

DEPARTMENT OF TAXATION
ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period from July 1, 2019 through June 30, 2020

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:

- I) The state resources committed to implementing the Cash Economy Enforcement Act; and
- II) The additional tax revenues raised as a result of the Act.

The Special Enforcement Section (SES) was established to enforce the Act. Its goal is to ensure that all sectors of Hawaii's economy, especially those that conduct a significant portion of business transactions in cash ("cash economy"), pay their fair share of taxes. In FY 2016, SES was given additional responsibilities for ensuring that short-term vacation rental operators comply with the state's transient accommodations tax laws.

BACKGROUND

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the "cash economy" by educating taxpayers about their tax obligations and by conducting civil tax investigations. The Act executes its mandate through the Special Enforcement Section, which is a specialized unit within the Department's Compliance Division comprised primarily of civil investigators.

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 SES operations. Furthermore, Section 2 of the Act authorized the Department to identify the proceeds of SES operations to substantially fund the unit. The SES is allowed to identify taxes collected from any taxpayer, assessment, investigation, or collection as a matter of the SES, 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 was initially 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.

Section 8 of the Act authorized establishing 6 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. In subsequent years, the legislature incrementally authorized the Department to retain additional funds and establish additional positions, currently up to \$2,000,000 and 13 FTE positions, to support SES's operations and help with enforcement of Transient Accommodations Tax laws, codified as HRS §235-20.5.

ACTIVITIES AND ACCOMPLISHMENTS

SES's FY 2020 accomplishments include:

- Until curtailed by the outbreak of the Covid-19 pandemic, conducted 94 site visits and compliance survey campaigns at retail districts, shopping malls, industrial parks, farmers' markets, craft fairs, and single and multi-dwelling residential neighborhoods involving 698 retail, wholesale, and restaurant businesses and short-term rental establishments throughout the state. Educated business operators about Hawaii's GET and/or TAT laws. Issued written warnings for various compliance violations, and requests for inspection of books and records of non-compliant businesses. SES has found increased voluntary compliance following these campaigns.
- Reviewed 349 complaints and referrals provided by the public and other departments and utilized investigative and analytical methods to identify business operators showing indications of noncompliance with GET and/or TAT laws and evaluated for possible investigation.
- Using various investigative techniques, conducted tax investigations of varying complexities to identify income sources and determine the amount of income subject to taxation.
- Requested and secured voluntarily filed GET and/or TAT returns and tax payments. When a return could not be secured from the taxpayer, referred the matter and evidence of income subject to tax to Office Audit for assessment.
- Furthered projects on vacation rental/transient accommodation businesses utilizing publicly available and confidential database sources to develop leads on taxpayers who appear to be out of compliance with GET and TAT laws. These projects utilized new resources made available by the Tax System Modernization Program (TSM) to evaluate large amounts of data. As a result, significant numbers of leads have been and continue to be generated showing unreported and under-reported income subject to GET and TAT.
- In FY 2020, the SES-Special Project was initiated as a result of information subpoenaed from vacation rental platform Airbnb. In the 7 months since SES-SP began receiving subpoenaed information from Airbnb, over 1000 vacation rental operators were contacted resulting in approximately \$3.4 M in TAT and GET revenue collected.

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

In FY 2020, SES incurred the following expenditures to support its compliance activities:

<u>Category</u>	<u>FY 2020</u>
Personnel Costs	\$1,081,953
Other Expenses	<u>545,628</u>
Total Expenditures	\$1,627,582
No. of Staff	10

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In FY 2020, SES continued to bring significant increases in tax collected from delinquent returns it secures. This was accomplished through increased levels of compliance campaigns and surveys, education, and compliance investigations.

SES measures its tax revenue accomplishments by determining the actual tax collections that were remitted by taxpayers on delinquent returns secured. In addition, as taxpayers brought into tax compliance by SES were largely non-filers, an estimate of SES's potential impact on tax revenues was asserted. This is because had SES not brought taxpayers into tax compliance, there is a strong likelihood that their non-compliance would have continued indefinitely. The potential impact tax revenues were based on tax collections remitted by taxpayers for a post compliance period of 18 months after they were brought into tax compliance. Delinquent return period tax collections and post compliance period collections aggregate to Impact Revenue. Accordingly, SES Total Impact Revenue grew to \$10,863,288 in FY 2020, as compared with \$8,549,112 in FY 2019, \$7,973,436 in FY 2018, \$5,268,362 in FY 2017, and \$3,505,618 in FY 2016. The following is a summary of SES's FY 2019, performance measures:

	<u>FY 2020</u>	<u>FY 2019</u>
Number of Compliance Campaigns Conducted	94 *	147
Businesses Educated on Compliance of Tax Laws	698 *	1,561
Complaints Received and Reviewed	349	328
Number of Extensive Investigations Completed	559	481
General Tax ¹ Revenue Collected from Delinquent Returns	\$3,710,089	\$3,213,657
TAT Revenue Collected from Delinquent Returns	<u>2,233,720</u>	<u>1,042,091</u>
Total Tax Collected from Delinquent Returns	\$5,943,809	\$4,255,748
General Tax Impact Revenue Collected	\$7,189,003	\$6,183,255
No. of Taxpayers Remitting General Tax Payments	1,211	1,165
Average General Tax Impact Revenue Collected per T/P	\$5,936	\$5,308
TAT Impact Revenue Collected	\$3,674,285	\$2,365,857
No. of Taxpayers Remitting TAT Payments	490	282
Average TAT Impact Revenue Collected per T/P	\$7,499	\$8,390
Total Impact Revenue Collected from Taxpayers	\$10,863,288	\$8,549,112

*Numbers are reflective of the outbreak of the Covid-19 pandemic when SES compliance campaigns involving on-site business and neighborhood visits were, and continue to be, suspended

¹ Includes all tax types (general excise, individual, estate, and corporate income taxes) except for transient accommodations tax. Also, includes general excise taxes associated with transient accommodation activities.