

DEPARTMENT OF TAXATION

ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period July 1, 2009 through December 21, 2009

December 21, 2009

Act 134, Session Laws of Hawaii 2009, also known as the "Cash Economy Enforcement Act" (hereinafter sometimes referred to as the "Act"), requires at Section 9 of the Act, that the Department of Taxation (Department) report the following information to the Legislature:

- 1) **The State resources committed to implementing the Cash Economy Enforcement Act; and**
- 2) **The additional revenues raised as a result of the Act.**

The report shall be submitted not later than 30 days prior to the convening of each regular session of the Legislature. This document serves as the report required by the Act.

I. STATE RESOURCES COMMITTED TO IMPLEMENTING THE CASH ECONOMY ENFORCEMENT ACT

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the cash economy, as well as high-risk and complex civil tax investigations in general. The primary focus of the Cash Economy Enforcement Act is the creation of the Special Enforcement Section, which is a specialized unit within the Department's Compliance Division. The Special Enforcement Section is comprised of civil investigators, as well as other support staff. Specifically, the Department was authorized at Section 2 of the Act (codified as Section 231-83(b), Hawaii Revised Statutes (HRS)), to utilize new hires, as well as existing labor resources to staff the Special Enforcement Section operations. Furthermore, Section 2 of the Act authorized the Department to identify the proceeds of Special Enforcement Section operations to assist in the funding of the unit. The Special Enforcement Section is allowed to identify any taxpayer, assessment, investigation, or collection matter as a matter of the Special Enforcement Section, which may then be deposited into the Tax Administration Special Fund (codified as HRS § 231-85). Within the Tax Administration Special Fund's expenditure authority, the Department is allowed to retain the first \$500,000 to fund the Section's operations, with the remaining collections being deposited into the General Fund. *See* HRS § 235-20.5, as amended by Section 4 of the Act. The Department was also provided legislative authority at Section 8 of the Act to establish six new full-time equivalent (FTE) positions that may be filled by investigators, investigator assistants, licensed attorneys, or other support staff, in addition to using current personnel. The six positions were not; however, funded in Fiscal Year 2010.

Since passage of the Cash Economy Enforcement Act, the Department has worked diligently in beginning the implementation of an entirely new operation within the Compliance

Division. In the Department's assessment, it believes that it has been successful, to date, in bringing the Special Enforcement Section online given the competing budget, compliance, and other priorities of the Department in the current economy. The Department has committed the following State resources in implementing the Cash Economy Enforcement Act—

DETAILING OF EXISTING PERSONNEL TO ACTIVATE THE SPECIAL ENFORCEMENT SECTION—To assist with the preliminary implementation of the Special Enforcement Section, the Director commissioned four¹ existing employees with expertise in compliance, auditing, collection, and tax law as Special Agents of the Special Enforcement Section. To ensure immediate integration of the Special Enforcement Section into the Department's overall operations, as well as to ensure timely deterrence in the community, utilizing existing personnel who are experts in their respective subject matters and familiar with these investigations was necessary. These individuals have been instrumental in bringing the Special Enforcement Section online.

The Department has since hired a Special Agent in an Administrative Rules Capacity. Applications are being reviewed and interviews for additional personnel began in early December to fill the remaining positions. Applicants will be notified that funding for these positions is only until June 30, 2010, unless funded in the 2010 Legislative Session.

Activities and accomplishments of these individuals, as well as other Department staff providing assistance in furtherance of the Special Enforcement Section's objectives to date, include:

- Procuring equipment and supplies;
- Drafting policies;
- Drafting administrative rules of procedure for contested case hearings;
- Drafting and procuring the cease & desist citations;
- Reviewing and selecting high-risk cases, including cash-based businesses, potential civil fraud cases, and complex collection matters;
- Procuring job vacancy announcements for Special Enforcement Section positions;
- Reviewing resumes of potential candidates. One individual was hired effective November 16, 2009;
- Administratively, keeping the Office of the Governor and the Department of Budget & Finance apprised of personnel and other administrative developments in the implementation of the Special Enforcement Section;
- Designing and activating a Special Enforcement Section website, which includes a tip line and other information about the Cash Economy Enforcement Act;
- Conducting outreach and public dissemination of information regarding the Special Enforcement Section and the Cash Economy Enforcement Act at local practitioner and Department events;

¹ One of these persons has since retired from service at the Department of Taxation. There are now three existing employees actively assisting the efforts of the Special Enforcement Section until full-time staff can be hired.

- Developing and displaying flyers and posters about the Cash Economy Enforcement Act. This information was translated into Chinese and Tagalog;
- Conducting field operation where Special Enforcement Section Agents were identifiable and integrated into the community inquiring about tax compliance and educated business persons. Field operations also included issuing warnings to business suspected to be in violation of Hawaii tax laws;
- Drafting news releases for public dissemination. Newspapers have published at least two stories on the Department's Special Enforcement Section enforcement efforts;
- Making arrangements within the Department's office configuration for the Special Enforcement Section;
- Investigating cases relevant to the Special Enforcement Section's mission, including cases involving potential fraud and underreporting of cash receipts, potential false returns, as well as complex collection matters;
- Investigation work includes drafting subpoenas for bank records as well as corporate or other entity documents, records, or agreements (*i.e.*, operating agreements or trust documents) used to avoid taxes, as well as serving subpoenas on a taxpayer and tax practitioner;
- Referral statistics for the Special Enforcement Section include both single-party case referrals, as well as multi-party, single-matter issues. There have been approximately 75 referrals regarding single-party matters. Based on the initial review of case quality to date, it appears approximately 20% of these cases merit further investigation. In the judgment of the Special Enforcement Section Special Agents, the other referrals lacked case potential. There have been two multi-party, single matter referrals. This latter category typically involves multiple taxpayers with similar tax issues relative to a single event or similar occurrence. Of the multi-party, single matter referrals, cases with optimal potential for collection will be investigated.
- Coordinating with other government agencies on matters of potential case development for the Special Enforcement Section, including the State Auditor and the Department of Land & Natural Resources. The Special Enforcement Section has also met with the Internal Revenue Service to discuss the new unit's parameters relative to IRS investigations. The Special Enforcement Section also is in the process of reaching out to other law enforcement agencies.

COMMITMENT OF FINANCIAL RESOURCES TO THE SPECIAL ENFORCEMENT SECTION—The Department has also begun expending monies to assist with the implementation of the Special Enforcement Section's mission. These expenditures include:

Category	Description	Amount
Personnel	Administrative Rules Specialist	\$1,625 to date.
Supplies	Special Enforcement Section Cease & Desist Citation Printing	\$734
Supplies	Equipment for the Special Enforcement Section	\$12,490

	TOTAL COMMITMENT OF FINANCIAL RESOURCES (as of December 18, 2009)	\$14,849
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II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

Given the size and propensity of Hawaii's cash economy, as well as other aggressive noncash tax matters that are discovered by the Department from time to time, the Department is confident that the deterrence effect if the Special Enforcement Section and the dedication of resources to these efforts will provide a significant return on the investment of general and special funds to implement this program. With all new tax compliance programs, it will take time and additional resources to fully realize this revenue generating potential. The Department anticipates that, once fully staffed and operational on a full-time basis, the Special Enforcement Section will yield considerable direct and indirect revenues for the State.

To date, the Special Enforcement Section has generated approximately \$147,000 in direct revenues. The Department estimates that approximately \$1,470,000 in indirect revenues has been generated.