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DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2011-09

RE: Act 105, Session Laws of Hawaii 2011, Relating to Taxation

On June 9, 2011, Governor Neil Abercrombie signed into law Senate Bill 754 SD1, HD1, CD1 as Act 105, Session Laws of Hawaii 2011.

This Act suspends temporarily the exemptions for certain persons and certain amounts of gross income or proceeds from the general excise and use tax and requires the payment of both taxes at a four per cent rate. The persons and amounts for which exemption under the general excise tax has been suspended are as follows:

1. Amounts deducted from the gross income received by contractors as described under section 237-13(3)(B);
2. Reimbursements received by federal cost-plus contractors for the costs of purchased materials, plant, and equipment as described under section 237-13(3)(C);
3. Gross receipts of home service providers acting as service carriers providing mobile telecommunications services to other home service providers as described under section 237-13(6)(D);
4. Amounts deducted from the gross income of real property lessees because of receipt from sublessees as described under section 237-16.5;
5. The value or gross income received by nonprofit organizations from certain conventions, conferences, trade show exhibits, or display spaces as described under section 237-16.8;
6. Amounts received by sugarcane producers as described under section 237-24(14);
7. Amounts received from the loading, transportation, and unloading of agricultural commodities shipped interisland as described under section 237-24.3(1);
8. Amounts received from the sale of intoxicating liquor, cigarettes and tobacco products, and agricultural, meat, or fish products to persons or common carriers engaged in interstate or foreign commerce as described under section 237-24.3(2);
9. Amounts received or accrued from the loading or unloading of cargo as described under section 237-24.3(4)(A);
10. Amounts received or accrued from tugboat and towage services as described under section 237-24.3(4)(B);
11. Amounts received or accrued from the transportation of pilots or government officials and other maritime-related services as described under section 237-

24.3(4)(C);

12. Amounts received by labor organizations for real property leases as described under section 237-24.3(10);
13. Amounts received as rent for aircraft or aircraft engines used for interstate air transportation as described under section 237-24.3(12);
14. Amounts received by exchanges and exchange members as described under section 237-24.5;
15. Amounts received as high technology research and development grants under section 206M-15 as described under section 237-24.7(10);
16. Amounts received from the servicing and maintenance of aircraft or construction of aircraft service and maintenance facilities as described under section 237-24.9;
17. Gross proceeds from the sale of the following:
    (A) Intoxicating liquor to the United States (including any agency or instrumentality of the United States that is wholly owned or otherwise so constituted as to be immune from the levy of a tax under chapter 238 or 244D, but not including national banks) or any organization to which the sale is permitted by the proviso of "Class 3" of section 281-31 that is located on any Army, Navy, or Air Force reservation as described under section 237-25(a)(1);
    (B) Tobacco products and cigarettes to the United States (including any agency or instrumentality thereof that is wholly owned or otherwise so constituted as to be immune from the levy of tax under chapter 238 or 245, but not including national banks) as described under section 237-25(a)(2); and
    (C) "Other tangible personal property" to the United States (including any agency, instrumentality, or federal credit union thereof, but not including national banks) and any state-chartered credit union as described under section 237-25(a)(3);
18. Amounts received by petroleum product refiners from other refiners for further refining of petroleum products as described under section 237-27;
19. Gross proceeds received from the construction, reconstruction, erection, operation, use, maintenance, or furnishing of air pollution control facilities, as described under section 237-27.5, that do not have valid certificates of exemption on July 1, 2011;
20. Gross proceeds received from shipbuilding and ship repairs as described under section 237-28.1;
21. Amounts received by telecommunications common carriers from call center operators for interstate or foreign telecommunications services as described under section 237-29.8;
22. Gross proceeds received by qualified businesses in enterprise zones, as described under section 209E-11, that do not have valid certificates of qualification from the department of business, economic development, and tourism on July 1, 2011; and
23. Gross proceeds received by contractors licensed under chapter 444 for construction within enterprise zones performed for qualified businesses within the enterprise zones or businesses approved by the department of business, economic

development, and tourism to enroll into the enterprise zone program, as described under section 209E-11.

The persons and amounts for which exemption under the use tax has been suspended are as follows:

1. The leasing or renting of aircraft or keeping of aircraft solely for leasing or renting for commercial transportation of passengers and goods or the acquisition or importation of aircraft or aircraft engines by a lessee or renter engaged in interstate air transportation, as described under paragraph (6) of the definition of "use" in section 238-1;
2. The use of oceangoing vehicles for passenger or passenger and goods transportation from one point to another within the State as a public utility, as described under paragraph (7) of the definition of "use" in section 238-1;
3. The use of material, parts, or tools imported or purchased by a person licensed under chapter 237 that are used for aircraft service and maintenance or the construction of an aircraft service and maintenance facility, as described under paragraph (8) of the definition of "use" in section 238-1;
4. The use or sale of intoxicating liquor and cigarette and tobacco products imported into the State and sold to any person or common carrier in interstate commerce, whether ocean-going or air, for consumption out of State by the person, crew, or passengers on the shipper's vessels or airplanes, as described under section 238-3(g);
5. The use of any vessel constructed under section 189-25 prior to July 1, 1969, as described under section 238-3(h); and
6. The use of any air pollution control facility subject to section 237-27.5 as described under section 238-3(k).

This Act also requires that, beginning July 1, 2011, taxpayers provide information reporting on any general excise or use tax exclusions or exemptions. The Act provides some exceptions to the information reporting requirement. There will be no information reporting on amounts exempt under section 237-24(1) through (7), which includes amounts received from some types of insurance policies, gifts, compensatory tort damages, employee wages, and alimony. The Department will provide forms to gather this information.

Following are some noteworthy issues arising from this legislation:

RATE - The suspension means that currently exempt amounts such as, e.g., amounts deducted from the gross income received by a contractor (the "subcontractor deduction"), will no longer be exempt from general excise tax beginning July 1, 2011 and will be taxable at the 4% rate. However, amounts for which the general excise tax exemption is temporarily suspended under this bill will continue to be exempt from the county surcharge of 0.5%.

GRANDFATHERING - The bill specifically states that gross income from "binding written contracts entered into prior to July 1, 2011, that do not permit the passing on of increased rates of taxes" will be exempt from GE tax even if the amounts would be made taxable by the suspension of an exemption under this bill. In order to be saved from paying tax by this grandfathering clause, a taxpayer must keep several things in mind. First, the contract must not permit the increase in the tax to be passed on to the consumer. Second, the contract must be in writing. Third, the contract must be binding prior to July 1, 2011. If these three conditions are met, any change orders relating to the original contract will be treated as entered into before July 1, 2011.

ACCOUNTING METHOD ISSUE - Gross proceeds for business transactions that occur prior to July 1, 2011 could be subject to different tax rates depending on the accounting method of the taxpayer. Generally, cash basis accounting method taxpayers report their gross income in the taxable year in which payments are actually or constructively received. Generally, accrual basis accounting method taxpayers report their income in the taxable year in which all events that fix the right to receive the income have occurred and the amount of the income can be determined with reasonable accuracy.

This means that two different taxpayers entering into identical transactions could potentially pay general excise tax at two different rates. If, for instance, all events that fix the right to receive income from a contract have occurred and the amount of income can be determined with reasonable accuracy on June 30, 2011 but cash payment is actually or constructively received July 1, 2011, then a cash-basis accounting taxpayer would be subject to the 4% GE tax rate on proceeds from the contract while an accrual-basis accounting taxpayer's proceeds would be exempt. Note also that the cash-basis taxpayer's proceeds would still be exempt if they were received pursuant to a binding written contract that met the grandfathering rules discussed above.

ENTERPRISE ZONES - The bill also suspends the exemption for gross receipts from activities conducted within enterprise zones. The same grandfathering considerations should be taken into account when determining whether gross proceeds from a construction contract within an enterprise zone are exempt.

Act 105 takes effect July 1, 2011 and is repealed June 30, 2013.

For more information on this Act, please contact the Rules Office at 808-587-1577.

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