

## VISIBLE PASSING ON OF THE GENERAL EXCISE TAX AND COMMISSION INCOME

A reader of the *Bulletin* wrote to us a few months ago to let us know that a number of real estate firms have begun adding the general excise tax (GET) to their commission amount on the Cooperating Broker's Separate Agreement form. The reader felt that this led to confusion in determining responsibility for paying the GET, and asked if there was a State law prohibiting this practice. The short answer is that nothing in Hawaii's tax law prohibits this practice. However, this is a new and interesting situation that warrants a more detailed discussion.

To truly answer this question, you first need to know that the GET is a tax levied on the gross income of a business' activities in Hawaii. That is, the person receiving business income is the person that is responsible for paying the GET.

Second, unlike sales taxes which require businesses to charge and collect a specific amount as sales tax, the GET law doesn't say that businesses must charge and collect a certain amount as tax from the customer. Businesses simply pay the GET out of the gross income it receives as compensation for its goods or services just as businesses pay for their other expenses. In fact, the only provision regarding this issue is one that states that the general excise tax is a component of the price being charged the customer, and businesses subject to the general excise tax therefore cannot say that there is no tax included in the price.

In a typical transaction, a broker representing the seller contracts with the seller to represent the seller for X% commission. When the property is sold, the seller's broker and the purchaser's broker each receive a share (usually half) of that commission. For example, if a 6% total commission is contracted for between the seller's broker and the seller and if the sales price is \$100,000, then the total commission is \$6,000 ( $\$100,000 \times 6\%$ ) of which each broker receives \$3,000 ( $\$100,000 \times 3\%$ ). For GET purposes, the \$3,000 commission is gross income subject to the GET. Each broker is responsible for paying the 4% GET on their respective \$3,000 commissions, so each must report on their GET returns \$3,000 in gross commission income and pay \$120 in GET ( $\$3,000 \times 4\%$ ).

In the situation presented by the reader, the seller's broker has arranged a commission of 6% with the seller that the broker expects to split with the purchaser's broker 50-50. However, when the purchaser's broker returns the Cooperating Broker's Separate Agreement, much to the seller's broker's surprise, the commission stated on the form is not, 3% of the sales price, but 3% of the sales price PLUS 4.166% GET!

For example, if a 6% total commission is contracted for between the seller's broker and the seller, and if the sales price is \$100,000, then the total commission is \$6,000 ( $\$100,000 \times 6\%$ ). The commission negotiated and received by the purchasing broker \$3,125 ( $\$100,000 \times 3\% = \$3,000; \$3,000 \times 4.166\% = \$125; \$3,000 + 125 = \$3,125$ ). That leaves \$2,875 in commission for the seller's broker. For GET purposes, the seller's broker's \$2,875 commission is gross income subject to the 4% GET ( $\$2,875 \times 4\% = \$115$  GET). The purchaser's broker's \$3,125 commission is gross income subject to the 4% GET ( $\$3,125 \times 4\% = \$125$  GET).

The practice of separately showing an amount represented as the GET is known as the visible passing on of the GET. It is important to point out here that the entire amount received by the purchaser's broker, including the GET visibly passed on, is gross commission income subject to the 4% GET. Furthermore, the seller's broker is NOT "collecting" the GET for the purchaser's broker. All that they have done is negotiated an agreement that does not split the total commission 50-50.

Though this transaction may not be to the liking of the seller's broker, it is not prohibited by State tax law. State tax law does not govern the payment agreements between the parties, but only looks at whether each party is correctly reporting its gross income and is paying the correct amount of tax on that income.

For more information on the visible passing on of the general excise tax, see Tax Facts No. 96-1, "General Excise vs. Sales Tax." This publication is available at any district tax office or by calling our request line at 587-7572 (toll-free at 1-800-222-7572). It also is available on our website at [www.state.hi.us/tax](http://www.state.hi.us/tax). Should you have further questions, please call us at 587-4242 (toll-free at 1-800-222-3229) or e-mail us at [Taxpayer\\_Services@tax.state.hi.us](mailto:Taxpayer_Services@tax.state.hi.us).



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