



Hawaii Tax News

Administering the tax laws for the State of Hawaii in a consistent, uniform, and fair manner

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State of Hawaii • Department of Taxation

SUMMER 2004

Tax Season Update

First, we would like to congratulate all of you who participated in the joint federal-State e-filing program for far exceeding our expectations! Last year, we had 114,120 e-filed Forms N-11. This year, we surpassed that number by mid-April and, as of the end of April, 131,333 returns had been e-filed!

In general, it seems that more taxpayers filed earlier this year than last year. Still, we collected approximately 3,900 tax documents during our annual April 20th curbside service this year which is much more than the approximately 2,700 we collected last year!

We are also happy to say that our reorganized one-stop Taxpayer Services Branch did a lot better in fielding tax inquiries than last year. On average, the number of callers who got through the telephone lines was 82%, although it dipped to 74% at one point late in the filing season.

Our new automated information service is proving to be a big hit, especially for those calling about their income tax refunds. Approximately 23% of the callers used the automated service.

That was the good news. On April 28, just 8 days after the filing deadline, we prematurely sent out 10,000 income tax bills to taxpayers, including a number to individuals who e-filed their income tax returns early in the season (which thereby created tax balances on those taxpayers' accounts) and who subsequently mailed in their payments close to the filing deadline.

We know that we can't open the mountain of mail that comes in right at the filing deadline and get all those payments processed in such a short time. What happened was that billing notices were prematurely generated, before we were able to post the corresponding payments. The results were predictable – lots of upset taxpayers.

We really heard it from all of you, but the bottom line is that we should not have sent many of those bills at that time. We did add a message to our automated information system and issue a news release to inform the public as soon as we became aware of the problem. A second income tax billing notice was sent out in early June, and only those taxpayers who receive a bill in June actually have a tax liability with us. We thoroughly apologize for this occurrence, and have already taken steps to ensure that it doesn't happen again.

Hawaii Tax Information at a Glance

Have you ever had to contact the Tax Department for or about something? If yes, did you always know what to do or who to contact?

Fortunately, we have made contact and resource information readily available to Hawaii taxpayers for a number of years. The April 2004 revision of our "Hawaii Tax Information at a Glance" brochure has just been printed and is definitely the one tax publication that you should keep handy.

This tri-fold brochure is packed with information about our website, our 24-hour forms by fax/mail service, e-filing, and more.

Do you have a tax question or problem, a problem that just can't seem to get resolved through the normal channels, or a need to learn more about running a small business? See the information about our one-stop Taxpayer Services, Taxpayer Advocate, and External Training and Outreach programs.

If you want to let us know what we're doing right or what we could be doing better, or if you want to make a suggestion or two, this brochure even lists the names, phone and fax numbers, and e-mail addresses for key Department personnel. Information about our Maui, Hawaii, and Kauai district tax offices is also included!

If you have been using an earlier version of this brochure, you'll need to get the latest revision since all of the Department's e-mail addresses have changed. Although we have been using both the old and the new e-mail addresses since the beginning of the year, the old

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The Direct Line

By Director Kurt Kawafuchi

The 2004 legislative session is over, and it has been a challenging one for my staff and I as we had to track a large number of tax-related bills. Included in this issue of the Hawaii Tax News is a summary of the tax-related bills passed by the 2004 Legislature. Unfortunately, administration proposals to increase the standard deduction and to seek penalties and injunctive relief against tax preparers who take unrealistic positions on clients' tax returns and promoters of abusive tax shelters were not passed by the Legislature.

I look forward to seeing you at one of our summer workshops which will include a discussion on the 2004 legislation.

Tax Information

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ones will soon be retired permanently.

To get your copy, download it from our website at www.state.hi.us/tax, or call our forms by fax/mail request line at 587-7572 (toll-free at 1-800-222-7572). Of course, you can also obtain a copy at any district tax office during business hours.

Summer Workshops

Planning has begun for our Summer Workshop series. The dates for the half-day workshops are:

Kauai - Tuesday, August 17, 2004

Kona - Wednesday, September 1, 2004

Hilo - Thursday, September 2, 2004

Oahu - Wednesday, September 8, 2004

Maui - Thursday, September 9, 2004

The workshops will be held from 8:30 A.M. to 12:30 P.M., and four hours of continuing professional education (CPE) credits will be offered. Attendees also will get a CD with the tax statutes and administrative rules, updated through December 31, 2003, in their workshop packets.

The information and registration flyer should be on our website at www.state.hi.us/tax in July. The price has increased, but so have our costs. It is also still very inexpensive for the number of CPE credits you get and, more importantly, we think you'll find the time spent

worthwhile.

One topic that may at first seem a little dry is an update of our Integrated Tax Information Management System. However, big changes are coming this October when the final component of the system comes on-line!

This part of the system replaces the old business tax computer system, and will have a major impact on licensing and other procedures relating to business taxes such as the general excise tax. Not only will there be a system implementation, but Phase III of the Department's planned reorganization also will occur on October 1, 2004.

Since many of you are registered for one or more of the affected taxes, we're sure that this will prove interesting and relevant to you.

Presentations also will be made on the 2004 tax legislation, licensing and tax clearance issues relating to single-member disregarded LLCs, and more!

Be sure to register soon because space is limited.

Practitioners' Forum

The Department of Taxation held its 2004 Practitioners' Forum on May 25 in the Princess Ruth Keelikolani Building. Topics which were discussed included electronic filing programs; feasibility of eliminating Form N-11 or N-12; general excise tax, transient accommodations tax, rental motor vehicle and tour vehicle surcharge tax, and withholding tax forms (including vouchers) returning to letter size; compliance issues; tax clearance issues relating to LLCs; and tax services and processing update.

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The Hawaii Tax News is a publication of the State of Hawaii, Department of Taxation.

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Practitioners' Forum

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The Practitioners' Forum is an informal meeting with Director Kurt Kawafuchi, key Department of Taxation staff members, and tax practitioners to discuss various matters, raise questions, and resolve problems and tax issues. This is not an educational workshop, but is instead an opportunity for the tax practitioner community to make their concerns known and to engage in an informal dialog with the Department about those concerns.

Cigarette Tax Rate Increase

The cigarette tax will be going up on July 1, 2004, from 6.5 cents per cigarette to 7 cents per cigarette. The new cigarette stamps are blue, and went on sale on June 1, 2004, at First Hawaiian Bank.

Packs of cigarettes with the current pink cigarette stamps affixed to them can continue to be sold after June 30th under certain circumstances. For more information, see Department of Taxation Announcement No. 2004-01, which is available on our website at www.state.hi.us/tax, by calling our request line at 587-7572 (toll-free at 1-800-222-7572), and at any district tax office.

Legislative Highlights

The following is a digest of bills passed by the 2004 Legislature. It includes only those measures which affect Hawaii's tax laws and is provided for your information. It is issued solely as a guide and is not intended to be either authoritative or complete.

Copies of the Senate and House bills passed by the Legislature may be obtained from the Senate and House printshops, or from the Legislature's website at www.capitol.hawaii.gov.

Administrative Tax Measures

ACT 123 (H.B. No. 851, H.D. 1, S.D. 1, C.D. 1)

Relating to Taxation Appeals

Makes the tax appeal procedures more fair and equitable by: (1) providing that the first appeal to either the Board of Review or the Tax Appeal Court may be made without payment of the assessed tax, and (2) allowing the

taxpayer to appeal an adverse decision made by the Board of Review or Tax Appeal Court after paying the outstanding tax assessment.

Applies to tax appeals filed on or after July 1, 2004.

ACT 113 (H.B. No. 2511, S.D. 1, C.D. 1)

Relating to Income Tax Withholding

Conforms the State withholding tax remittance due date for employers with an annual State withholding tax liability that exceeds \$40,000, to the remittance due date required under federal employment tax provisions. Also changes the State remittance due date from monthly to "semi-weekly" and lowers the electronic funds transfer threshold amount for withholding taxes to amounts that exceed \$40,000.

Applies to withholding requirements for payroll periods beginning on or after December 31, 2004.

ACT 115 (S.B. No. 2990, H.D. 1)

Relating to the Integrated Tax Information Management Systems Acquisition by the Department of Taxation

Extends the "sunset date" of the Integrated Tax Information Management Systems special fund to July 1, 2005, to provide additional time for remaining work on the Department of Taxation's computer project.

Effective June 30, 2004.

General Excise/Use Tax Measures

S.B. No. 2396, S.D. 1, H.D. 1, C.D. 1

Relating to the General Excise Tax

Exempts from the general excise tax all of the value or gross income derived by an Internal Revenue Code section 501(c) organization from fees for convention, conference, or trade show exhibit or display spaces; provided that the gross proceeds of sales by a vendor through the use of exhibit or display space at a conference, convention, or trade show shall be subject to the general excise tax.

Effective July 1, 2004.

ACT 114 (S.B. No. 2994, S.D. 1, H.D. 2)

Relating to the Use Tax

Clarifies when a seller is subject to the 0.5 percent use tax. Restores the imposition of taxes on goods purchased both within and outside the State. Clarifies that the use tax applies to sellers who acquire goods from outside the State and import the product for sale or resale in the State.

Effective retroactive to taxable years beginning after December 31, 1998.

Income Tax Measures

H.B. No. 1848, H.D. 1, S.D. 1, C.D. 1

Relating to Exceptional Trees

Establishes an income tax deduction from gross income for amounts paid by an individual taxpayer for

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expenditures to maintain an exceptional tree on the taxpayer's real property. The deduction, up to \$3,000 per exceptional tree, is allowed once every three consecutive taxable years.

Applies to amounts paid in taxable years beginning after December 31, 2003.

H.B. No. 1860, H.D. 1, S.D. 2, C.D. 1

Relating to Child Abuse and Neglect

Allows an individual whose state income tax refund for any taxable year is \$5 or more to designate \$5 of the refund to be paid over as follows:

- (1) One-third to the Hawaii children's trust fund, and
- (2) Two-thirds to be divided equally among:
 - (a) The domestic violence prevention special fund under the Department of Health;
 - (b) The spouse and child abuse special account under the Department of Human Services; and
 - (c) The spouse and child abuse special account under the Judiciary.

Applies to taxable years beginning after December 31, 2004.

H.B. No. 1904, H.D. 1, S.D. 2, C.D. 1

Relating to Taxation

Increases the allowable income tax deduction for National Guard members and reservists to amounts equivalent to pay received for forty-eight drills (equivalent of twelve weekends) and fifteen days of annual duty at stated pay grades over five years beginning in taxable year 2005.

Effective January 1, 2005.

H.B. No. 2396, H.D. 2, S.D. 2, C.D. 1

Relating to Capital Investments

- Establishes the State Private Investment Fund to provide additional financing tools to meet the growing needs of the high technology industry.
- Extends the provisions for the high technology business investment tax credit, technology infrastructure renovation tax credit, and the tax credit for research activities through 2010.
- Modifies the definition of qualified research as it relates to the development and design of computer software to provide that qualified research means the development and design of computer software for ultimate commercial sale, lease, license or to be otherwise marketed, for economic consideration. With respect to the software's development and design, the business shall have substantial control and retain substantial rights to the resulting

intellectual property.

- Removes language that the high technology tax incentives be "liberally" construed by the Department of Taxation.
- For the high technology business investment tax credit and the tax credit for research activities:
The taxpayer shall submit a written, certified statement before March 31 identifying: (1) qualified investments or expenditures, if any, made in the previous taxable year; and (2) the amount of tax credits claimed, if any, in the previous taxable year.
The Department of Taxation shall: (1) maintain information including the name, address, and the total amount of qualified investments or expenditures; (2) verify the nature and amount of the qualifying investments or expenditures; (3) total all qualifying and cumulative investments or expenditures certified; and (4) certify the amount of the tax credit for each taxable year and the cumulative amount of the tax credit.
The Department of Taxation shall issue a certificate to the taxpayer verifying the information submitted to the Department which the taxpayer will attach to the taxpayer's tax return.

- Allows the Department of Taxation to charge a fee for the issuance of comfort letters and certificates.

Effective July 1, 2004.

S.B. No. 1611, H.D. 2, C.D. 1

Relating to the Deposit Beverage Container Program

As it relates to taxation, creates a net income tax exemption for amounts received as a deposit beverage container deposit.

Effective upon approval.

ACT 89 (S.B. No. 2983, S.D. 2, H.D. 1)

Relating to Conformity of the Hawaii Income Tax Law to the Internal Revenue Code

Amends section 235-2.3(a), HRS, to conform the Hawaii Income Tax Law to the operative Internal Revenue Code (IRC) sections of subtitle A, chapter 1, amended as of December 31, 2003. Generally, subtitle A, chapter 1, refers to IRC sections 1 through 1400. For conformity purposes, the federal effective dates for amendments to operative IRC sections are adopted.

This bill conforms Hawaii's income tax law to all of the tax provisions of the Military Family Tax Relief Act of 2003, including the following:

- Above-the-line deduction for overnight travel expenses of National Guard and Reserve members.
- Special rule for excluding the gain from the sale of a principal residence for members of the uniformed services or foreign service.
- Expansion of combat zone filing rules to persons

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Legislative Highlights

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deployed outside the U.S. who are participating in contingency operations as designated by the Secretary of Defense.

Also conforms to provisions affecting medical savings accounts to the extent applicable to Hawaii taxation.

Amends section 235-2.4, HRS, relating to operative IRC sections for which the State provides specific treatment by providing that Hawaii does not conform to:

- IRC section 163(d)(4)(B) which excludes dividends from net investment income and allows those dividends to be taxed at capital gain rates.
- IRC section 168(k) which provides a 50 percent bonus depreciation and an increase of the first-year depreciation for certain passenger automobiles.
- IRC section 179(b)(1) which increases the maximum deduction to \$100,000.
- IRC section 179(b)(2) which increases the qualifying investment amount to \$400,000.
- IRC section 179(d)(1) which includes computer software in the definition of section 179 property.
- IRC section 179(b)(5) inflation adjustments.
- IRC section 179(c)(2) irrevocable election.

Applies to taxable years beginning after December 31, 2003.

ACT 97 (S.B. No. 3162, S.D. 1, H.D. 1, C.D. 1)

Relating to Renewable Energy Technologies Income Tax Credit

Clarifies that the credit is nonrefundable and that any unused credit may be claimed in subsequent taxable years until exhausted. Clarifies that financial institutions, partnerships, S corporations, estates, and trusts are eligible to claim the credit.

Applies to taxable years beginning after December 31, 2002.

ACT 140 (S.B. No. 3207, S.D. 2, H.D. 2, C.D. 1)

Relating to Ethanol Tax Credit

Changes the ethanol investment tax credit to a facility tax credit. Clarifies that the tax credit shall not exceed the amount invested in the qualifying ethanol production facility. Clarifies that the credit may be claimed in a year that the production of ethanol, on an annualized basis, is equal to at least seventy-five percent of the nameplate capacity of the facility. Clarifies the definition of "investment". Prohibits a taxpayer from claiming or receiving any other income tax credit relating to the development of the qualifying ethanol production facility for any taxable year in which the credit is claimed.

Applies to taxable years beginning after December 31, 2003.

Miscellaneous Tax Measures

VETOED (H.B. No. 2061, H.D. 2, S.D. 1, C.D. 1)

Relating to Transient Accommodations Tax

As it relates to taxation, redistributes the percentage of transient accommodations tax revenues given to each county.

Effective July 1, 2004.

ACT 96 (S.B. No. 1239, S.D. 1, H.D. 2, C.D. 1)

Relating to Energy

Reduces the tax rate on alternative fuel for operation of an internal combustion engine from 1 cent to .25 cents; and reduces the percentages that are applied to the rate for diesel oil in determining the rates for ethanol (from .29 to .145); methanol (from .22 to .11); biodiesel (from .5 to .25); and other alternative fuels, other than liquefied petroleum gas.

Effective July 1, 2004.

ACT 157 (S.B. No. 2840, S.D. 2, H.D. 2, C.D. 1)

Relating to Tobacco

Prohibits the distribution of untaxed cigarettes via telephone, mail order, the Internet, or other on-line sources to address the availability of low-priced cigarettes to underage smokers. Revises the provisions relating to the Attorney General's seizure and confiscation authority. Limits supersedeas bond amount for tobacco master settlement signatories to ensure their ability to continue to make settlement payments.

Effective July 1, 2004.

Tax-Related Resolution

H.R. No. 69, H.D. 1

Requesting the Departments of Taxation and Business, Economic Development, and Tourism to Conduct a Review and Cost Benefit Analysis of All Current Tax Incentives Under Title 14, Hawaii Revised Statutes

Requests the Department of Taxation (DOTAX) to compile data on all current tax incentives provided under title 14, Hawaii Revised Statutes, that benefit a specific person, group, or organization and does not apply to the general public. Requests DOTAX to provide the data to the Department of Business, Economic Development, and Tourism (DBEDT), which is requested to conduct a review and cost benefit analysis of all current tax incentives, with the assistance of DOTAX, Enterprise Honolulu, and the University of Hawaii Economic Research Organization. DBEDT is to include in its review and cost benefit analysis a detailed justification for each of these tax incentives.

Announcements describing the provisions of the acts will be posted on the Department of Taxation website at www.state.hi.us/tax.



Recently Issued Tax Publications

The following is a list of the publications issued by the Department of Taxation from July 2003 through June 2004. Copies of these publications may be obtained from our website at www.state.hi.us/tax. With the exception of the Reports, copies of these publications also may be obtained by calling our request line at 587-7572 (toll-free at 1-800-222-7572), or from any district tax office.

A limited number of the Reports are available for a nominal fee from our Tax Research and Planning Office. Contact them by phone at 808-587-1440 or by e-mail at Tax.Research@hawaii.gov to request an order form.

Announcement No. 2003-12 - Announces the adoption of the IRS optional standard mileage rates for 2004.

Announcement No. 2004-01 - Provides information on the increase in the cigarette tax to 7 cents per cigarette for sales, use, or possession of cigarettes after June 30, 2004.

Hawaii Tax Information at a Glance Brochure - Revised April 2004.

Digest of Tax Measures - Enacted by the State of Hawaii, Twenty-Second Legislature, Regular Session of 2003.

Reports:

- Annual Report 2002-2003
- Tax Credits Claimed by Hawaii Taxpayers - 2001
- Hawaii Income Patterns - Individuals - 2001

Pending Tax Publications

The following is a list of some of the Department's pending tax publications.

Administration of Taxes

- Application of penalties and interest and the waiver of penalties and interest - sections 231-3 and 231-39, HRS.
- Clarification of the offers in compromise process.

Income Tax Law

- Clarification of the application of the Hawaii tax credit for increasing research activities.

General Excise Tax Law

- Clarification of the general excise tax rules, including the application of the general excise tax for

reimbursements - section 237-20, HRS.

Transient Accommodations Tax

- Clarification of the application of the transient accommodations tax.

Conveyance Tax Law

- Clarification of the application of the conveyance tax.



Third Quarter State Tax Collections

January 2004 - March 2004

(In Millions of Dollars)

	<u>FY 2004</u>	<u>FY 2003</u>	<u>Difference</u>	
			<u>Amount</u>	<u>Percent</u>
Individual Income Tax	\$ 261.8	\$ 254.1	\$ 7.7	3.0%
Corporate Income Tax	12.0	-25.4	37.4	nm*
General Excise Tax	506.1	455.0	51.1	11.2%
Transient Accommodations Tax	50.2	44.0	6.2	14.0%
All Others	186.3	169.0	17.3	10.2%
Total Tax Collections	\$ 1,016.4	\$ 896.7	\$ 119.7	13.3%
General Fund Revenues	\$ 874.0	\$ 761.9	\$ 112.1	14.7%

(Note: Totals may not add up due to rounding.)

nm* = not meaningful

Total tax collections for the third quarter of fiscal year 2004 amounted to \$1,016.4 million, or \$119.7 million more than the same period of last fiscal year. General fund revenues of \$874.0 million for the third quarter also advanced \$112.1 million from last year's total of \$761.9 million. All major tax components have increased significantly as the economy continues to grow strongly. General excise tax collections jumped \$51.1 million, while transient accommodations tax collections went up by \$6.2 million. Corporate and individual income tax collections also grew by \$37.4 million and \$7.7 million, respectively.

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808-587-1418 (TDD - For the hearing impaired)

1-800-887-8974 (TDD Toll-Free - For the hearing impaired)

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808-587-7572

1-800-222-7572 (Toll-Free)