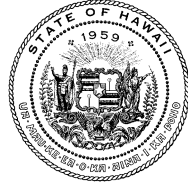


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DEPARTMENT OF TAXATION INFORMATION RELEASE NO. 2021-02

RE: Imposition of General Excise and Income Taxes on Statutory Employees

The purpose of this Tax Information Release is to provide guidance on the imposition of General Excise Tax (GET) and income tax on statutory employees. A *statutory employee* is an individual that is deemed to be an “employee” under Internal Revenue Code (IRC) section 3121(d)(3) for the sole purposes of the Federal Insurance Contributions Act (FICA).

An individual qualifies as a statutory employee pursuant to section 3121(d)(3) only if such individual is not a “common law” employee pursuant to section 3121(d)(2).¹ Statutory employees include full-time life insurance salespeople, certain agent or commission drivers, certain traveling salespeople, and certain homeworkers.

IRC section 62(a) provides that the term “adjusted gross income” means, in the case of an individual, gross income minus certain deductions, including allowable deductions attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

IRC section 67(a) provides that, in computing taxable income, miscellaneous itemized deductions for any taxable year shall be allowed to an individual only to the extent that the aggregate of those deductions exceeds two percent of adjusted gross income.² IRC section 67(b) provides that the term “miscellaneous itemized deductions” means all itemized deductions other than certain deductions enumerated within that statute. Business expenses under IRC section 162 are a type of itemized deduction not listed in section 67(b), and thus IRC section 162 business expenses can be “miscellaneous itemized deductions.”

The Internal Revenue Service, in Revenue Ruling 90-93, concluded that a statutory employee is *not* an employee for the purposes of IRC sections 62 and 67; thus, a statutory employee is not subject to the miscellaneous itemized deductions limitations under IRC section 67(a). A statutory employee may properly report business income and expenses in full on Schedule C of their federal Form 1040, and thereby avoid the Schedule A limitations on the deduction of employee business expenses and the phaseout of itemized deductions.³

1 Ewens & Miller, Inc. v. Commissioner. 117 T.C. 263, 269 (2001).

2 Note that the Tax Cuts and Jobs Act, P.L. 115-97, suspended miscellaneous deductions and the two percent floor through 2025. Nonetheless, the principle remains valid. Further, for Hawaii income tax purposes, miscellaneous itemized deductions and the two percent floor are still operative law.

3 See Prouty v. Commissioner. T.C.M. 2002-175 (citing Rev. Rul. 90-93, 1990-2 C.B. 33).

General Excise Tax

Hawaii's GET is a broad-based business privilege tax that casts a wide and tight net and applies to virtually every economic activity imaginable.⁴ Specifically, GET is imposed on income received for services under Hawaii Revised Statutes (HRS) section 237-13(6). In other words, GET applies unless a specific exemption applies. In the current context, many taxpayers mistakenly believe that because the income they received was reported on a federal Form W-2, that the exemption from GET for salaries or wages paid by an employer to an employee for services rendered under HRS section 237-24(6) applies. To qualify for the exemption under HRS section 237-24(6), the income must be received by a person that is an employee for Hawaii state income tax purposes.

As discussed above, a statutory employee is not a "common law" employee and is not an employee for federal income tax purposes.⁵ Hawaii conforms to IRC sections 62 and 67⁶, and follows the principles informing the federal treatment; thus, a statutory employee is also *not* an "employee" for Hawaii income tax purposes. As such, the amounts received by a statutory employee are subject to GET and are *not* exempted under HRS section 237-24(6). Statutory employees must register for a GET license, file all required returns, and pay any taxes due.

Hawaii Income Tax

Statutory employees are allowed to report income and deduct ordinary and necessary business expenses on Schedule C of federal Form 1040. The net profit or loss from Schedule C becomes part of the federal adjusted gross income from which Hawaii adjusted gross income is calculated. Statutory employees are not subject to the miscellaneous itemized deduction limitations contained in IRC section 67.

If you have any questions, you may contact the Department of Taxation Rules Office at tax.rules.office@hawaii.gov, or call (808) 587-1530.

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⁴ *In re: Island Holidays, Ltd.*, 59 Haw. 307, 316 (1978), *Pratt v. Kondo*, 53 Haw. 436, 436 (1972).

⁵ For more information, please see <https://www.irs.gov/businesses/small-businesses-self-employed/employee-common-law-employee>.

⁶ Hawaii Revised Statutes sections 235-2.3(a), 235-2.4(b).