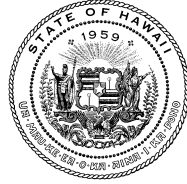


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August 3, 2005

TAX INFORMATION RELEASE NO. 2005-02

RE: Taxation of Income from Merchant Discount

This Tax Information Release ("TIR") clarifies and expands upon footnote 3 of TIR 2001-3 relating to income from merchant discount. Income from merchant discount is a fee or discount paid to a financial institution by a merchant for the right to participate in a program or system where a credit card is accepted in payment for merchandise or services sold to the credit card holder. Income from merchant discount is not exempt from Hawaii Revised Statutes Chapter 237, Hawaii's General Excise Tax. This TIR also sets forth the Department's position that income from merchant discount is subject to general excise tax under HRS § 237-13(9) as income received from a merchant resulting from the merchant's right to use a system.

I. Income from Merchant Discount

"Merchant discount" is defined in Hawaii Administrative Rules § 18-241-4-02 as "the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder." For purposes of merchant discount, the term credit card also includes charge cards where the card holder is required to pay all monthly charges. Income from merchant discount is subject to general excise tax as income from the right to use a system taxable under HRS § 237-13(9). Income from merchant discount received by taxpayers from Hawaii merchants is subject to tax under HRS § 237-13(9) at the rate of four percent (4%).

Please note that the Department's position that income from merchant discount can be taxed as income received from merchant's right to use a system is not the Department's exclusive remedy for pursuing any tax lawfully owed by any person with respect to the use of any credit or charge card in Hawaii.

II. Financial Institutions Are Subject to General Excise Tax from Hawaii Income from Merchant Discount.

HRS § 237-24.8 exempts from GET amounts received by a financial institution from, among other items, as set forth in HRS § 237-24.8(a)(1)(A) "interest, discount, points, commitment fees, loan fees, loan origination charges and finance charges which are part of the computed annual percentage rate of interest and which are contracted and received for the use of

money." Further HRS § 237-24.8(a)(1)(C) exempts amounts received by a financial institution from "fees or charges relating to the administration of deposits". Notwithstanding the foregoing language, the term "discount" as used in HRS § 237-24.8(a)(1)(A) does not encompass merchant discount, but instead refers to amounts that are contracted and received for the use of money in traditional lending transactions. Further, merchant discount is not a fee or a charge relating to the administration of deposits within the definition of HRS § 237-24.8(a)(1)(C). Thus, "financial institutions" as defined in HRS Section 237-24.8(b) may not exclude from their general excise tax liability income from merchant discount paid by Hawaii merchants under HRS § 237-24.8(a)(1)(A) or 237-24.8(a)(1)(C).

Forms and other tax information are available at the Department's website at www.state.hi.us/tax. On Oahu, forms may be ordered by calling the Department's Forms Request Line at: 587-7572. Persons who are not calling from Oahu, may call: 1-800-222-7572 (toll-free) to receive forms by mail or by fax.

A handwritten signature in black ink, appearing to read 'Kurt Kawafuchi', with a stylized flourish at the end.

Kurt Kawafuchi
Director of Taxation

HRS Sections Explained: HRS sections 237-13(9) and 237-24.8(a)(1).