

DEPARTMENT OF TAXATION

ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period July 1, 2012 through June 30, 2013

February 5, 2014

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.**

BACKGROUND

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 primarily of civil investigators. 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 taxes from 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 fiscal year 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.

ACTIVITIES AND ACCOMPLISHMENTS

Since passage of the Cash Economy Enforcement Act, the Department has worked diligently in implementing the 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 (SES) online given the competing compliance, and other priorities in the

Department in the current economy. The emphasis for this fiscal year was on educating the public on the laws as enforced by the Special Enforcement Section. An update on the activities and accomplishments of the SES include:

- Conducting outreach and public dissemination of information regarding the Special Enforcement Section and the Cash Economy Enforcement Act on Oahu, Maui, Hawaii and Kauai through industry groups and to various groups that requested meetings;
- Continuing to field complaints and information from the public to determine if there is a valid tax issue for investigation or further review by the Department;
- Conducting site visits where Special Enforcement Section Agents were identifiable. Site visits were conducted at farmers' markets, craft fairs, shopping malls, industrial parks, restaurants and other locations across the state and included issuing acknowledgment forms to vendors to inform them of potential violations of Hawaii and Special Enforcement Section tax laws;
- After contact made at the above events the Special Enforcement Section began to make contact informing non-compliant taxpayers of missing tax returns and requesting them to be voluntarily filed. The letters are to assist taxpayers who may be unaware of the missing returns and giving these taxpayers an opportunity to file without investigation;
- Through tracking of non-compliant taxpayers at time of the site visit the unit has found that there has been an increase in voluntary compliance after contact with Special Enforcement Section Agents;
- 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;
- Working with non-compliant taxpayers under investigation to voluntarily file the requested tax returns. This is vital for the continued filing of the returns by the taxpayers. It has been shown that the voluntary filers continue after the conclusion of the investigation.

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

In Fiscal Year 2013, only three investigators remained in the unit. During this fiscal year one of the investigators was named as Supervisor of the unit with oversight from Director, Frederick Pablo, and the Office Audit Branch Chief, Don Kuriki.

For Fiscal Year 2013, SES expenditures were as follows:

| Category | Fiscal Year 2012 |
|-----------------|-------------------------|
| Personnel | \$194,324.68 |
| Other Expenses | \$29,436.38 |
| Total | \$223,761.06 |

As of November 1, 2013, Fiscal Year 2014 SES expenditures were \$108,802.84 consisting of \$92,995.53 personnel and \$15,807.31 other current expenses. The expenditures increase is due to the full staffing of the unit in August 2013. At this time there are five investigators and the supervisor position filled.

The Special Enforcement Section has expanded its focus of cash-based businesses to other areas of cash-based businesses that may not be compliant with all tax laws. The main focus of the SES unit site visits have been the above named businesses. SES has begun to expand this to include several "brick and mortar" businesses. Recent visits to the neighbor islands have included site visits to these more permanent businesses and non-compliance is being found at these establishments as well. The increased staffing has allowed for an expansion of the focus on all areas of cash-based business.

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In Fiscal Year 2013, the SES generated \$679,570 in revenues.

Since July 1, 2012 through June 30, 2013, SES reports the following statistics:

| | |
|--|-------------|
| Complaints filed by anonymous persons: | 136 |
| Vendors educated as to how to comply with tax law: | 885 |
| Site visitations throughout the State of Hawaii: | 54 |
| Number of Investigations completed: | 10 |
| Number of Investigations sent to Audit: | 10 |
| Total Dollars Assessed: | \$512,055 |
| Total Dollars Secured Returns: | \$1,496,206 |
| Revenue Collected: | \$679,570 |