

DEPARTMENT OF TAXATION
ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9
For the period from July 1, 2020 through June 30, 2021

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 2021 accomplishments include:

- Reviewed 271 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.
- The SES-Airbnb Special Project initiated in FY 2020, continued and expanded in FY 2021. In the 19 months since SES-SP began receiving subpoenaed information from Airbnb, over 2900 vacation rental operators/hosts have been contacted resulting in approximately \$8.8M in TAT and related GET revenue collected.
- Initiated investigations of on-line retail and service companies which had heretofore been a neglected sector of the economy, in order to ensure they paid their fair share. Due primarily to a focus on large internet companies, non-TA related GET revenue collections grew to nearly \$25M in FY 2021.

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

In FY 2021, SES incurred the following expenditures to support its compliance activities:

<u>Category</u>	<u>FY 2021</u>
Personnel Costs	\$729,708
Other Expenses	<u>310,286</u>
Total Expenditures	\$1,039,994
No. of Staff	10

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY

ENFORCEMENT ACT

In several ways, FY2021 was a breakthrough year for SES. While the persistence of the Covid-19 pandemic led to the continued suspension of field visits to businesses and vendor events, SES was still able to achieve record gains in both GET and TAT revenue collected, as well as taxes assessed.

SES Total Impact Revenue¹ grew to \$33,773,110 in FY 2021, as compared with \$10,863,288 in FY 2020. This represents a nearly 211% increase in total revenue over the previous fiscal year. Of the GET revenue collected, \$24,961,783 came from non-TA related sources. Accounting for the majority of this increase was revenue derived from SES's focus on online retailers and service companies, a heretofore neglected sector of the economy. Focusing on this sector is part of SES's on-going effort to ensure all taxpayers pay their fair share.

Regarding TAT, SES was able to pursue leads developed through publicly available and confidential database sources that identified taxpayers who were potentially not compliant with transient accommodations and general excise tax laws. In FY 2021, this effort yielded \$6,239,863 in TAT collections compared to \$3,674,285 for last fiscal year, representing a nearly 70% increase. When \$2,571,464 of GET collections related to transient accommodations are added in, total revenue attributable to SES's efforts with regard to transient accommodations amounts to \$8,811,327.

Details of SES's performance compared with the previous fiscal year are as follows:

	<u>FY 2021</u>	<u>FY 2020</u>
Number of Events Visited Throughout the State	0 *	94*
Businesses Educated on Compliance of Tax Laws	0 *	698*
Complaints Received and Reviewed	271	349
Number of Investigations Completed	522	559
General Tax ² Revenue Collected from Delinquent Returns	\$5,388,494	\$3,710,089
TAT Revenue Collected from Delinquent Returns	<u>4,834,190</u>	<u>2,233,720</u>
Total Tax Collected from Delinquent Returns	\$10,222,684	\$5,943,809

* In FY2021, the numbers for Businesses Educated on Tax Compliance, and the Number of Site Visits Throughout the State, are reflective of the suspension of SES site visits to businesses and vendor events due to the Covid-19 pandemic.

¹ SES measures its accomplishments by determining the actual tax collections that were remitted by taxpayers on delinquent returns secured by SES. In addition, SES is credited with tax collections remitted by taxpayers for a post compliance period of 18 months after they were brought into tax compliance. This is because had SES not brought the taxpayer into tax compliance, there is a strong likelihood that their non-compliance would have continued indefinitely. Delinquent period tax collections and post compliance period collections aggregate to Impact Revenue.

² Includes all tax types (general excise, individual, estate, withholding and corporate income taxes) except for transient accommodations tax. Also, includes general excise taxes associated with transient accommodation activities.

General Tax Impact Revenue Collected	\$27,533,247	\$7,189,003
No. of Taxpayers Remitting General Tax Payments	1,610	1,211
Average General Tax Impact Revenue Collected per T/P	\$17,101	\$5,936
TAT Impact Revenue Collected	\$6,239,863	\$3,674,285
No. of Taxpayers Remitting TAT Payments	656	490
Average TAT Impact Revenue Collected per T/P	\$9,512	\$7,499
Total Impact Revenue Collected from Taxpayers	\$33,773,110	\$10,863,288