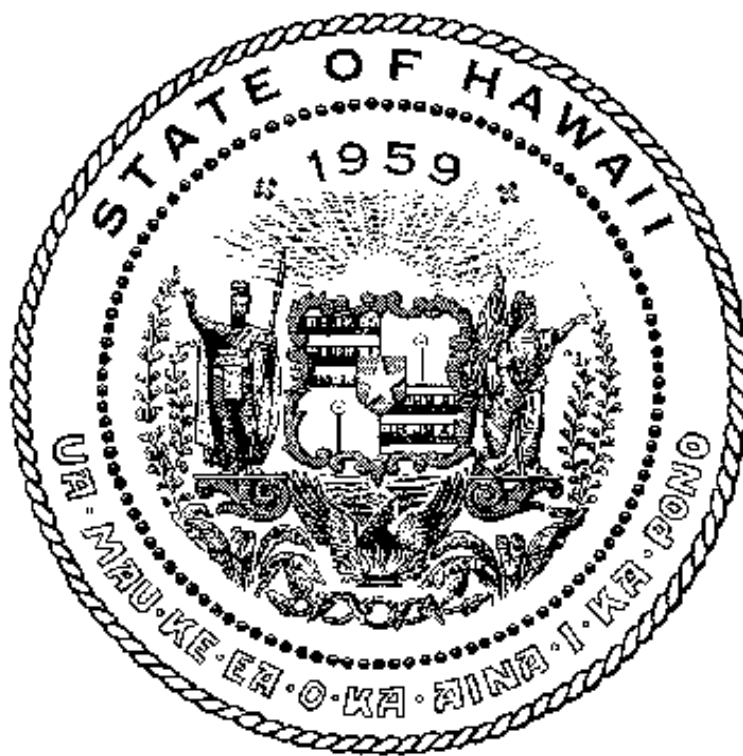


DEPARTMENT OF TAXATION STATE OF HAWAII



ANNUAL REPORT 2002-2003

October 22, 2003

The Honorable Linda Lingle
Governor
State of Hawaii

Dear Governor Lingle:

It is my pleasure to present to you this summary of the accomplishments of the Department of Taxation in the fiscal year just ended.

As I assume my duties in your administration, I take this opportunity to articulate our immediate priorities for the department. These are: (1) to enforce the collection of taxes from all taxpayers, particularly from those not in compliance; (2) to avail the department of the latest technology to increase productivity efficiency; and (3) to enhance the department's quality of customer service.

As the revenue-raising arm of state government, the department will do its utmost to ensure the receipt of the proper amount of taxes from each and every household and business in the state. We will do so in a manner that is fair and within the law. Where taxpayers have chosen to comply less than fully, we will take the necessary legal steps to ascertain and obtain each individual's obligations of citizenship.

If the department is to increase its productivity, it must keep pace with the breath-taking pace of technology. The department has migrated to an environment populated exclusively with pc's and laptops and is aggressively pushing paperless electronic filing. Although much is yet to be done, we have started on the path to reduced paper and increased electronic record keeping.

The department will take a major step forward by introducing "one-stop service". Under the management proposal, taxpayers would expect direct service from point of initial contact, with minimum referrals to other offices. This should result in quicker responses and more customer satisfaction.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kurt K. Kawafuchi". The signature is fluid and cursive, with a prominent initial "K" and a long, sweeping underline.

KURT K. KAWAFUCHI
Director of Taxation

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THE YEAR IN REVIEW

TAX SERVICES AND PROCESSING DIVISION

The objectives of the Tax Services and Processing Division are achieved through the activities of the three branches that comprise the division. These are the Document Processing Branch, the Revenue Accounting Branch, and the Taxpayer Services Branch.

The major objective of the Document Processing Branch is to efficiently process all tax returns and documents. This branch processed over 95,000 pounds or 2.6 million pieces of incoming mail, including 1.3 million payment transactions. Collections through the electronic funds transfer (EFT) program exceeded \$1.9 billion. Working through a joint electronic filing program with the Internal Revenue Service (IRS), this branch accepted and processed 113,000 electronically filed individual income tax returns for the fiscal year. This represented an increase of approximately 33,000 returns over the previous year's electronically filed total of 80,000 returns. This branch also implemented the new remittance processing system (RPS), which facilitates more efficient depositing of payments and faster availability of payment transaction information to users.

The objectives of the Revenue Accounting Branch are to maintain accurate records and to prepare timely accounting reports. This was achieved through controlling and accounting for all tax collections, adjustments, and refunds.

The primary objectives of the Taxpayer Services Branch are to provide service and disseminate information and forms to taxpayers through a variety of channels. Taxpayers can access service directly over the counter, through telephone inquiries, and via written and e-mail correspondence. In partnership with the Hawaii State Public Library System, this branch offered tax forms and brochures for public distribution at all fifty state public libraries. Each library also received the department's tax information CD-ROM and indexed binders with all 2002 income tax forms, which could then be photocopied by patrons as needed.

Taxpayers can access information and forms through the department's website. Use of the website increased markedly to 5.1 million hits compared to 3.4 million hits the previous year as more taxpayers took advantage of such convenient features as quick access to tax information and downloading of tax forms, the latest publications on tax topics, and recent tax-related legislation.

Another service delivery channel of the Taxpayer Services Branch is the forms by fax/mail service, which offers taxpayers the opportunity to direct requests for forms to "live person" rather than automated phone answering equipment. The number of calls received by this service increased 35% over the previous fiscal year. With the trend to new technology, there has been an increase in the number of inquiries received via internet e-mail and a decrease in the number of paper inquiries. The department's CD-ROM, which tax preparers find very useful, continues to allow taxpayers to input data into forms and print the completed forms.

COMPLIANCE DIVISION

The primary objective of the Compliance Division continues to be the maximization of taxpayer compliance with Hawaii tax laws. The division is composed of the Oahu Office Audit Branch, the Oahu Collections Branch, the Field Audit Branch, and the District Offices of Maui, Hawaii, and Kauai. There are four programs established in the division to meet the objective of system based on voluntary compliance and self-assessment: 1) auditing and examination; 2) returns processing and exception handling; 3) collection; and 4) taxpayer services and information dissemination.

Returns Processing – Exception Handling/Error Correction

The Oahu Office Audit Branch and the Office Audit Sections in the neighbor island district offices perform the exception handling and error correction duties for tax returns and other documents processed by the department. During the fiscal year, over 151,000 net income tax related documents were processed through error correction within the established clocking periods.

The Office Audit units also perform exception handling for general excise, use, transient accommodations, and miscellaneous tax returns. These types of returns represent the largest volume of returns processed by the department and include both periodic (monthly, quarterly, and semiannual) and annual tax returns.

Auditing/Examination

To support self-assessment and voluntary compliance, both the Office Audit and Field Audit units performed the following examinations and audits during the fiscal year:

	Number	Assessments
Total Office Audits in FY2003	1,922	\$ 6,076,673
Total Office Audits in FY2002	<u>5,176</u>	<u>34,943,444</u>
Difference	(3,254)	\$ (28,866,771)
Total Field Audits in FY2003	254	\$ 65,703,740
Total Field Audits in FY2002	<u>279</u>	<u>82,852,251</u>
Difference	(25)	\$ (17,148,511)

Decline in the number of examinations and audits can be attributed to a hiring freeze on vacant positions, assignment of personnel to the Integrated Tax Information Management System (ITIMS) project, and training time needed to familiarize personnel with the ITIMS Collection System (ICS) and ITIMS Tax Processing System (ITPS) programs.

Criminal Tax Unit

This unit obtained indictments and complaints against 30 individuals and four corporations. These activities resulted in \$42,500 in judicial fines and tax assessments in excess of \$2.3 million.

Taxpayer Assistance

During the fiscal year, division staff provided taxpayers with 126,000 instances of telephone assistance and nearly 70,000 instances of assistance via correspondence. On the neighbor islands, Compliance Division staff provided over 53,500 instances of taxpayer assistance over the counter and assisted with over 6,900 tax clearances. Providing taxpayer assistance is part of the division's emphasis on maintaining taxpayer willingness to accurately and voluntarily comply with state tax laws.

Special Projects

The Oahu Field Audit Branch has pursued its federal contractors project since 1996. During the 2003 fiscal year, the branch completed 25 audits resulting in \$1.9 million in assessments and \$0.9 million in collections. This branch's Mainland Audit Project sent nine field auditors to conduct 55 audits in various states. Thus far, 31 cases have been closed with \$7.6 million in assessments and \$3.2 million in collections. The remaining 24 cases are projected to produce nearly \$4 million in assessments.

The Hawaii District Office continued its public service company compliance project begun in 1998. During the fiscal year, two cases were assigned and one closed with assessments of \$12,698 and collections of \$58,957.

Delinquent Tax Collections

The Oahu Collections Branch and the Collections Sections in the Maui, Hawaii, and Kauai District Offices operated the Compliance Division Tax Enforcement Program and achieved several positive increases in key performance measurements. Most notable was a 43.1% increase in the amount of cash collected for delinquent taxes from \$113.1 million in fiscal 2002 to \$161.9 million in fiscal 2003.

<u>Measurement</u> (dollar amounts in millions)	<u>FY 2003</u>	<u>FY 2002</u>	<u>Difference</u>	<u>% Change</u>
Total Delinquent Tax Balance	\$ 329.5	\$ 302.8	\$ 26.7	8.8%
Total New Delinquent Referrals	\$ 189.9	\$ 183.6	\$ 6.3	3.4%
Total Cash Collected	\$ 161.9	\$ 113.1	\$ 48.8	43.1%
Uncollectible Tax Write-offs	\$ 1.3	\$ 3.9	(\$ 2.6)	(66.7%)
Payment Plans Instituted	9,282	6,215	3,067	49.3%
Tax Liens Filed	2,455	2,449	6	0.2%
Levies Served	1,795	2,070	(275)	(13.3%)

STAFF OFFICES

Administrative Services Office

Fiscal Office

The Administrative Services Office submitted the fiscal biennium budget for fiscal years 2004 and 2005 to the 2003 legislature. For fiscal year 2004, the department was appropriated \$18.3 million.

In carrying out its duties, the Department of Taxation incurred operating expenditures of \$18.3 million for fiscal year 2003. Total taxes collected and administered by the department rose by \$227 million, while operating expenditures increased by only \$0.2 million. As a result, the cost to collect \$100 of taxes decreased from \$0.48 in fiscal 2002 to \$0.46 in fiscal 2003.

Personnel Management

For fiscal 2003, the department was authorized 335 positions, down from 343 the previous year. One half-time position was authorized in the Compliance Division and another half-time position was authorized in the Tax Services and Processing Division. Employees were geographically distributed as follows: Oahu, 269; Hawaii, 28; Maui/Molokai 24; and Kauai, 14.

Personnel actions included 16 new civil service hires, 15 retirements, 111 temporary hires, 11 promotions, 11 transfers, and six resignations. Other personnel actions included temporary assignments of employees to higher levels to provide services for employees temporarily assigned to the ITIMS project.

STAFFING PATTERN (Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Headquarters Administration	43	40	40
Tax Services and Processing Division	97½	99	99
Compliance Division	<u>194½</u>	<u>204</u>	<u>204</u>
TOTAL	335	343	343

Employees participated in various training programs to expand their professional skills, thus increasing their efficiency and effectiveness in operations. In total, the Personnel Office recorded 305 training sessions attended by departmental employees during the fiscal year.

Rules Office

The Rules Office is currently comprised of the Rules staff, the External Training and Outreach Section, and the Technical Section.

Rules Staff

The Rules staff serves as the department's advisory arm to the director of taxation on tax policy. In addition to drafting and analyzing Hawaii tax proposals, the Rules staff develops Hawaii tax policy through rules, tax information releases, announcements, directives, and other publications.

For the 2003 legislative session, the Rules staff submitted seven administration-sponsored bills. After reviewing approximately 3,000 bills that were introduced in both houses of the legislature, the Rules staff determined that 353 of them proposed tax law changes and analyzed them in depth. Staff members prepared 229 written testimonies for hearings scheduled by legislative committees, 123 for the Senate and 106 for the House. The Rules staff submitted comments to the governor on 15 acts passed by the legislature.

Also during the fiscal year, the Rules staff prepared letters for the governor and the director, 19 announcements, and three tax information releases. The Rules staff also requested approval to hold a public hearing on rules amending chapters 18-237D (transient accommodations tax) and 18-247 (conveyance tax) and worked on rules amending chapter 18-237 (general excise tax).

The Rules staff also testified at legislative committee hearings on behalf of the director, reviewed rules of other agencies, and provided training for department employees and spoke at several workshops for practitioners.

External Training & Outreach

The newly created External Training and Outreach section, under the direct supervision of the Rules Officer, formally incorporates the functions of the pilot Team T.E.A.C.H. (Taxpayer Education and Awareness for Compliance in Hawaii) program. In addition to the External Training and Outreach staff, the Team T.E.A.C.H. program includes representatives on each of the neighbor island district tax offices who may give presentations as their regular duties permit.

External Training and Outreach drafts articles regularly appearing in newsletters and other publications issued by professional and business organizations and other government agencies, provides tax forms and other materials to educators, and teaches classes and gives presentations on tax topics and issues in cooperation with other government agencies, nonprofit organizations, industry and professional organizations, and other parties requesting educational presentations.

Almost 1,500 individuals directly benefited from presentations given by External Training and Outreach during the 2002-2003 fiscal year, and many more indirectly.

Beginning in 2002, External Training and Outreach assumed responsibility for coordinating the department's semiannual workshops on Oahu, Maui, Hilo and West Hawaii on the island of Hawaii, and Kauai. Over 300 people attended the Summer Workshop 2002, and almost 400 attended the Year-End Workshop 2002.

Technical Section

The Technical Section became part of the Rules Office in 2002, consolidating in one office the employees that provide assistance on complex technical questions to the public, practitioners, and department employees.

In addition to answering questions raised in telephone calls, emails, and letters, the Technical Section develops and revises tax forms and instructions to incorporate annual changes in the Hawaii tax law and federal tax law. During the past year the Technical Section reviewed 209 tax forms and 38 instructions and developed 14 new tax forms and five new sets of instructions.

The Technical Section is also responsible for reviewing applications for certain tax exemptions. Staff members approved 162 nonprofit (general excise tax) applications and 2,963 conveyance tax exemptions.

System Administration Office

In response to the need to make the transition to the new Integrated Tax Information Management System (ITIMS) as smooth as possible and to insure proper coordination of all parts of the system, the department created the new System Administration Office. The overall system administrator is assisted by four process system administrators focusing on these areas: collections, customer inquiry, intake, and audit.

Information Technology Services Office

The Information Technology Services Office (ITSO) is responsible for the development, modification, and maintenance of the Department's computerized tax systems and components. ITSO worked on several projects, with most of its efforts and resources focused on the Integrated Tax Information Management System (ITIMS) project.

Continuing into its fourth year, the five-year ITIMS project is developing and implementing an integrated client/server system to replace the existing Comprehensive Net Income Tax (CNIT) and General Excise, Withholding, Transient Accommodations, and Rental Vehicle/Tour Vehicle Surcharge Tax (GEW/TAT) mainframe computer systems. The old CNIT system was replaced in November 2002 with the successful implementation of the new ITIMS Tax Processing System (ITPS) for Comprehensive Net Income Taxes. The 2003 tax season was processed entirely using the new ITPS client/server system. Additionally, a read-only replacement was created to provide the department with reference to historical information.

The ITPS development also involved several other interrelated systems and projects. The ITIMS Collection System (ICS) was modified significantly to integrate into ITPS. The Federal Refund Offset project was implemented in June 2003 and enables the department to participate in the federal Treasury Offset Program (TOP) with the IRS. This program further automates revenue collection by applying delinquent state income tax debts that meet set requirements against federal income tax refunds. A Remittance Processing System (RPS) implemented in January 2003 uses imaging technology to enable payment vouchers to be electronically captured and

processed by the ITPS and GEW/TAT systems. RPS reduces the time delay between depositing payments to the bank and recording payments into the ITPS accounting system.

Another set of initiatives concentrated on the department's electronic filing programs. The Federal/State Joint Electronic Filing (JELF) program again certified more software developers for participation. This, coupled with more awareness of the program, resulted in a large increase in the number of electronically filed N-11 returns (112,029 vs. 79,498) during the fiscal year. The Internet Electronic Filing (ELF) program continues to provide taxpayers with opportunities to file and pay their taxes online. At the close of the fiscal year, there were 14,504 taxpayers registered with the website and 17,167 (more than four times last fiscal year) tax forms filed. A Bulk Filing program was implemented in November 2002, enabling entities that file large volumes of tax forms the capability to send the information through the department's web site. Other improvements to the department's web site included better taxpayer privacy through a "Clear Form" button for downloadable tax forms with writable fields and conformity of the alphabetical listing of tax forms with American Disability Act (ADA) guidelines and specifications. In an ongoing effort to save costs in printing and mailing tax booklets, taxpayers who electronically filed their N-11 or N-13 were sent mailing labels instead of tax booklets for tax year 2002. This resulted in a reduction of over 80,000 tax booklets.

Technical infrastructure and network resources continue to be improved in support of departmental users in all district offices. Obsolete mainframe access technology was phased-out and replaced with newer technology, Internet Protocol (IP) on the mainframe and IP printing, to access the GEW/TAT system and other mainframe resources. Ongoing support is provided to the department and ITIMS project with research, procurement, installation, configuration, testing, implementation and training of new advancements in technology, including: Windows-based operating systems; software and hardware upgrades; redundancy; connectivity and security improvements.

Already in progress for the next fiscal year are development of ITPS for the GEW/TAT system replacement, upgrades to operating systems, and conversion of the departmental e-mail system. Planning for direct deposit of refunds and an Interactive Voice Response (IVR) system is also underway.

Tax Research and Planning Office

A major function of the Tax Research and Planning Office (TR&P) is to provide the legislature with estimates of tax revenue impact of all bills affecting state taxes. For the 2003 legislative session, TR&P analyzed 331 proposals relating to taxation.

Another major TR&P function is to provide technical support to the Council on Revenues, which consists of seven community experts who provide the state with projections of state general fund tax revenues and state total personal income. This information is used to determine the State's general fund expenditure limits. The Council estimated a 1.8% increase in general fund tax revenues for fiscal 2003 and a 3.8% growth for total personal income in calendar 2002. Actual general fund tax revenues of \$3,182.0 million for fiscal 2003 represented a 4.4% increase over fiscal 2002. Excluding unforeseen technical factors, the comparable growth rate for FY2003 was

approximately 2.5%. Total personal income for calendar 2002 amounted to nearly \$37.4 billion, representing a 5.0% growth from the previous calendar year. The Council has indicated that the economy was growing better than expected, as construction output improved significantly.

A third major TR&P function is the preparation of the department's research and statistical reports, including this annual report. In April 2003, TR&P drafted its annual study entitled, "Tax Credits Claimed by Hawaii Taxpayers (2001)". This study noted the dramatic increase in certain tax credits, especially the high technology and research credits. The new residential remodeling credit also contributed to an increase in total tax credits claimed, which rose to \$114 million from \$93 million the previous year.

In May 2003, TR&P drafted its other major annual statistical study, "Hawaii Income Patterns – Individuals (2001)". This study noted a decline in tax liability from the prior year due primarily to the implementation of the second stage of a three-stage reduction in individual income taxes. Also noted was a sharp decline in income from capital gains.

Taxpayer Advocate

The Department of Taxation's Taxpayer Advocate provides a one-stop service for taxpayer concerns that cannot be resolved through normal channels. Currently, the Taxpayer Advocacy Program is a one-person operation with its main focus on the needs of the taxpayer on a case-by-case basis. Due to the recent reorganization of the department, the Taxpayer Advocate officially became a part of the Director's Office. The position is still under review by Department of Human Resources.

For fiscal year ending 2003, the advocacy program assisted 136 taxpayers with the resolution of their tax matters. Problems can consist of erroneous billings, non-receipt of refunds, waiver requests for penalty and interest, verifications of tax liabilities, explanations of letters and assessments, non-filed returns, collection issues, delay in responses to inquiries, and general tax information. Additional cases did not require direct intervention by the advocate and were resolved by guiding the taxpayer to the right management personnel.

During the tax season, personnel from the Department of Taxation and the Internal Revenue Service's Wage and Investment Division, Field Assistance, Area 6 held outreach services in Kaunakakai on the island of Molokai and Waianae on the island of Oahu. The Taxpayer Advocate coordinated the department's partnership in this joint outreach venture that provides tax services to communities that do not normally have access to these services. A variety of tax services were provided such as acceptance of the general excise tax license applications, explanation of assessment notices, arrangement of payment plans, acceptance of requests for waiver of penalties and interest amounts, preparation of individual income tax and general excise tax returns, and answering tax questions.

In general, the majority of the taxpayers are satisfied with the outcome of their cases, regardless of whether a decision was made in their favor. The Taxpayer Advocacy program has focused on taxpayer needs while maintaining taxpayer confidence that the department will administer Hawaii's tax laws in a consistent, uniform and fair manner.

MANAGEMENT PERSONNEL

OFFICE OF THE DIRECTOR

Director of Taxation.....Kurt Kawafuchi
Deputy Director of Taxation.....Marie Laderta

STAFF OFFICES

Rules Officer.....Grant Tanimoto
Tax Research & Planning Officer.....Francis Okano
Information Technology Services Officer.....Clay Sato
Administrative Services Officer.....Warren Higashi
Personnel Officer.....Alexandra Nakamura

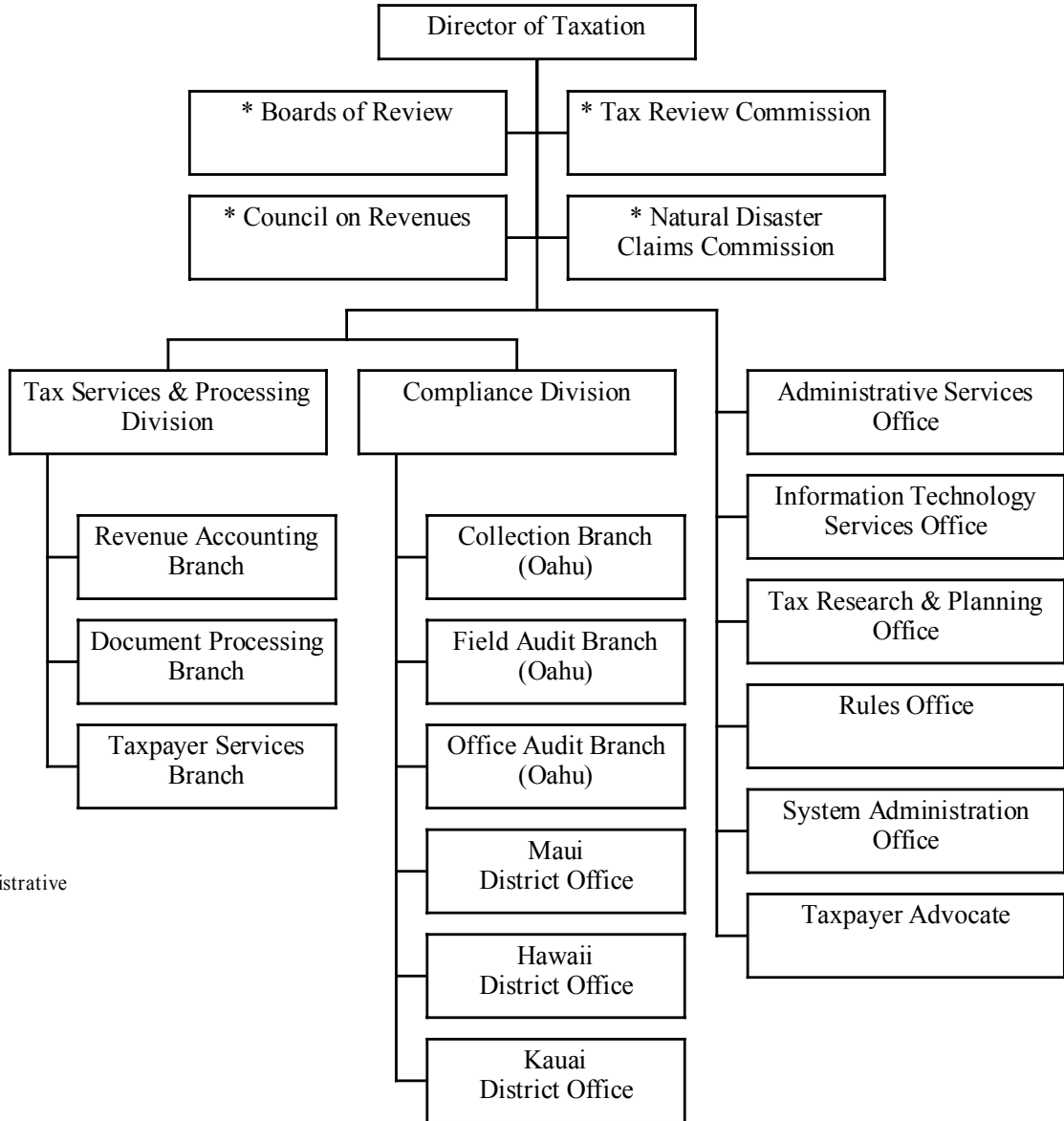
OPERATIONS STAFF

Compliance Division Chief.....Wayne Kinoshita (acting)
Tax Audit Technical Coordinator.....Richard Chiogioji
Tax Collection Technical Coordinator.....Wayne Kinoshita
Oahu Field Audit Branch Chief.....Judy Chan (acting)
Oahu Office Audit Branch Chief.....Jill Yamasaki
Oahu Collection Branch Chief.....Lynne Kaneta
Maui District Tax Manager.....Karie Klein
Hawaii District Tax Manager.....Ronald Yabe
Kauai District Tax Manager.....Ernest Balderas

Tax Services and Processing Division Chief.....Jerry Ebesu (acting)
Taxpayer Services Branch Chief.....Annette Yamanuha (acting)
Document Processing Branch Chief.....Jerry Ebesu
Revenue Accounting Branch Chief.....Deanne Obatake

ORGANIZATION CHART

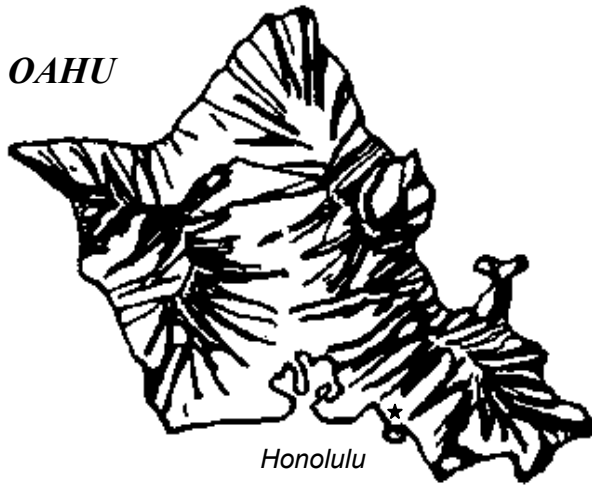
Department of Taxation
State of Hawaii



* For Administrative Purposes

FIRST TAXATION DISTRICT

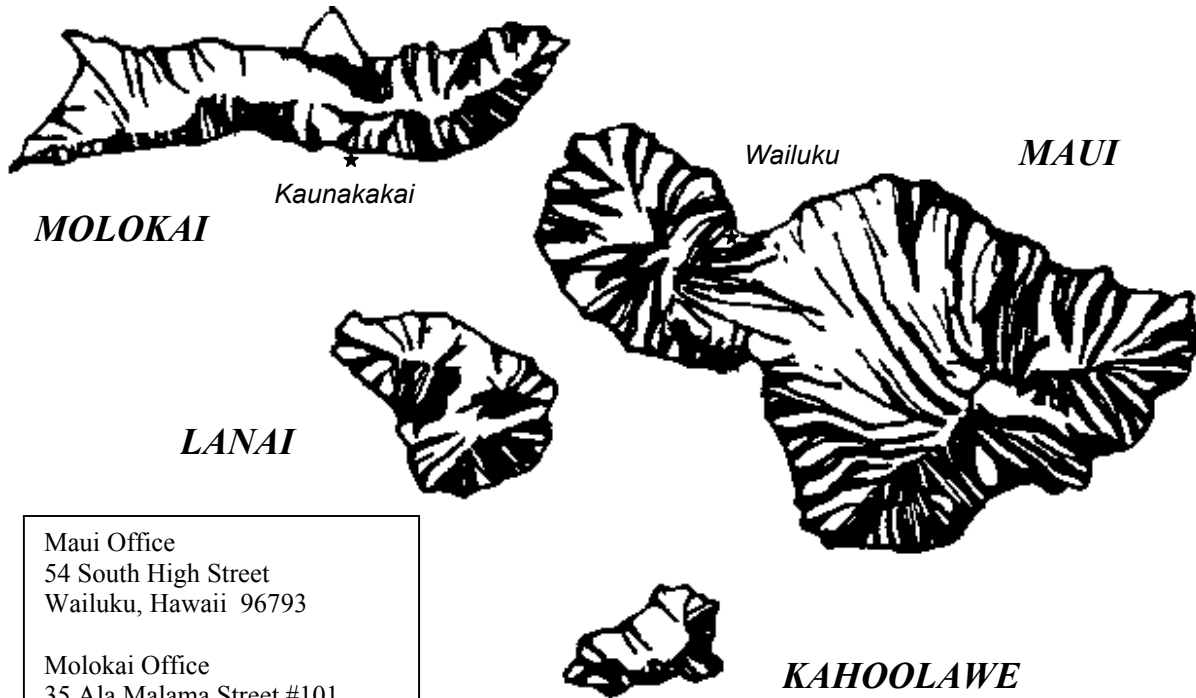
Island of Oahu



Oahu Office
830 Punchbowl Street
Honolulu, Hawaii 96813

SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



Maui Office
54 South High Street
Wailuku, Hawaii 96793

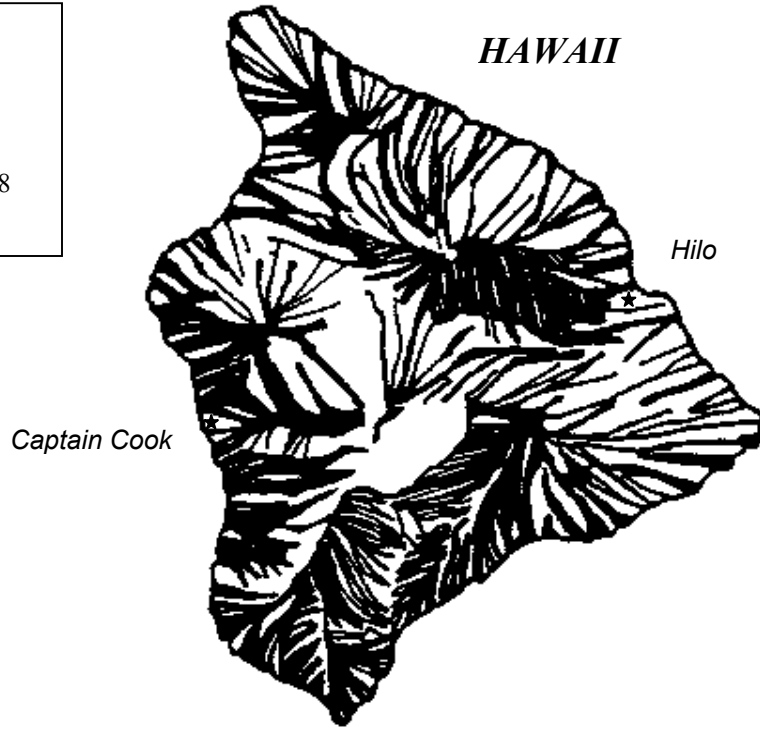
Molokai Office
35 Ala Malama Street #101
Kaunakakai, Hawaii 96748

THIRD TAXATION DISTRICT

Island of Hawaii

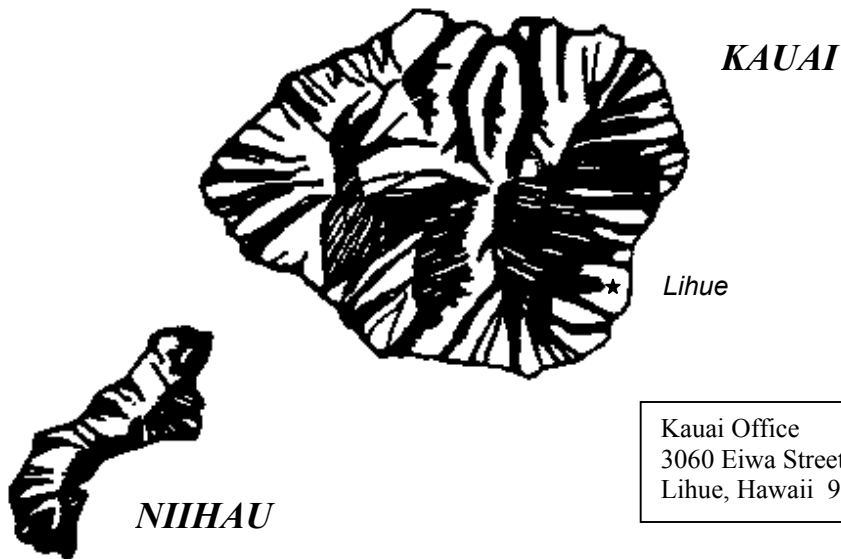
Hilo Office
75 Aupuni Street
Hilo, Hawaii 96720

Kona Office
82-6130 Mamalahoa Highway #8
Captain Cook, Hawaii 96704



FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau



Kauai Office
3060 Eiwa Street #105
Lihue, Hawaii 96766

TAX APPEALS AND LITIGATION

BOARDS OF REVIEW

Each taxation district has a Board of Review consisting of five members. Tax disputes that are not resolved at the district tax office level may be presented to the Board of Review. A summary of the number of appeals before the boards by tax district follows:

	<u>Oahu</u>	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals Pending – Beginning	70	13	4	0	87
New Appeals Filed	41	1	3	1	46
Appeals Settled	35	0	3	1	39
Appeals Pending – Ending	76	14	4	0	94

COURT DECISION

Darick v. Kamikawa, et al., Civil No. 02-15597, United States Court of Appeals for the Ninth Circuit

Warren J. Darick (“Darick”) appealed to the United States Court of Appeals for the Ninth Circuit (“Ninth Circuit Court of Appeals”), challenging the United States District Court’s (“USDC”) holding that the Tax Injunction Act, 28 U.S.C. § 1341, deprived the USDC of jurisdiction because the state court provided “plain speedy and efficient” remedies and dismissing his action for declaratory and injunctive relief. The Ninth Circuit Court of Appeals summarily affirmed the decision of the USDC.

CRIMINAL CASES

During fiscal year 2003, the Criminal Justice section of the Department of the Attorney General filed five complaints against two corporations and three individuals and 30 indictments against two corporations and 28 individuals. Taxes, penalties, and interest from these actions totaled \$2,349,198.

A significant case involved a former convicted person, Richard Basuel of RB Tax Service, for multiple felony violations involving false preparation of client tax returns. Trial is scheduled for July 14, 2003. The investigation of Mr. Basuel uncovered a widespread scheme where his clients were receiving refunds of state tax withholdings because their wages were excluded from income. As a result, at least ten individuals were indicted and have pleaded “no contest” to filing false income tax returns.

The monetary total mentioned earlier does not represent the total revenue recovery value of the criminal justice section. A principal function of criminal enforcement of tax laws is to create a deterrence factor. Revenue gained through the deterrence factor is not easily measurable. For example, a taxpayer recently offered to file tax returns for the past 12 years and pay taxes and interest exceeding \$800,000, provided he would not face criminal prosecution and would receive a waiver of penalties for late filing. Such instances of voluntary compliance occur often but are not routinely recorded and tracked unless the tax liability involved is unusually high.

Other Matters Closed

Appeals	6
Bankruptcies	234
Foreclosures	30
Subpoenas	19
Opinions	5
Contracts	6
Legislation	395
Miscellaneous	15

Amounts Collected

Tax Appeals	\$	1,105.92
Foreclosures	\$	206,437.19
Bankruptcies	\$	5,873,868.74
Criminal	\$	3,066.11
Miscellaneous	\$	<u>223,315.55</u>
Total	\$	6,307,793.51

LEGISLATION

The 2003 legislature enacted the following tax-related measures:

<u>Act</u>	<u>Brief Description</u>
14	Corrects an inadvertent effect of Act 190, SLH 2002, which reduced the percentages used to determine the required estimated tax annual payments for individuals with adjusted gross incomes of more than \$50,000. Ensures that all taxpayers are treated equally by applying the same percentages for determining the required estimated annual payments to all taxpayers, regardless of adjusted gross income. For taxable years beginning after December 31, 2002, an individual taxpayer may avoid the estimated tax underpayment penalty by paying the lesser of: (1) 60% of the current year's liability; or (2) 100% of the preceding year's liability. Allows department to grant extensions of time to file tax returns for a period of more than six months in exceptional circumstances. Applicable to taxable years beginning after December 31, 2002.
77	Enhances the attorney general's ability to monitor, enforce, and administer the Master Settlement Agreement and cigarette tax stamp program, gray market, and tobacco reporting requirements under state law. Requires each tobacco product manufacturer whose cigarettes are sold in Hawaii to certify to the attorney general that it is either a "participating manufacturer" with respect to the Tobacco Master Settlement Agreement or in full compliance with the agreement. Requires the attorney general to maintain a directory of all certified manufacturers. Effective May 20, 2003.
100	Establishes a nonrefundable, carry-forward tax credit for qualified costs incurred for the development of attractions and educational facilities at the Ko Olina Resort and Marina or the development of a training and educational facility at the Makaha Resort (excludes costs for land acquisition). Provides a tax credit equal to 100% of qualified costs incurred during the six-year period from June 1, 2003 through May 31, 2009, up to a maximum of \$75 million in aggregate. Allows credit to be claimed for tax years beginning after December 31, 2004, but limits aggregate credit claims to a maximum of \$7.5 million per year. The credit may be used to offset net income, general excise, transient accommodations, use, public service company, franchise, or insurance premium taxes. Requires all qualified taxpayers to submit a written report to the Department of Business, Economic Development, and Tourism (which will verify and certify claims) by March 31 of each year following a year in which qualified costs were incurred. Applicable to costs incurred after May 31, 2003.
113	Provides that transient accommodations tax revenues for the Hawaii Statewide Trail and Access Program be deposited into the Special Land and Development Fund established by section 171-19, HRS, from which expenditures for the trails and access program can be made. Effective May 30, 2003.

- 135 Amends or repeals obsolete tax provisions. Repeals references to “retailing” activity throughout chapter 237, HRS, and replaces them with a single definition of “retailing”. Repeals general excise tax exemption for locally produced agricultural, meat, and fish products, which was found to violate the U.S. constitution. Repeals the general excise tax exemption for producers of motion picture or television films, which sunset on July 1, 1976. Repeals all references to the county general excise and use tax surcharge, which none of the counties chose to enact. The deadline for enactment of such a surcharge was December 31, 2002. Effective June 4, 2003.
- 136 Allows tax director to accept, without the governor’s approval, offers in compromise when the tax liability, exclusive of penalties and interest, is \$50,000 or less. Requires the Department of Taxation to post certain information regarding the terms of the offer in compromise on its internet website five days before the tax director may accept the offer. Authorizes the department to grant remissions of penalty and interest regardless of whether tax is delinquent for more than 90 days. Allows tax director to appoint tax criminal investigators. Effective June 4, 2003.
- 172 Conforms Hawaii tax laws to the following federal tax law changes: (1) expansion of the income exclusion for qualified foster care payments; (2) closing of a loophole used by shareholders of bankrupt S-corporations; (3) limitation on the use of non-accrual experience method of accounting; (4) extension of the Archer Medical Savings Account program through December 31, 2003; (5) clarification that the limit for catch-up contributions applies to all qualified retirement plans, SEPs and SIMPLE plan maintained by the same employer on an aggregated basis, as if all plans were a single plan; and (6) above-the-line deduction for expenses incurred by elementary and secondary teachers for materials used in the classroom. Note: Does not conform to bonus depreciation and expansion of net operating loss carry-back periods. Applicable to taxable years beginning after December 31, 2002.
- 173 Authorizes Hawaii to participate in multi-state discussions relating to the Streamlined Sales Tax Project (SSTP). Provides that a certified service provider serving as an agent to a seller to collect and remit sales and use tax is liable for the sales and use taxes due each member state on all sales transactions it processes for the seller. Provides that a seller is not responsible for the sales or use taxes imposed on transactions processed by the certified service provider, unless the seller misrepresented the types of items it sells or committed fraud. Effective when Hawaii becomes a member of SSTP.
- 177 Consolidates the tax stamp fees collected for the enforcement of the cigarette tax with the monies received for enforcement of the Tobacco Master Settlement Agreement and further refines the laws relating to the agreement. Effective June 30, 2003.
- 179 Repeals the exemption from administrative fees charged by the director of budget and finance to administer the cigarette tax stamp enforcement special fund, the cigarette tax stamp administrative special fund, and the tobacco enforcement special fund.

- Makes an appropriation to the department of taxation for fees relating to the cigarette tax stamp administrative special fund. Effective July 1, 2003.
- 193 Allows an individual whose state income tax refund for any taxable year is \$2 or more to designate on the state income tax return that \$2 of such refund be deposited into the state library special fund (\$4 in the case of a joint return of a husband and wife). Applies to taxable years beginning after December 31, 2003.
- 207 Establishes a nonrefundable income tax credit for renewable energy technology systems installed after June 30, 2003 and based on wind, solar thermal, or solar photovoltaic energy. Does not extend tax credits for heat pumps and ice storage systems, which sunset on June 30, 2003. Effective July 1, 2003, to be repealed on January 1, 2008.

INCOME ASSESSMENT AND AUDIT

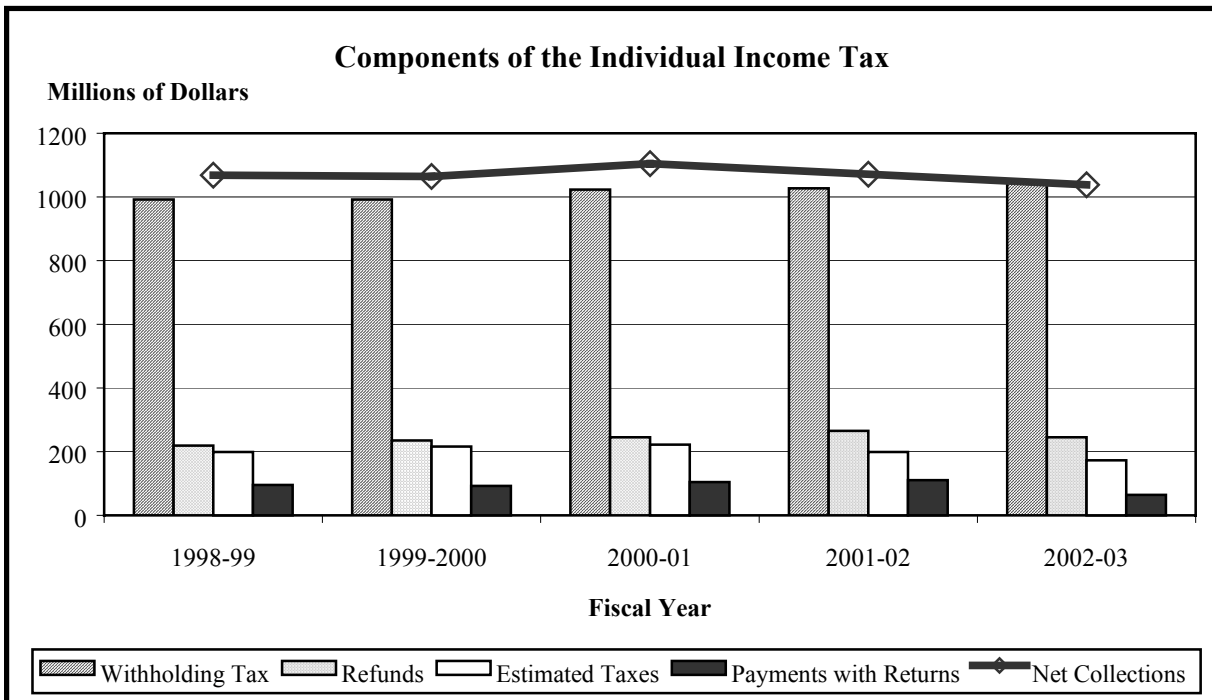
INDIVIDUAL INCOME TAX

Individual income tax revenue declined by 3.1% despite a 1.9% increase in taxes withheld on wages. Estimated tax declarations fell 13% and payments with returns declined by \$47 million. The final stage of the three-stage reduction of personal income taxes promulgated by Act 157, SLH 1998, took effect for tax year 2002 and impacted the growth rate of the withholding tax on wages in fiscal 2003.

TAXES PAID BY INDIVIDUALS (In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 173,245	\$ 199,376	\$ (26,131)	(13.1)
Payment with Return	64,196	110,984	(46,788)	(42.2)
Withholding Tax on Wages	<u>1,046,183</u>	<u>1,027,031</u>	<u>19,151</u>	<u>1.9</u>
Subtotal	\$ 1,283,624	\$ 1,337,391	\$ (53,768)	(4.0)
Refunds	<u>245,516</u>	<u>265,801</u>	<u>(20,284)</u>	<u>(7.6)</u>
NET	<u>\$ 1,038,107</u>	<u>\$ 1,071,591</u>	<u>\$ (33,484)</u>	<u>(3.1)</u>

NOTE: Due to rounding, details may not add to totals.



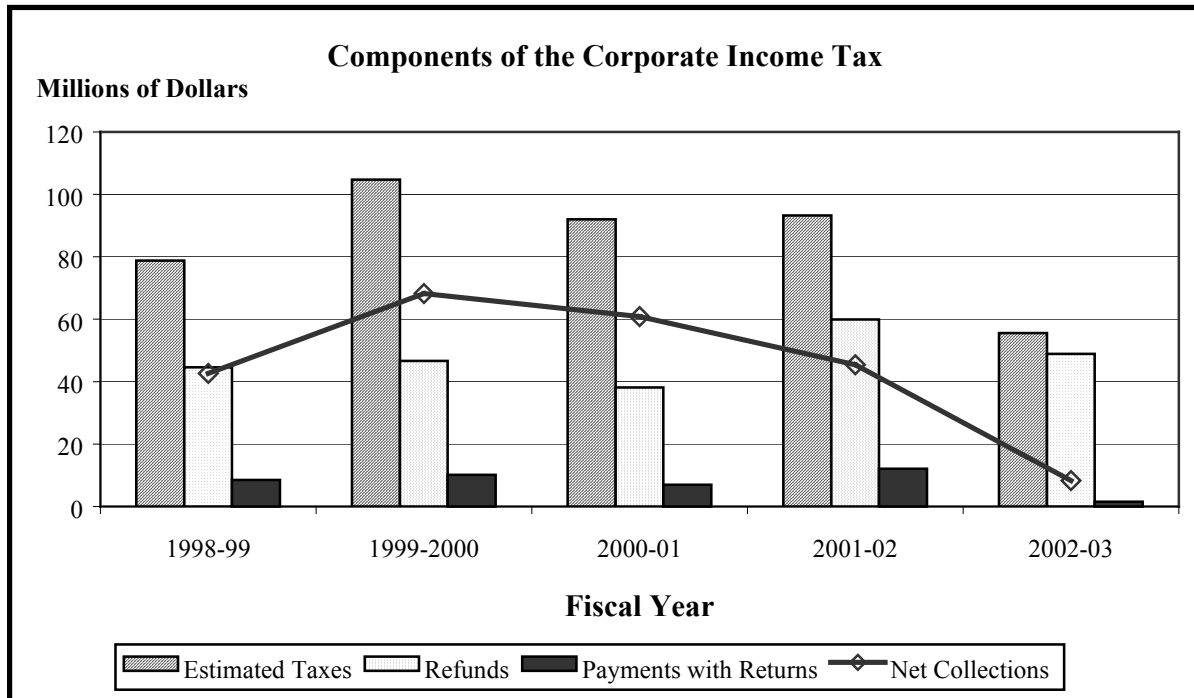
CORPORATE INCOME TAX

Net corporate income tax revenue plunged to \$8.3 million in fiscal 2003 from \$45.5 million the previous year. Since many larger corporations file late in the tax season, they filed their 2001 income tax returns in fiscal 2003. These returns were affected by three major factors that negatively affected income: 1) business declines in the aftermath of the September 11, 2001 disaster; 2) claims for the expanded research tax credit, many of which were filed on amended returns; and 3) the devastating effect of the bear market on 2001 portfolio income when compared to 2000.

TAXES PAID BY CORPORATIONS (In Thousands of Dollars)

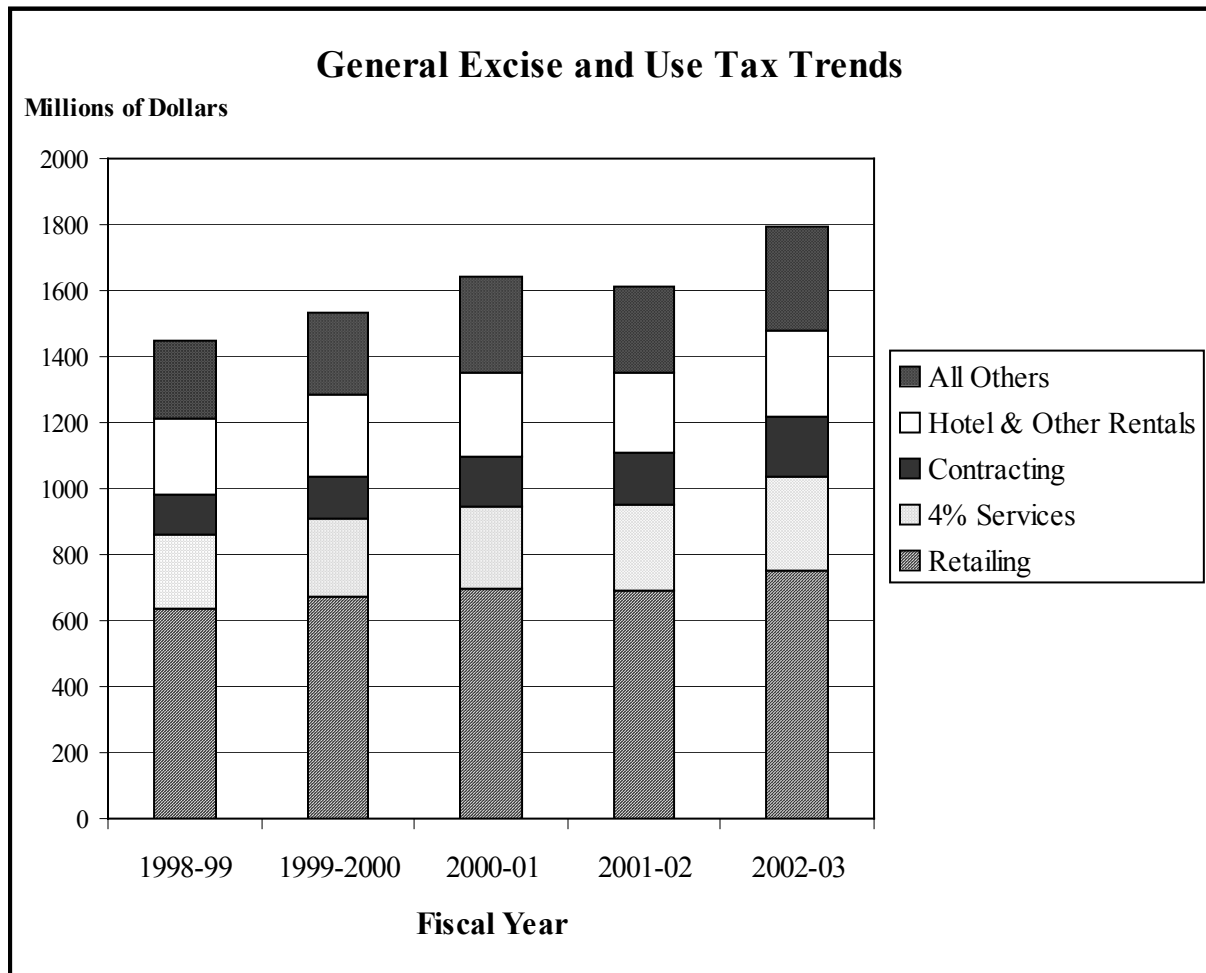
	FY2003	FY2002	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 55,609	\$ 93,239	\$ (37,630)	(40.4)
Payment with Return	1,544	12,092	(10,548)	(87.2)
Subtotal	\$ 57,153	\$ 105,331	\$ (48,178)	(45.7)
Refunds	48,890	59,854	(10,964)	(18.3)
NET	<u>\$ 8,262</u>	<u>\$ 45,477</u>	<u>\$ (37,214)</u>	<u>(81.8)</u>

NOTE: Due to rounding, details may not add to totals.



GENERAL EXCISE AND USE TAXES

Fiscal 2003 general excise and use tax revenue increased by 11.2% over fiscal 2002. Since larger businesses must file general excise and use tax returns on a monthly basis, this tax is a better indicator of current business activity than the corporate income tax, which can be filed almost a year after the period covered by the return. The following chart shows the rebound in revenue from this source from the levels of fiscal 2001-2002, a year affected by the aftermath of the September 11 terrorist attacks. Contracting was especially strong and rose nearly 19%, helped by declining interest rates and by the residential construction and remodeling tax credit adopted by the legislature as an industry stimulus. The retail and service sectors also showed healthy increases.



GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 2003 AND 2002
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY2003	FY2002	Difference	
				Amount	%
TAX BASE					
Retailing		\$ 18,806,693	\$ 17,250,136	\$1,556,557	9.0
Services		7,113,153	6,554,010	559,143	8.5
Contracting		4,597,832	3,866,266	731,566	18.9
Hotel Rentals		2,352,117	2,185,361	166,755	7.6
All Other Rentals		4,062,313	3,885,473	176,840	4.6
All Others (4%)		3,451,686	3,206,655	245,032	7.6
Subtotal		\$ 40,383,794	\$ 36,947,901	\$3,435,893	9.3
Sugar Processing		\$ 2,792	\$ 1,493	\$ 1,299	87.0
Pineapple Canning		3,553	3,394	159	4.7
Producing		529,316	510,682	18,634	3.6
Manufacturing		626,546	594,033	32,513	5.5
Wholesaling		9,616,601	8,960,164	656,437	7.3
Use (1/2%)		5,648,475	4,812,396	836,079	17.4
Intermediary Services		337,797	344,724	(6,928)	(2.0)
Insurance Commissions		797,181	1,157,035	(359,854)	(31.1)
Subtotal		\$ 17,562,260	\$ 16,383,921	\$1,178,339	7.2
TOTAL - ALL ACTIVITIES		\$ 57,946,054	\$ 53,331,822	\$4,614,232	8.7
TAX					
Retailing	4.00%	\$ 752,268	\$ 690,005	\$ 62,262	9.0
Services	4.00%	284,526	262,160	22,366	8.5
Contracting	4.00%	183,913	154,651	29,263	18.9
Hotel Rentals	4.00%	94,085	87,414	6,670	7.6
All Other Rentals	4.00%	162,493	155,419	7,074	4.6
All Other (4%)	4.00%	138,067	128,266	9,801	7.6
Subtotal		\$ 1,615,352	\$ 1,477,916	\$ 137,436	9.3
Sugar Processing	0.50%	\$ 14	\$ 7	\$ 6	87.0
Pineapple Canning	0.50%	18	17	1	4.7
Producing	0.50%	2,647	2,553	93	3.6
Manufacturing	0.50%	3,133	2,970	163	5.5
Wholesaling	0.50%	48,083	44,801	3,282	7.3
Use (1/2%)	0.50%	28,242	24,062	4,180	17.4
Intermediary Services	0.50%	1,689	1,724	(35)	(2.0)
Insurance Commissions	0.15%	1,196	1,736	(540)	(31.1)
Subtotal		\$ 85,021	\$ 77,870	\$ 7,151	9.2
Unallocated*		\$ 92,326	\$ 56,547	\$ 35,778	63.3
TOTAL - ALL ACTIVITIES		\$ 1,792,699	\$ 1,612,333	\$ 180,365	11.2

* Included are collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements, etc.

NOTE: Due to rounding, details may not add to totals.

TRANSIENT ACCOMMODATIONS TAX

Transient accommodations tax (TAT) revenue grew by 8.4% in fiscal 2002-2003 from the previous year. The 2002 legislature adopted two measures that significantly affected the distribution of TAT revenue. Act 253, SLH 2002, provided that the 17.3% share of TAT revenue previously deposited into the general fund must be deposited into a new convention center enterprise fund beginning July 1, 2002. This explains the large drop in net TAT deposits to the general fund in fiscal 2002-2003. Act 253 further provided that if the share going to the convention center enterprise fund in any calendar year exceeds \$31 million, the excess must be deposited into the general fund. The department will monitor the size of this fund during calendar 2003 to ascertain whether this provision is met.

Act 250, SLH 2002, changed the share of TAT revenue going to the Tourism Special Fund from 37.9% to 32.6%. It provided that the difference of 5.3% be deposited into a new TAT Trust Fund, which would be a temporary holding area until the end of the fiscal year. At the end of fiscal 2003, the TAT Trust Fund had accumulated \$9,055,829. Of this amount, \$7,590,111 was transferred to the Tourism Special Fund to satisfy the provision of Act 250 that required that revenue be transferred from the TAT Trust Fund to the Tourism Special Fund until that fund balance reaches \$63,292,000. The excess, which amounted to \$1,465,717, was deposited into the general fund in accordance with Act 250.

TRANSIENT ACCOMMODATIONS TAX (In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
Trans. Accom./Time Share Occ. Tax	\$ 170,865	\$ 157,634	\$ 13,230	8.4
Trans. Accom./Time Share Occ. Fees	<u>9</u>	<u>9</u>	<u>(0)</u>	<u>(0.4)</u>
Subtotal	\$ 170,874	\$ 157,644	\$ 13,230	8.4
Counties Share	76,547	70,620	5,927	8.4
Convention Center Enterprise Fund	29,560	-	29,560	nm
Tourism Special Fund	<u>63,292</u>	<u>59,743</u>	<u>3,549</u>	<u>5.9</u>
Net Addition to General Fund	<u>\$ 1,475</u>	<u>\$ 27,280</u>	<u>\$ (25,805)</u>	<u>(94.6)</u>

nm = not meaningful

NOTE: Due to rounding, details may not add to totals and percent difference may not compute exactly.

FUEL AND MOTOR VEHICLE TAXES

Fuel consumption fell by 100 million gallons in fiscal 2003 following a decline of 26 million gallons the prior year. Most of the decline for fiscal 2003 was due to consumption reductions of 49 million gallons in aviation fuel and 60 million in diesel oil used off highways. Gasoline consumption was virtually unchanged.

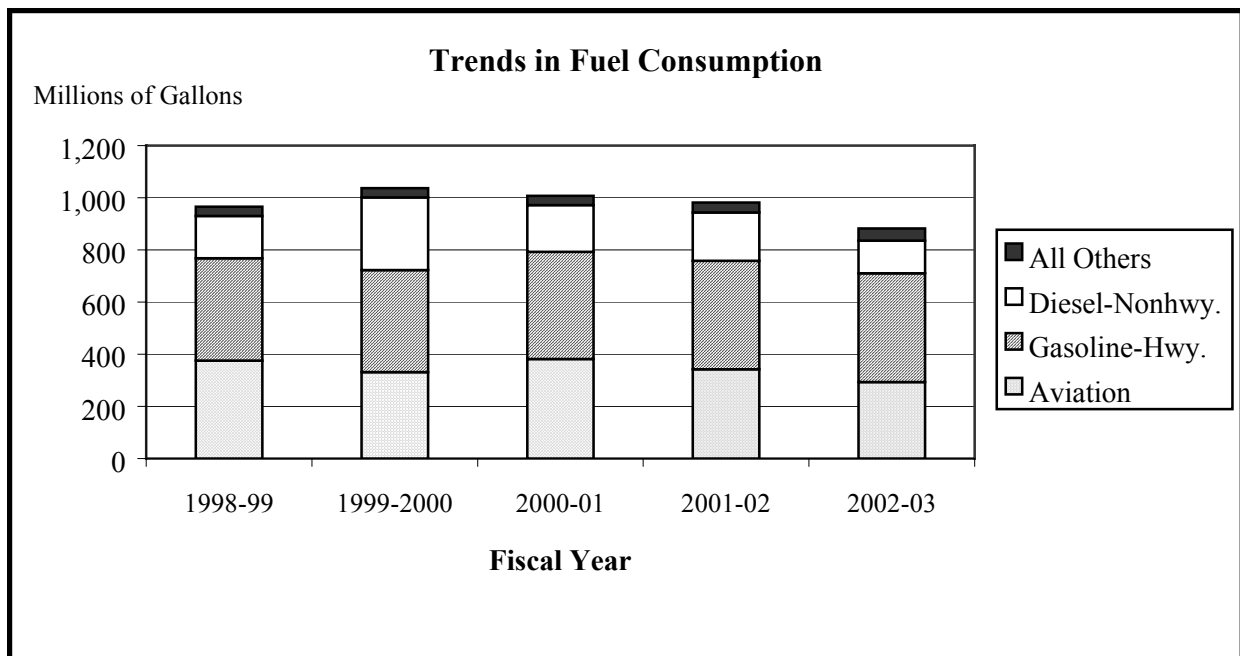
GALLONS OF FUEL CONSUMED (In Thousands of Gallons)

	FY2003	FY2002	Difference	
			Amount	%
Gasoline	417,399	416,820	579	0.1
Diesel Oil - Nonhighway	124,886	184,960	(60,074)	(32.5)
Diesel Oil - Highway	36,216	34,686	1,530	4.4
Liq. Pet. Gas - Off Highway	9,842	2,916	6,926	237.5
Liq. Pet. Gas - Highway	319	263	56	21.2
Small Boats - Gasoline	5	7	(1)	(19.9)
Small Boats - Diesel Oil	31	48	(17)	(35.9)
Aviation Fuel	293,065	341,820	(48,755)	(14.3)
Other Fuel *	64	3	61	nm
Total Gallons	881,827	981,522	(99,696)	(10.2)
Environmental Tax (Barrel)	31,242	35,676	(4,434)	(12.4)

* Includes ethanol, methanol, biodiesel.

nm = not meaningful.

NOTE: Due to rounding, details may not add to totals.



Fuel taxes are imposed per gallon, except the environmental response tax, which is imposed at a rate of 5 cents per barrel sold by distributors to retail dealers and end users.

FUEL TAX RATES PER GALLON ¹

	State	County	Total
GASOLINE AND DIESEL OIL (HWY. USE) ²			
City & County of Honolulu	16.0 ¢	16.5 ¢	32.5 ¢
County of Maui	16.0	13.0	29.0
County of Hawaii	16.0	8.8	24.8
County of Kauai	16.0	13.0	29.0
LIQUID PETROLEUM GAS (HWY. USE)			
City & County of Honolulu	5.3 ¢	5.4 ¢	10.7 ¢
County of Maui	5.3	4.3	9.6
County of Hawaii	5.3	2.9	8.2
County of Kauai	5.3	4.3	9.6
ETHANOL			
City & County of Honolulu	4.6 ¢	4.8 ¢	9.4 ¢
County of Maui	4.6	3.8	8.4
County of Hawaii	4.6	2.6	7.2
County of Kauai	4.6	3.8	8.4
METHANOL			
City & County of Honolulu	3.5 ¢	3.7 ¢	7.2 ¢
County of Maui	3.5	2.9	6.4
County of Hawaii	3.5	2.0	5.5
County of Kauai	3.5	2.9	6.4
BIODIESEL			
City & County of Honolulu	8.0 ¢	8.3 ¢	16.3 ¢
County of Maui ³	8.0	0.0	8.0
County of Hawaii	8.0	4.4	12.4
County of Kauai	8.0	6.5	14.5
ENVIRONMENTAL RESPONSE TAX (per barrel)			
All Counties	5.0 ¢	0.0 ¢	5.0 ¢

¹ Gasoline used for agricultural equipment off highways, aviation fuel, and all other fuels used off highways are taxed by the state at 1 cent per gallon.

² Includes 1 cent State license tax on diesel oil.

³ Maui Ordinance No. 3044 reduced Maui County biodiesel rate from 6.5 cents to zero cents per gallon, effective April 1, 2002.

Taxes on fuel consumption are directed to special funds that support the infrastructure that fuel consumers utilize. The boating special fund received \$1.4 million in fiscal 2003, which is 1% of state and county fuel taxes exclusive of aviation fuel taxes. The state airport fund received all fuel taxes on aviation fuel, amounting to \$3.0 million in fiscal 2003. The environmental

response revolving fund received \$1.6 million from the environmental response tax on petroleum distributors. The remaining state fuel tax revenue, \$75.7 million, was deposited into the state highway fund. County fuel taxes amounting to \$67.0 million was transferred to the county highway funds.

Besides revenue from fuel taxes, the state highway fund also received \$49.0 million in state motor vehicle weight taxes and registration fees collected by the counties as well as \$39.5 million in rental vehicle surcharge taxes and fees.

ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
STATE HIGHWAY FUND				
Gasoline	\$ 68,641	\$ 65,887	\$ 2,754	4.2
Diesel Oil - Nonhighway	1,237	1,832	(595)	(32.5)
Diesel Oil - Highway	5,737	5,494	242	4.4
Liquid Petroleum Gas - Off Highway	97	29	68	235.3
Liquid Petroleum Gas - Highway	17	24	(7)	(30.1)
Other Fuel	5	-	5	nm
Subtotal	\$ 75,733	\$ 73,266	\$ 2,468	3.4
Motor Vehicle	48,957	44,548	4,409	9.9
Rental Vehicle	39,473	36,054	3,419	9.5
TOTAL	<u>\$ 164,163</u>	<u>\$ 153,868</u>	<u>\$ 10,296</u>	<u>6.7</u>
COUNTY HIGHWAY FUNDS				
City & County of Honolulu	\$ 47,156	\$ 46,729	\$ 426	0.9
County of Maui	8,720	8,070	650	8.1
County of Hawaii	7,270	6,498	772	11.9
County of Kauai	3,824	3,523	301	8.6
TOTAL	<u>\$ 66,970</u>	<u>\$ 64,821</u>	<u>\$ 2,149</u>	<u>3.3</u>
BOATING SPECIAL FUND	<u>\$ 1,441</u>	<u>\$ 1,395</u>	<u>\$ 47</u>	<u>3.3</u>
STATE AIRPORT FUND				
Aviation Fuel	<u>\$ 2,973</u>	<u>\$ 3,418</u>	<u>\$ (446)</u>	<u>(13.0)</u>
ENVIRONMENTAL TAX FUND	<u>\$ 1,562</u>	<u>\$ 1,784</u>	<u>\$ (222)</u>	<u>(12.4)</u>

NOTE: Due to rounding, details may not add to totals.

nm = not meaningful

PUBLIC SERVICE COMPANY TAXES

Public service company taxes, including penalty and interest, expanded by 22.2% to \$114.1 million. Since October 1, 2001, most transportation service providers have been paying the general excise tax instead of the public service company tax as provided for by Act 9, Third Special Session, SLH 2001. As a result, public utility companies accounted for nearly all of public service company revenue since that time.

PUBLIC SERVICE COMPANY TAXES (In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
Public Service Company Taxes	\$ 113,611	\$ 91,907	\$ 21,704	23.6
Penalty & Interest	<u>504</u>	<u>1,499</u>	<u>(995)</u>	<u>(66.4)</u>
TOTAL	<u>\$ 114,115</u>	<u>\$ 93,406</u>	<u>\$ 20,709</u>	<u>22.2</u>

NOTE: Due to rounding, details may not add to totals.

ESTATE AND TRANSFER TAXES

During fiscal year 2003, a total of 524 estates were settled, of which 417 were taxable. Collections from the estate tax amounted to \$15.5 million as compared to \$16.6 million in the previous year.

ESTATE AND TRANSFER TAXES (In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
Estate Tax	\$ 15,482	\$ 16,554	\$ (1,072)	(6.5)
Penalty & Interest	<u>42</u>	<u>70</u>	<u>(28)</u>	<u>(39.6)</u>
TOTAL	<u>\$ 15,524</u>	<u>\$ 16,624</u>	<u>\$ (1,100)</u>	<u>(6.6)</u>

NOTE: Due to rounding, details may not add to totals.

OTHER TAXES

Banks and other financial corporations pay a franchise tax instead of the corporate income tax. Although total collections from this source increased by \$15.2 million, tax revenue from normal payments actually declined somewhat because \$16.5 million of the total represented protested payments that was to be transferred into a litigated claims fund at the beginning of fiscal 2004.

A convenient barometer of the real estate industry, the conveyance tax is assessed at 10 cents per \$100 paid in consideration for the purchase of real estate. Conveyance taxes rose by 13%, reflecting continued improvement in the real estate market spurred in part by declining interest rates.

Employment security contributions are employer payments on behalf of their employees. Revenue from this source is deposited into the unemployment trust fund, which is used to issue unemployment insurance payments. Revenue for fiscal 2003 rose 21.5% as a result of increase in tax rates stemming from a change in rate schedules for calendar 2003. Changes in rate schedules are dependent on the ratio of the current reserve fund to an adequate reserve fund.

Tobacco tax revenue increased by 10.3% in fiscal 2003, following an increase of 19% the previous year. The fiscal 2002 increase stemmed primarily from the implementation of mandatory cigarette stamping while the fiscal 2003 increase was the result of a rate increase from five cents to six cents per cigarette in October 2002.

MISCELLANEOUS TAXES*

(In Thousands of Dollars)

	FY2003	FY2002	Difference	
			Amount	%
Banks & Other Financial Corp.	\$ 22,342	\$ 7,164	\$ 15,178	211.9
Conveyance	11,130	9,820	1,309	13.3
Empl. Security Contributions	135,991	111,908	24,083	21.5
Insurance Premiums	73,240	67,941	5,300	7.8
Liquor & Permits	41,186	39,091	2,095	5.4
Tobacco & Licenses	72,297	65,547	6,750	10.3
General Excise Licenses & Fees	607	587	21	3.5
TOTAL	\$ 356,793	\$ 302,056	\$ 54,736	18.1

* Includes allocation to special funds.

NOTE: Due to rounding, details may not add to totals.

COLLECTION AND ACCOUNTING OF TAXES

TAX COLLECTIONS

Tax collections by and for the Department of Taxation amounted to \$3.73 billion in fiscal 2003, an increase of 5.9% over the \$3.52 billion collected the prior fiscal year. The department collected 96.4% of the fiscal 2003 total. The remainder collected by other agencies included \$49.0 million in state motor vehicle weight taxes and registration fees by the counties, \$73.2 million in insurance premium taxes by the Department of Commerce and Consumer Affairs, and \$11.1 million in conveyance taxes by the Department of Land and Natural Resources.

As shown in the accompanying table, the general excise and use tax is the state's most important source of revenue, accounting for nearly half of all tax collections. Next in size is the individual income tax, which contributed just over a quarter of tax collections.

TAX COLLECTIONS

SOURCE OF REVENUE	FY2003		FY2002	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 22,341,484	0.6	\$ 7,163,569	0.2
Conveyance	11,129,526	0.3	9,820,207	0.3
Employment Security Contributions	135,990,779	3.6	111,907,876	3.2
Fuel	148,679,527	4.0	144,683,499	4.1
General Excise & Use	1,792,698,569	48.0	1,612,333,427	45.7
Income - Corporations	8,262,406	0.2	45,476,813	1.3
Income - Individuals	1,038,107,305	27.8	1,071,590,823	30.4
Inheritance and Estate	15,524,382	0.4	16,624,283	0.5
Insurance Premiums	73,240,227	2.0	67,940,550	1.9
Liquor & Permits	41,185,860	1.1	39,090,536	1.1
Motor Vehicle Tax *	88,429,454	2.4	80,602,003	2.3
Public Service Companies	114,115,299	3.1	93,405,754	2.7
Tobacco & Licenses	72,297,212	1.9	65,546,890	1.9
Trans. Accom. Tax	170,864,689	4.6	157,634,488	4.5
All Others	<u>664,787</u>	<u>0.0</u>	<u>606,856</u>	<u>0.0</u>
TOTAL	<u>\$3,733,531,506</u>	<u>100.0</u>	<u>\$3,524,427,575</u>	<u>100.0</u>

* Includes Motor Vehicle Weight Tax, Registration Fees, Commercial Driver's License, Periodic Mtr. Vehicle Inspection, Rental Vehicle Registration Fees, and Rental Vehicle Surcharge Tax.

NOTE: Due to rounding, details may not add to totals.

DISTRIBUTION OF TAXES

Of the \$3.73 billion in taxes collected for and by the state, \$3.18 billion, or 85.2%, was deposited into the state general fund. The counties received \$143.5 million, or 3.8%, from county fuel taxes and transient accommodation taxes. The remaining \$408.0 million was distributed to state special funds. Largest in size was the distribution of \$164.2 million to the state highway fund.

Next in size was the transfer of \$136.0 million in employment security contributions to the unemployment trust fund, followed by the \$63.3 million distribution of transient accommodations taxes to the tourism special fund.

New in fiscal 2003 is the convention center enterprise fund, which receives the 17.3% share of the transient accommodations tax that formerly went to the general fund.

DISTRIBUTION OF COLLECTIONS

	FY2003		FY2002	
	Amount Collected	% of Total	Amount Collected	% of Total
STATE FUNDS				
State General	\$ 3,182,042,715	85.2	\$ 3,048,530,375	86.5
State Highway	164,162,686	4.4	153,867,797	4.4
State Airport	2,972,647	0.1	3,418,200	0.1
Boating Special Fund	1,441,448	0.0	1,394,815	0.0
Environmental Fund	1,562,115	0.0	1,783,813	0.1
Cigarette Stamp Admin/Enf. Fund	1,024,263	0.0	1,077,744	0.0
Compliance Resolution Fund	2,000,000	0.1	2,000,000	0.1
Unemployment Trust	135,990,779	3.6	111,907,876	3.2
Election Campaign Fund	281,832	0.0	244,664	0.0
Convention Center Enterprise Fund	29,559,591	0.8	-	nm
Tourism Special Fund	63,292,000	1.7	59,743,471	1.7
Rental Housing Fund	2,782,381	0.1	2,455,052	0.1
Natural Area Reserve Fund	2,782,381	0.1	2,455,052	0.1
School Repairs & Maintenance Fund	119,202	0.0	107,590	0.0
Subtotal - State	\$ 3,590,014,040	96.2	\$ 3,388,986,448	96.2
REVENUES TRANSFERRED TO COUNTIES				
Fuel	66,970,085	1.8	64,820,877	1.8
Trans. Accom. Tax	76,547,381	2.1	70,620,251	2.0
Subtotal - Counties	\$ 143,517,466	3.8	\$ 135,441,128	3.8
TOTAL	\$ 3,733,531,506	100.0	\$ 3,524,427,575	100.0

nm = not meaningful

NOTE: Due to rounding, details may not add to totals.

BRIEF SUMMARY OF HAWAII'S TAX SYSTEM

Two notable characteristics of Hawaii's tax structure are the high degree of centralization at the state level and the broad-based nature of its primary revenue source, the general excise tax. Hawaii's general excise tax is imposed on most sales of goods and services. Some transactions are exempted because they are subject to other taxes or because the legislature wished to encourage certain economic activities.

Hawaii offers a variety of income tax credits. The most common tax credits claimed by individuals include the low-income credit, the renter's credit, the dependent care credit, the energy device credit, and the child passenger restraint credit. The low-income credit, which is available to residents with income of not more than \$20,000, is a credit that gradually phases out as income increases. The renter's credit, which is available to residents with income under \$30,000, is a flat \$50 credit per qualified exemption. Like its federal counterpart, Hawaii's dependent care credit reimburses a portion of expenses paid to care for qualified dependents in order to allow the taxpayer to hold gainful employment. The energy device credit is available to taxpayers who purchase qualified alternate energy devices. A flat \$25 credit per return is available to individuals who purchase qualified child passenger restraint systems. For many years, the bulk of Hawaii's tax credits were targeted at individuals. Many of these credits, such as the low-income credit and the rent credit sought to enhance the progressivity of the tax system by targeting lower-income individuals.

Beginning with the capital goods excise tax credit, which was inaugurated in the 1988 tax year, the Hawaii legislature began targeting tax credits for business stimulation. This trend accelerated near the turn of the century to the point where business stimulation credits now claim more tax dollars than the personal credits. Another trend is that some of these business credits, such as the high technology credit and the research credit are very large in size but are claimed by only a select few taxpayers.

Hawaii has seventeen separate tax laws, of which fourteen are administered by the state. The remaining three – real property tax, motor vehicle weight tax, and public utility franchise tax – are administered by the counties. Until July 1, 1981, the real property tax law was administered by the state, with revenue from this source accruing to the counties. At present, the counties administer all of the real property functions. Administration of the state and county motor vehicle weight taxes is vested in the counties with the revenue accruing to the state and county highway funds.

Revenues from eleven of the state-administered taxes go into the state's general fund and are used to provide government services. Although the fuel tax is administered by the state, it is a source of revenue for both the state and county highway funds. The employment security tax is a dedicated tax used exclusively to provide benefits to cover unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the state highway fund. A portion of the transient accommodations tax supports the tourism special fund used to promote the visitor industry and the convention center enterprise fund used to operate the center. The rental housing fund and the natural area reserve fund each receives a 25% share of the conveyance tax. To the extent that individuals designate \$2 for election campaigns on their individual income tax returns, that amount goes to the election campaign fund.

STATE GENERAL FUND

SOURCE OF REVENUE	FY2003		FY2002	
	Amount Collected *	% of Total	Amount Collected *	% of Total
Banks - Financial Corps.	\$ 20,341,484	0.6	\$ 5,163,569	0.2
Conveyance	5,564,763	0.2	4,910,103	0.2
General Excise & Use	1,792,698,569	56.3	1,612,333,427	52.9
Income - Corporations	8,262,406	0.3	45,476,813	1.5
Income - Individuals	1,037,706,271	32.6	1,071,238,569	35.1
Inheritance and Estate	15,524,382	0.5	16,624,283	0.5
Insurance Premiums	73,240,227	2.3	67,940,550	2.2
Liquor & Permits	41,185,860	1.3	39,090,536	1.3
Public Service Companies	114,115,299	3.6	93,405,754	3.1
Tobacco & Licenses	71,272,949	2.2	64,469,147	2.1
Trans. Accom. Tax	1,465,717	0.0	27,270,766	0.9
All Others	664,787	0.0	606,857	0.0
TOTAL	\$ 3,182,042,715	100.0	\$ 3,048,530,375	100.0

* Net of transfers to special funds.

NOTE: Due to rounding, details may not add to totals.

OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2003

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(1) Net Income</p> <p>Chapter 235 — Section 235-1 to 235-130</p>	<p>For taxable years beginning after December 31, 2001, the tax rates for individuals as well as estates and trusts range from 1.4% to 8.25% of taxable income. The allowable standard deduction amounts vary by filing status. The standard deduction amount for married filing joint return or surviving spouse with dependent child is \$1,900; single is \$1,500; head of household is \$1,650; and married filing separately is \$950. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000 of taxable income.</p>	<p>Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$5,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. For employers whose liability for taxes withheld exceeds \$100,000 a year, withholding returns due monthly on or before the 10th day of the following calendar month. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.</p>	<p>In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th.</p>
<p>(2) Estate and Transfer (for decedents dying after 6/30/83)</p> <p>Chapter 236D — Section 236D-1 to 236D-18</p>	<p>Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For nonresident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions.</p> <p>For generation-skipping transfers after June 30, 1994, a tax in an amount equal to the federal credit is imposed on every generation-skipping transfer of (1) property located in Hawaii and (2) property from a resident trust.</p>	<p>Report (Form M-6) must be filed by person responsible for filing Federal Estate Tax Return (federal Form 706). No report required and no tax due when federal Form 706 not required. To obtain release of property, file Request for Release (Form M-6A).</p> <p>Report (Form M-6GS) must be filed by person responsible for filing Generation-Skipping Transfer Tax Return for Distributions (federal Form 706GS(D)) or Generation-Skipping Transfer Tax Return for Terminations (federal Form 706GS(T)).</p>	<p>On or before the due date for filing federal Form 706, including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p> <p>On or before the due date for filing federal Form 706GS(D) or 706GS(T), including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p>
<p>(3) General Excise (Gross Income)</p> <p>Chapter 237 — Section 237-1 to 237-49</p>	<p>This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 1% of 1% on wholesaling and intermediary services, producing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed at 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at .15%. Beginning January 1, 2000, the wholesale tax treatment is expanded to more goods and services transactions. Qualifying transactions will be taxed at 3.5% in calendar year 2000, and will be reduced by 0.5% each January 1st until a 0.5% rate is fully phased-in on January 1, 2006. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(4) Transient Accommodations Tax Chapter 237D — Section 237D-1 to 237D-16</p>	<p>This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 7.25%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units. Effective January 1, 1999, the transient accommodations tax of 7.25% is imposed on the fair market rental value of time share vacation units.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(5) Use Chapter 238 — Section 238-1 to 238-16</p>	<p>This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: ½ of 1%, if for resale at retail; 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4. The use tax is imposed on the value of services or contracting that are performed by an unlicensed seller at a point outside the State and imported or purchased for use in the State, effective for use taxes accruing after December 31, 1999.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.</p>	<p>At time of filing returns.</p>
<p>(6) Public Service Company Chapter 239 — Section 239-1 to 239-25</p>	<p>Nature of Tax—Public utility business in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, ½ of 1%. (iii) All other revenues: 4% of gross income. Beginning with January 1, 2001 filings, the sale of telecommunications services by a public utility to an interstate or foreign telecommunications services provider that is subject to the general excise tax and that resells the services to retail customers, is subject to a 5.5% PSC tax rate, reduced by 0.5% each January 1st until a 0.5% rate is fully phased-in on January 1, 2007. The general excise tax, rather than the public service company tax, is imposed on transportation service providers for gross income received on or after October 1, 2001.</p>	<p>Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.</p>	<p>First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.</p>
<p>(7) Banks, Building and Loan Financial Services Loan Companies and Certain Other Financial Corporations Chapter 241 — Section 241-1 to 241-7</p>	<p>(1) (a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax (in lieu of net income and general excise taxes) on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.</p>	<p>Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.</p>	<p>First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.</p>

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 1c per gallon on aviation fuel; an initial 1c per gallon on diesel oil, alternative fuels for operation of an internal combustion engine and from 24.8c to 34c per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 24.8c to 34c per gallon on diesel oil and at the rates specified below per gallon on alternative fuels used to operate motor vehicles upon the public highways, however, they are not required to pay these additional taxes if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways or diesel oil and alternative fuels used for motor vehicles not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5c per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed. Effective for taxable years beginning after December 31, 2001, the fuel tax is adjusted to reflect the energy content of alternative fuels as follows: ethanol- 0.29 times the rate for diesel; methanol- 0.22 times the rate for diesel; biodiesel- 0.50 times the rate for diesel; alternative fuels- 0.33 times the rate for diesel; and for other alternative fuels, the rate is based on the energy content of the fuels as compared to diesel fuel, using a lower heating value of 130,000 BTUs per gallon as a standard for diesel, so that the tax rate, on an energy content basis, is equal to half the rate for diesel fuel.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon "dealers" as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$.85 on cooler beverages, \$.93 on beer other than draft beer, and \$.54 on draft beer.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(10) Cigarette and Tobacco Chapter 245 — Section 245-1 to 245-63	"Wholesalers" and "dealers" as defined in the law must pay an excise tax on sale or use of tobacco products equal to 40% of the wholesale price and a fixed tax rate of 6.5c on each cigarette sold, used, or possessed after June 30, 2003. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year. Effective January 1, 2001, cigarette and tobacco wholesalers and dealers are required to affix stamps to individual cigarette packages as proof of payment of cigarette taxes. Section 245-3 increases the cigarette excise tax from 6.5c for each cigarette sold, used, or possessed to 7c after June 30, 2004.	Returns are due monthly on or before the last day of the following month.	At time of filing returns. Cigarette tax paid through the purchase of cigarette tax stamps by licensees.
(11) Conveyance Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property. The rate is 10c per \$100 of the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction. (Documents of certain conveyances are exempted.)	A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.	At time of filing the certificate, but no later than 90 days after the taxable transaction.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax Chapter 251 — Section 251-1 to 251-15</p>	<p>There is a rental motor vehicle surcharge tax of \$3 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(13) Unemployment Insurance Chapter 383 — Section 383-1 to 383-176</p>	<p>This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.4%. There is also an additional employment and training (E & T) fund assessment on taxable wages paid to an employee. The percentage rate for this additional tax is .01%. The E & T assessment is applicable to all employing units with unemployment insurance contribution rates greater than 0.00% and less than 5.4%. There is a limitation of the tax on wages paid to an employee called the "tax base". The tax base represents 100% of the state's average annual wages reported by employers contributing to the unemployment trust fund.</p>	<p>On a quarterly basis, employers submit Form UC-B6, "Quarterly Wage, Contribution and Employment and Training Assessment Report." The report must be filed on or before the last day of the month following the report quarter.</p>	<p>At time of filing returns.</p>
<p>(14) Insurance Premiums Chapter 431 — Section 431:7-201 to 431:7-209</p>	<p>Tax on insurance companies (Underwriters) based on premiums received in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.</p>	<p>Quarterly tax statement is due on or before the last day of the calendar month following the quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.</p>	<p>At time of filing statements.</p>

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