



STATE OF HAWAII
DEPARTMENT OF TAXATION

P.O. BOX 259
HONOLULU, HAWAII 96809-0259

July 25, 1994

TAX INFORMATION RELEASE NO. 94-6

RE: Resale Certificates

This Tax Information Release (TIR) answers questions that have been raised regarding the additional amount a seller may require a purchaser to pay if a purchaser has given a seller a resale certificate, and it is later found that some or all of the sales covered by the certificate are retail sales. This TIR clarifies section 237-13(2)(F), Hawaii Revised Statutes (HRS), and section 18-237-13-02(d)(2)(B), Hawaii Administrative Rules (HAR).

Under the law governing resale certificates, section 237-13(2)(F)(i), HRS, a purchaser who gives a resale certificate to a seller is obligated to pay the seller, upon demand, "the amount of additional tax which by reason thereof (i.e., because the sale is not in fact at wholesale) is imposed upon the seller". To accomplish the remedial purposes of a resale certificate, and because interest is added to and becomes part of the tax under section 231-39(b), HRS, interest is recoverable from the purchaser under section 237-13(2)(F)(i), HRS.

Penalties also are added to and become part of the tax. In contrast to interest, however, a penalty or may not be recoverable from the purchaser, depending on why it was imposed. A failure to file penalty, for example, would not be recoverable because failure to file has nothing to do with the accuracy of the resale certificate; the seller was required to file a return whether or not the certificate was accurate. This TIR does not address the question of what kinds of penalties, if any, would be recoverable.

The 4 scenarios in this TIR all involve the following basic facts:

In March, 1991, R, a licensed retailer, purchased 1000 articles of tangible personal property from taxpayer T, a licensed wholesaler for purposes of resale at retail. T is a calendar year taxpayer. The 1000 articles were sold at \$100 each, without any visible pass on of general excise tax, for a total price of \$100,000. T reported the sales as income from wholesaling and paid \$500 in general excise tax to the Department of Taxation, however, R consumed 100 of the articles without informing T.

Scenario 1:

R's consumption of the 100 articles is discovered by the Department in 1994, and R had not given a resale certificate to T.

The sale of the 100 articles must be reclassified as a retail sale. Because \$50 in tax already has been paid on these articles at the

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wholesale rate, the Department will assess T an additional \$350 in tax, plus interest at the underpayment rate of 8 per cent a year.

T has no recourse against R except under the private agreement between them that resulted in the original sale, or under other nontax law. If T recovers against R, the amount recovered is subject to the general excise tax. Any recovery by T is treated as additional income from retailing, reported on line 8 on the return for the period in which the income is recognized under T's method of accounting.

Scenario 2:

R's consumption of the 100 articles is discovered by the Department in 1994, and R had given a resale certificate to T.

The sale of the 100 articles must be reclassified as a retail sale. The Department will assess T an additional \$350 in tax, plus interest at 8 per cent a year. The amounts to be recovered in the examples set forth in section 18-237-13-02(d)(2)(D), HAR, are incorrectly calculated and will be amended to be consistent with this TIR.

Assume that the interest is \$84, and penalties are not charged.

In this example, R is obligated to pay T $\$350 + 84 = \434 on demand. If T then recovers \$434 from R, T has received additional gross income. The amount recovered is treated as additional income from retailing, reported on line 8 on the return for the period in which the income is recognized under T's method of accounting. The income does not qualify as a nontaxable reimbursement under section 237-20, HRS. Thus, an additional \$17.36 (4 per cent of \$434) in general excise tax is due from T.

T does not have recourse against R for the additional \$17.36 under section 237-13(2)(F)(i), HRS. Under section 237-13(2)(F)(i), HRS, R only is liable to pay the additional tax which "by reason thereof" is imposed upon the seller. The additional tax liability for the \$17.36 was not created by reason of R's consumption of the 100 articles, but because T received \$434 of additional income. Furthermore, the Department has historically and consistently treated the passing on of a seller's tax to the buyer as a matter governed exclusively by private agreement. Thus the law governing the resale certificate does not obligate R to pay T anything on account of the additional \$17.36 tax imposed upon T. T, however, may have additional recourse against R if their private agreement, or other nontax law, so provides.

Scenario 3:

R's consumption of the 100 articles is discovered when R so informs T in 1992, and R had not given a resale certificate to T.

The sale of the 100 articles must be reclassified as a retail sale.

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If T has not yet filed the 1991 annual reconciliation return and the statutory due date for the 1991 annual reconciliation return has not yet passed, T must file an amended periodic return, Form G-54, for the period in which the sale was reported as a wholesale sale. T must reclassify the \$10,000 as income from retailing. Here, T's amended periodic return for the period including March, 1991, would show \$10,000 of retailing and \$90,000 of wholesaling income, for which the tax would be \$850 (4 per cent of \$10,000 plus 0.5 per cent of \$90,000). The \$500 paid then would be subtracted, to arrive at a \$350 balance due. The 1991 annual reconciliation return reflecting this reclassification then is filed normally at the proper time.

If T already has filed the 1991 annual reconciliation return, T must file an amended annual return, Form G-55, for 1991. An amended periodic return on Form G-54 should not be filed. T must reclassify the \$10,000 as income from retailing, as described in the previous paragraph, to arrive at a \$350 balance due. Interest also is due on the \$350. The interest is computed according to the instructions to Form G-55.

As in Scenario 1, T has no recourse against R except as provided in their private agreement, or by other nontax law.

Scenario 4:

R's consumption of the 100 articles is discovered when R so informs T in 1992, and R has given a resale certificate to T.

If T has not yet filed the 1991 annual reconciliation return and the statutory due date for the 1991 annual reconciliation return has not yet passed, T must file an amended periodic return, Form G-54, for the period in which the sale was reported as a wholesale sale. T must reclassify the \$10,000 as income from retailing. Here, T's amended periodic return for the period including March, 1991, would show \$10,000 of retailing and \$90,000 of wholesaling income, for which the tax would be \$850 (4 per cent of \$10,000 plus 0.5 per cent of \$90,000). The \$500 paid then would be subtracted, to arrive at a \$350 balance due. The 1991 annual reconciliation return reflecting this reclassification then is filed normally at the proper time.

If T already has filed the 1991 annual reconciliation return, T must file an amended annual return, Form G-55, for 1991. An amended periodic return on Form G-54 should not be filed. T must reclassify the \$10,000 as income from retailing, as described in the previous paragraph, to arrive at a \$350 balance due. Interest also is due on the \$350. The interest is computed according to the instructions to Form G-55.

As in Scenario 2, T is entitled to recover \$350 plus any interest, and possibly penalties, from R. If and when T recognizes that recovery under its method of accounting, T will have additional gross income on which general excise tax will be due and payable.

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The law governing the resale certificate does not entitle T to recover against R for any tax imposed on T because of the additional gross income. T may have additional recourse if the private agreement between them, or other nontax law, so provides.

This Tax Information Release does not address net income tax consequences in any of the above scenarios.


RICHARD F. KAHLE, JR.
Director of Taxation

HRS Sections Explained: HRS §§237-13(2)(F), 237-30, 237-33

Rules Sections Explained: §18-237-13-02(d)