislature while the county councils set the county rates. The effective rates for fiscal year 1996 are summarized below:

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

	<u>State</u>	<u>County</u>	<u>Total</u>
<b>GASOLINE AND DIESEL OIL (HWY. USE):<sup>2</sup></b>			
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui <sup>3</sup>	16.0¢	13.0¢	29.0¢
County of Hawai'i	16.0¢	8.8¢	24.8¢
County of Kaua'i	16.0¢	10.0¢	26.0¢
<b>LIQUID PETROLEUM GAS (HWY. USE):</b>			
City & County of Honolulu	11.0¢	11.0¢	22.0¢
County of Maui <sup>3</sup>	11.0¢	9.0¢	20.0¢
County of Hawai'i	11.0¢	6.0¢	17.0¢
County of Kaua'i	11.0¢	7.0¢	18.0¢
<b>ENVIRONMENTAL RESPONSE TAX (per barrel)<sup>4</sup></b>			
All Counties	5.0¢	-	5.0¢

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

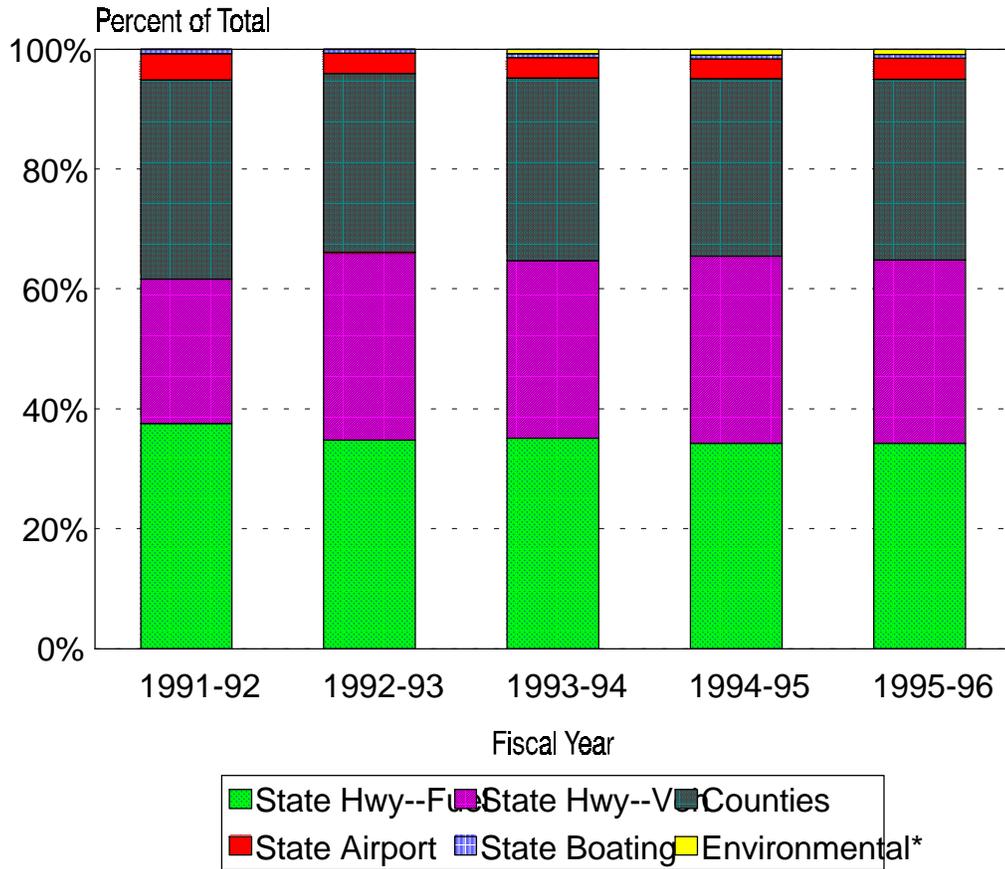
<sup>2</sup>Includes 1¢ state license tax on diesel oil.

<sup>3</sup>Maui County tax rates effective August 1, 1995.

<sup>4</sup>Effective July 1, 1993.

Revenues from the aviation fuel tax is deposited into the airport fund. All other state fuel tax revenues accrue to the state highway fund, with 1% of the fuel taxes collected at the state and county levels deposited into the state boating fund. Revenues deposited into the state highway fund totaled \$69.0 million, nearly 2% above the previous year's total. Hawaii's state highway fund is augmented by motor vehicle weight taxes and fees, which is administered and collected by the counties, and rental motor vehicle and tour vehicle surcharge levies. Revenues from all of these taxes and fees reached \$130.5 million, an increase of 1.0% from \$129.2 million in fiscal year 1995.

## Distribution of Fuel Tax Collections by Type of Fund



\*Effective July 1, 1993

ALLOCATION OF FUEL TAXES  
(In Thousands of Dollars)

	<u>FY 1996</u>	<u>FY 1995</u>	<u>Difference</u>
<b>STATE HIGHWAY FUND:</b>			
Gasoline	\$ 62,961	\$ 61,583	\$ 1,379
Diesel Oil - Non-highway	1,484	1,716	(232)
Diesel Oil - Highway	4,484	4,318	166
Liq. Pet. Gas - Off Highway	32	28	4
Liq. Pet. Gas - Highway	<u>49</u>	<u>58</u>	<u>(9)</u>
Subtotal	\$ 69,010	\$ 67,702	\$ 1,308
Motor Vehicle Weight Tax/Reg. Fees	39,543	40,007	(464)
Rental Vehicle Surcharge Tax/Fees	<u>21,951</u>	<u>21,465</u>	<u>486</u>
TOTAL	<u>\$ 130,504</u>	<u>\$ 129,175</u>	<u>\$ 1,330</u>
<b>COUNTY HIGHWAY FUNDS:</b>			
City & County of Honolulu	\$ 45,989	\$ 44,708	\$ 1,281
County of Maui	6,792	5,745	1,047
County of Hawaii	5,706	5,632	74
County of Kauai	<u>2,423</u>	<u>2,501</u>	<u>(78)</u>
TOTAL	<u>\$ 60,911</u>	<u>\$ 58,587</u>	<u>\$ 2,325</u>
BOATING SPECIAL FUND	<u>\$ 1,312</u>	<u>\$ 1,276</u>	<u>\$ 37</u>
<b>STATE AIRPORT FUND:</b>			
Aviation Fuel	<u>\$ 7,033</u>	<u>\$ 6,467</u>	<u>\$ 567</u>
ENVIRONMENTAL TAX FUND	<u>\$ 1,669</u>	<u>\$ 1,953</u>	<u>\$ (283)</u>

**PUBLIC SERVICE COMPANY TAXES**

Public service company taxes paid by public utilities rose \$3.0 million to \$88.7 million in fiscal year 1996. Tax revenues from motor carriers and contract carriers rose 4.1% to \$15.1 million. Together with penalty and interest, the total increased 3.6% from \$100.5 million to \$104.1 million.

PUBLIC SERVICE COMPANY TAXES  
(In Thousands of Dollars)

	<u>FY 1996</u>	<u>FY 1995</u>	<u>Av. Annual Change (Percent)</u>	
			<u>1995-96</u>	<u>1992-96</u>
Public Service Company Taxes	\$103,777	\$100,201	3.6	6.8
Penalty & Interest	<u>353</u>	<u>304</u>	<u>16.1</u>	<u>34.3</u>
TOTAL	<u>\$104,131</u>	<u>\$100,505</u>	<u>3.6</u>	<u>6.8</u>

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

## INHERITANCE AND ESTATE TAXES

A total of 2,128 estates were settled during the year of which 431 estates, or 20.3%, were taxable. Tax collections rose 6.7% to \$17.5 million in contrast to \$16.4 million for fiscal year 1995.

Estates of persons who passed away before June 30, 1983, are subject to the inheritance tax. After June 30, 1983, a Hawaii estate tax is imposed only if the estate is subject to the federal estate tax.

	INHERITANCE AND ESTATE TAXES (In Thousands of Dollars)		Av. Annual Change (Percent)	
	<u>FY 1996</u>	<u>FY 1995</u>	<u>1995-96</u>	<u>1992-96</u>
Estate Tax	\$ 16,681	\$ 16,068	3.8	20.9
Penalty & Interest	<u>859</u>	<u>369</u>	<u>132.6</u>	<u>258.8</u>
TOTAL	<u>\$ 17,540</u>	<u>\$ 16,438</u>	<u>6.7</u>	<u>22.8</u>

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

## OTHER TAXES

As tabulated in the table below, combined revenues from various miscellaneous taxes escalated 21.7%, or \$60.7 million, to \$340.7 million in fiscal year 1996. Employment security contributions advanced nearly 50% to \$183.5 million and tobacco tax collections rose almost 12% to \$39.6 million. In contrast, revenue from banks and other financial corporations rose a nominal 0.4% from \$17.0 million to \$17.1 million.

Reflecting the slowdown in real estate transactions, conveyance tax collections dipped nearly 19% to \$2.8 million. Revenues from the insurance premium tax and liquor tax also slipped compared to fiscal year 1995.

	MISCELLANEOUS TAXES (In Thousands of Dollars)		Av. Annual Change (Percent)	
	<u>FY 1996</u>	<u>FY 1995</u>	<u>1995-96</u>	<u>1992-96</u>
Banks & Other Financial Corp.	\$ 17,109	\$ 17,048	0.4	- 0.3
Conveyance*	2,835	3,476	-18.5	-12.3
Empl. Security Contributions	183,526	122,806	49.4	24.6
Insurance Premiums	59,164	62,271	- 5.0	6.5
Liquor & Permits	37,811	38,362	- 1.4	- 1.5
Tobacco & Licenses	39,572	35,386	11.8	8.7
General Excise Licenses & Fees	<u>685</u>	<u>658</u>	<u>4.1</u>	<u>- 3.2</u>
TOTAL	<u>\$ 340,701</u>	<u>\$ 280,001</u>	<u>21.7</u>	<u>9.4</u>

\*Includes allocation to "Rental Housing Fund" and "Natural Area Reserves Fund"

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

## COLLECTION AND ACCOUNTING OF TAXES

### TAX COLLECTIONS

Net tax collections by the Department rose 8.7% from \$2,906.0 million in fiscal year 1995 to \$3,158.0 million. Included in this total are fuel taxes collected for the counties and employment security contributions collected for the Department of Labor and Industrial Relations. The following table shows a breakdown by taxation districts.

TAX COLLECTIONS (In Thousands of Dollars)		Av. Annual Change (Percent)		
	<u>FY 1996</u>	<u>FY 1995</u>	<u>1995-96</u>	<u>1992-96</u>
<b>OAHU</b>				
Gross Collections*	\$ 3,066,180	\$ 2,869,213	6.9	3.5
Less Appeals, Payments Under Protest, & Refunds	<u>295,718</u>	<u>318,519</u>	<u>-7.2</u>	<u>2.9</u>
Net Collections by Department	<u>\$ 2,770,463</u>	<u>\$ 2,550,694</u>	<u>8.6</u>	<u>3.6</u>
<b>MAUI</b>				
Gross Collections*	\$ 193,804	\$ 191,798	1.0	1.4
Less Appeals, Payments Under Protest, & Refunds	<u>16,370</u>	<u>31,147</u>	<u>-47.4</u>	<u>-5.9</u>
Net Collections by Department	<u>\$ 177,434</u>	<u>\$ 160,652</u>	<u>10.4</u>	<u>2.9</u>
<b>HAWAII</b>				
Gross Collections*	\$ 163,102	\$ 169,338	-3.7	-2.0
Less Appeals, Payments Under Protest, & Refunds	<u>13,853</u>	<u>34,589</u>	<u>-59.9</u>	<u>-7.6</u>
Net Collections by Department	<u>\$ 149,249</u>	<u>\$ 134,749</u>	<u>10.8</u>	<u>-0.3</u>
<b>KAUAI</b>				
Gross Collections*	\$ 72,078	\$ 77,286	-6.7	-0.9
Less Appeals, Payments Under Protest, & Refunds	<u>11,183</u>	<u>17,388</u>	<u>-35.7</u>	<u>0.8</u>
Net Collections by Department	<u>\$ 60,896</u>	<u>\$ 59,898</u>	<u>1.7</u>	<u>-0.8</u>

\*Excludes conveyance, insurance premiums, and motor vehicle weight taxes.

Taxes collected by other agencies include \$5.7 million in conveyance tax collected by the Department of Land and Natural Resources, \$59.2 million in insurance premium taxes collected by the Department of Commerce and Consumer Affairs, and \$39.5 million in state motor vehicle weight taxes and registration fees collected by the counties. Total collections for the state amounted to \$3,262.6 million, up 8.2% from \$3,015.2 million for fiscal 1995.

## TAX COLLECTIONS

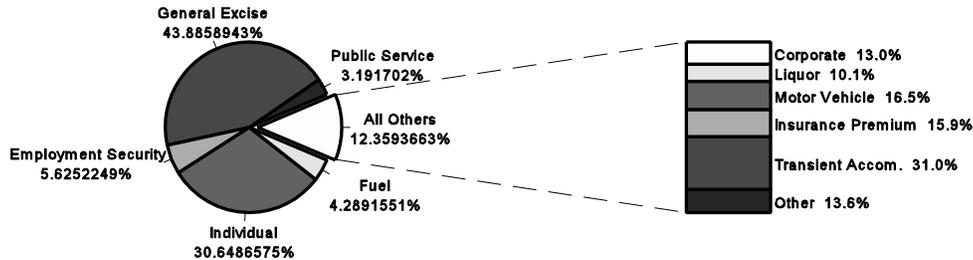
SOURCE OF REVENUE	FY 1996		FY 1995	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 17,108,600	0.52%	\$ 17,047,622	0.57%
Conveyance	5,669,074	0.17%	6,951,725	0.23%
Employment Security Contributions	183,526,023	5.63%	122,801,309	4.07%
Fuel	139,936,366	4.29%	135,984,065	4.51%
General Excise & Use	1,431,801,812	43.89%	1,363,262,352	45.21%
Income - Corporations	48,438,414	1.48%	30,248,826	1.00%
Income - Individuals	999,928,324	30.65%	925,703,641	30.70%
Inheritance and Estate	17,540,096	0.54%	16,437,851	0.55%
Insurance Premiums	59,164,180	1.81%	62,271,329	2.07%
Liquor & Permits	37,810,985	1.16%	38,361,650	1.27%
Motor Vehicle Tax*	61,494,048	1.88%	61,473,386	2.04%
Public Service Companies	104,130,810	3.19%	100,505,158	3.33%
Tobacco & Licenses	39,571,941	1.21%	35,385,569	1.17%
Trans. Accom. Fees	6,215	0.00%	6,217	0.00%
Trans. Accom. Tax	115,740,954	3.55%	98,039,650	3.25%
All Others	686,446	0.02%	743,560	0.02%
<b>TOTAL</b>	<b>\$ 3,262,554,288</b>	<b>100.00%</b>	<b>\$ 3,015,223,910</b>	<b>100.00%</b>

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

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

## Tax Composition

*Fiscal Year 1995-96*



Accruals to the state general fund totaled \$2,758.5 million, or 84.6% of total tax collections. Distributions to the counties accounted for 4.7% of the total, or \$60.9 million from the fuel tax and \$91.6 million from the transient accommodations tax.

The remainder was distributed among the various state funds, including \$130.5 million to the state highway fund, \$183.5 million to the unemployment trust fund, and \$19.3 million to the convention center fund. Tabulated below are the distribution amounts for each of the state special funds.

#### DISTRIBUTION OF COLLECTIONS

STATE FUNDS:	FY 1996		FY 1995	
	Amount Distributed	% of Total	Amount Distributed	% of Total
State General	\$ 2,758,541,260	84.55%	\$ 2,592,218,701	85.97%
State Highway	130,504,377	4.00%	129,175,698	4.28%
State Airport	7,033,261	0.22%	6,466,757	0.21%
Boating Special Fund	1,312,338	0.04%	1,275,645	0.04%
Environmental Fund	1,669,354	0.05%	1,952,804	0.06%
Bond Reserve Fund	5,000,000	0.15%	5,000,000	0.17%
Unemployment Trust	183,526,023	5.63%	122,801,309	4.07%
Election Campaign Fund	303,640	0.01%	365,646	0.01%
Rental Housing Fund	1,417,269	0.04%	1,737,931	0.06%
Natural Area Reserve Fund	1,417,269	0.04%	1,737,931	0.06%
Convention Center Fund	<u>19,290,159</u>	<u>0.59%</u>	<u>15,345,469</u>	<u>0.51%</u>
Subtotal - State	\$ 3,110,014,950	95.32%	\$ 2,878,077,891	95.45%
COUNTY REVENUES:				
Fuel	60,911,085	1.87%	58,586,547	1.94%
Trans. Accom. Tax	<u>91,628,256</u>	<u>2.81%</u>	<u>78,559,472</u>	<u>2.61%</u>
Subtotal - Counties	\$ 152,539,341	4.68%	\$ 137,146,019	4.55%
TOTAL	<u>\$ 3,262,554,291</u>	<u>100.00%</u>	<u>\$ 3,015,223,910</u>	<u>100.00%</u>

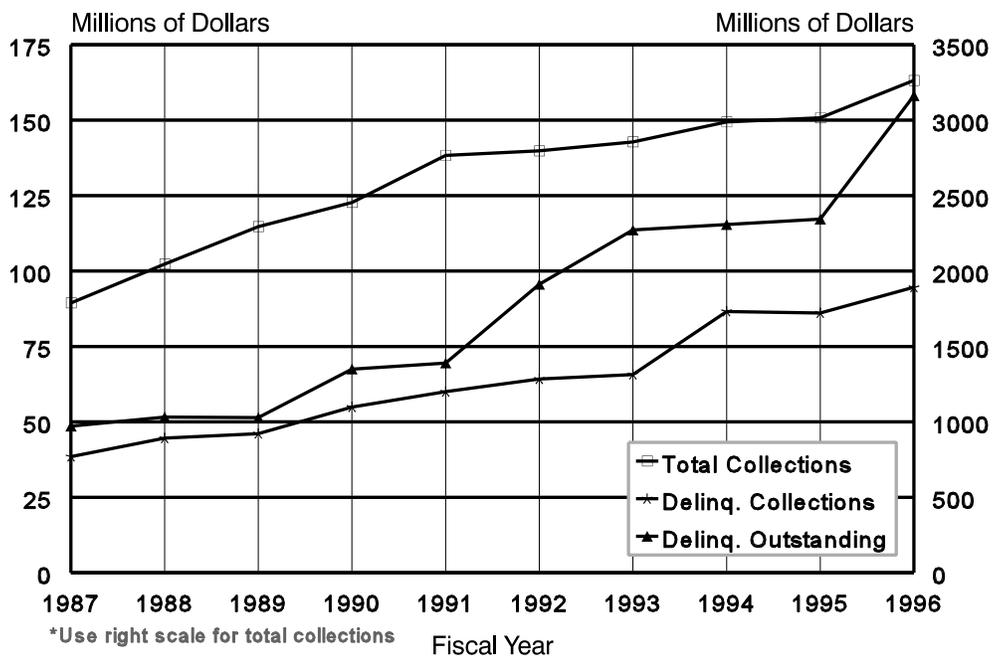
NOTE: Due to rounding, detail may not add to totals.

## DELINQUENT TAXES

The Department started the fiscal year with 41,400 delinquent accounts amounting to \$117.2 million. A total of 68,953 new referrals were filed, increasing outstanding delinquencies by \$141.8 million. Through the use of aggressive procedures by its collectors, the Department was able to close 69,542 accounts, write off \$6.4 million as uncollectable, and collect \$94.6 million, which is nearly 10% above the fiscal year 1995 cash collection of \$86.1 million. The result at the end of the year was 40,811 delinquent accounts totaling \$158.0 million.

The average outstanding delinquent account at year's end escalated from \$2,831 in fiscal year 1995 to \$3,873. Despite the advancing totals, the Department was able to close 2,699 more accounts and collect \$8.5 million more compared to the previous year, thus pushing the average amount collected per account from \$1,399 to \$1,452.

### Delinquent Taxes Collected and Outstanding



## BRIEF SUMMARY OF HAWAII'S TAX SYSTEM

Two notable characteristics of Hawaii's tax structure are the high degree of centralization at the state level and the comprehensive utilization of revenue sources. Although relying heavily on the general excise tax, the overall system has been made progressive through the use of the graduated individual income tax and, to a lesser extent, of income tax credits.

Responding to budget restraints, the 1995 legislature repealed both the excise tax credit offered residents with adjusted gross incomes under \$30,000 and the medical services excise tax credit available to qualified residents. The food tax credit, equal to \$55 per qualified resident, was reduced to \$27 per qualified individual. All of the changes became effective after December 31, 1994. Qualified residents at all income levels may claim the food, dependent care, energy, capital goods excise, child passenger restraint and nursing facility tax credits. The renter's tax credit is available to eligible taxpayers satisfying the \$30,000 adjusted gross income cap.

Article VII, Section 6, of the state constitution mandates the legislature to provide a tax refund or credit whenever general fund year-end balances exceed 5 percent of general fund revenues for two successive fiscal years. Act 93 of the 1995 legislature provided a \$1 general income tax credit to residents for tax year 1995.

Hawaii has eighteen separate tax laws of which fifteen are administered by the state. The remaining three -- the real property tax, the motor vehicle weight tax, and the public utility franchise tax -- are administered by the counties. Until July 1, 1981, the real property tax law was administered by the state, with revenue from this source accruing to the counties. At present, the counties administer all of the real property functions. Administration of the state and county motor vehicle weight taxes is vested in the counties with the revenue accruing to the state and county highway funds.

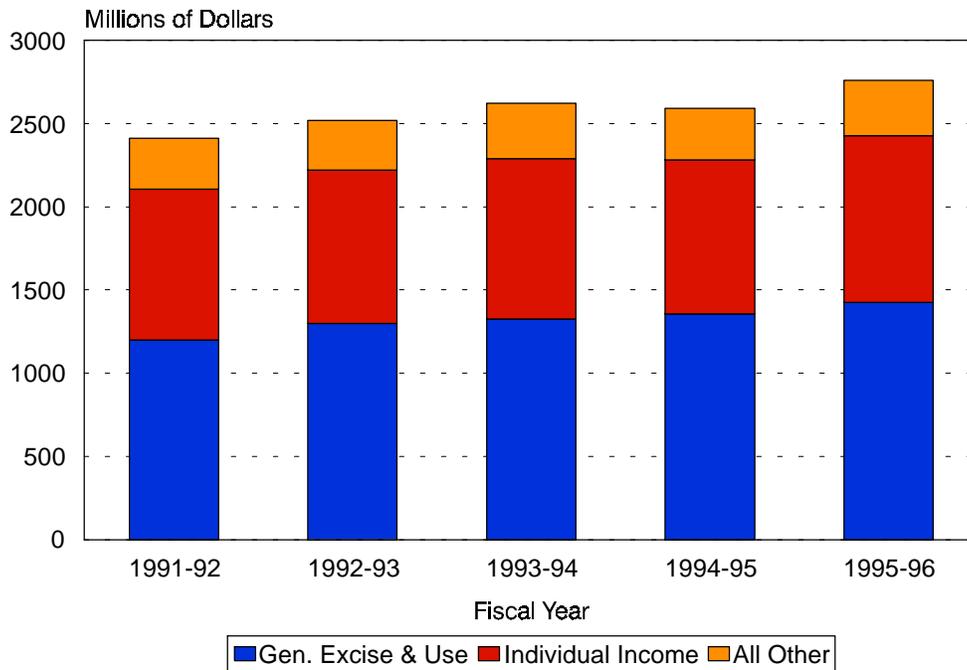
Revenues from eleven of the state-administered taxes go into the state's general fund and are used to provide government services, including the educational system which is a state function in Hawaii. Although the fuel tax is administered by the state, it is a source of revenue for both the state and county highway funds. The employment security tax is a dedicated tax, used exclusively to provide benefits to covered unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the state highway fund. Revenue from the nursing facility tax is deposited into the health care revolving fund.

## STATE GENERAL FUND

SOURCE OF REVENUE	FY 1996		FY 1995	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 17,108,600	0.62%	\$ 17,047,622	0.66%
Conveyance	2,834,536	0.10%	3,475,862	0.13%
General Excise & Use	1,426,801,812	51.72%	1,358,262,352	52.40%
Income - Corporations	48,438,414	1.76%	30,248,826	1.17%
Income - Individuals	999,624,684	36.24%	925,337,995	35.70%
Inheritance & Estate	17,540,096	0.64%	16,437,851	0.63%
Insurance Premiums	59,164,180	2.14%	62,271,329	2.40%
Liquor & Licenses	37,810,985	1.37%	38,361,650	1.48%
Public Service Companies	104,130,810	3.77%	100,505,158	3.88%
Tobacco & Licenses	39,571,941	1.43%	35,385,569	1.37%
Trans. Accom. Fees	6,215	0.00%	6,217	0.00%
Trans. Accom. Tax	4,822,539	0.17%	4,134,709	0.16%
All Others	686,446	0.02%	743,560	0.03%
<b>TOTAL</b>	<b>\$ 2,758,541,258</b>	<b>100.00%</b>	<b>\$ 2,591,218,701</b>	<b>100.00%</b>

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

## Trends in General Fund Revenue



# OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 1996

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(1) Net Income</p> <p>Chapter 235 — Section 235-1 to 235-130</p>	<p>Tax rates for individuals as well as estates and trusts range from 2.0% to 10.0% of taxable income. The allowable standard deduction amounts vary by filing status. The standard deduction amount for married filing joint return or surviving spouse with dependent child is \$1,900; single is \$1,500; head of household is \$1,650; and married filing separately is \$950. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000.</p>	<p>Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$1,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. For employers whose liability for taxes withheld exceeds \$100,000 a year, withholding returns due monthly on or before the 10th day of the following calendar month. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.</p>	<p>In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th.</p>
<p>(2) Estate and Transfer (for decedents dying after 6/30/83)</p> <p>Chapter 236D — Section 236D-1 to 236D-18</p>	<p>Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For nonresident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions.</p> <p>For generation-skipping transfers after June 30, 1994, a tax in an amount equal to the federal credit is imposed on every generation-skipping transfer of (1) property located in Hawaii and (2) property from a resident trust.</p>	<p>Report (Form M-6) must be filed by person responsible for filing federal Estate Tax Return (federal Form 706). No report required and no tax due when federal Form 706 not required. To obtain release of property, file Request for Release (Form M-6A).</p> <p>Report (Form M-6GS) must be filed by person responsible for filing Generation-Skipping Transfer Tax Return for Distributions (federal Form 706GS(D)) or Generation-Skipping Transfer Tax Return for Terminations (federal Form 706GS(T)).</p>	<p>On or before the due date for filing federal Form 706, including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p> <p>On or before the due date for filing federal Form 706GS(D) or 706GS(T), including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p>
<p>(3) General Excise (Gross Income)</p> <p>Chapter 237 — Section 237-1 to 237-49</p>	<p>This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 1/2 of 1% on wholesaling and intermediary services, blind vendors, producing, manufacturing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at .15%. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(4) Transient Accommodations Tax</p> <p>Chapter 237D — Section 237D-1 to 237D-16</p>	<p>This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 6%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>

<b>KIND OF TAX &amp; LEGAL REFERENCES (HAWAII REVISED STATUTES)</b>	<b>MEASURE AND RATE OF TAX</b>	<b>REPORTS</b>	<b>TAX PAYABLE</b>
(5) Use  Chapter 238 — Section 238-1 to 238-16	This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: 1/2 of 1%, if for resale at retail; 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.	At time of filing returns.
(6) Public Service Company  Chapter 239 — Section 239-1 to 239-11	Nature of Tax—(1) Public utility business in lieu of general excise and real property taxes. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, 1/2 of 1%. (iii) All other revenues: If ratio of net to gross income is 15% or less, 5.885%; for each 1% increase in ratio of net to gross, rate increase .2675%. (2) Motor carrier, common carrier by water and contract carrier business (other than motor carrier business) in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from motor carrier, common carrier by water and contract carrier business for preceding calendar year. For exception, see sections 239-9 and 239-11. (b) Rate: 4% of gross income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations  Chapter 241 — Section 241-1 to 241-7	(1)(a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. Specific exempt activities are enumerated under chapter 237. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel  Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 1¢ per gallon on aviation fuel; an initial 1¢ per gallon on diesel oil, liquefied petroleum gas for operation of an internal combustion engine and from 24.8¢ to 32.5¢ per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 24.8¢ to 32.5¢ per gallon on diesel oil and from 17¢ to 22¢ per gallon on liquefied petroleum gas used to operate motor vehicles upon the public highways, however, they are not required to pay these additional taxes if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways or diesel oil and liquefied petroleum gas used for motor vehicles not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5¢ per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor  Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon “dealers” as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. Act 89, SLH 1994, increases the liquor tax rate each fiscal year from July 1, 1995, to July 1, 1998, for the 6 liquor categories by 1% on distilled spirits and 1.25% for the remaining categories of liquor. The liquor tax rate adjustment provision is repealed. For the period beginning July 1, 1996, to June 30, 1997, the tax rates per wine gallon are \$5.87 on distilled spirits, \$2.06 on sparkling wine, \$1.34 on still wine, \$.83 on cooler beverages, \$.91 on beer other than draft beer, and \$.52 on draft beer.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(10) Cigarette and Tobacco  Chapter 245 — Section 245-1 to 245-15	“Wholesalers” as defined in the law and certain others must pay an excise tax on sale or use of tobacco products, equal to 40% of the wholesale price, and a fixed tax rate of 3¢ on each cigarette. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(11) Conveyance  Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property. The rate is 10¢ per \$100 of the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction. (Documents of certain conveyances are exempted.)	A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.	At time of filing the certificate, but no later than 90 days after the taxable transaction.
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax  Chapter 251 — Section 251-1 to 251-15	There is a rental motor vehicle surcharge tax of \$2 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.

<b>KIND OF TAX &amp; LEGAL REFERENCES (HAWAII REVISED STATUTES)</b>	<b>MEASURE AND RATE OF TAX</b>	<b>REPORTS</b>	<b>TAX PAYABLE</b>
(13) Nursing Facility Tax  Chapter 346E — Section 346E-1 to 346E-16	There is a nursing facility tax in the amount of 6% on nursing facility income. The tax is levied on the nursing facility operator. The tax shall apply to nursing facility income arising from activities occurring on and after July 1, 1993, and before July 1, 1995. Act 176, SLH 1995, extends the nursing facility tax to July 1, 1997.	Quarterly returns are due on or before the 15th day of February, May, August, and November, or for fiscal year taxpayers on or before the 45th day after the close of the fiscal quarter. When the total tax liability does not exceed \$1,000 for the taxable year, returns may be filed semiannually on or before the last day of the calendar month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns; or the Department and the operator may agree in writing that the Department will withhold all or part of the amount of taxes owing for a quarter from Medicaid payments owed by the Department to the operator.
(14) Unemployment Insurance  Chapter 383 — Section 383-1 to 383-176	This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.40%. There is a .05% employment and training fund assessment on taxable wages paid to all employees by employing units with contribution rates greater than 0.00% but less than 5.40%.	Returns filed on or before the last day of the month following the taxable quarter.	At time of filing returns.
(15) Insurance Premiums  Chapter 431 — Section 431:7-201 to 431:7-207	Tax on insurance companies (Underwriters) based on premiums received in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.	Monthly/Quarterly interim statement is due on or before the last day of the calendar month following the month/quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.	At time of filing statements.

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