DEPARTMENT OF TAXATION
STATE OF HAWAII

ANNUAL REPORT
2004-2005

November 29, 2005

The Honorable Linda Lingle
Governor
State of Hawaii

Dear Governor Lingle:

I am pleased to present to you this summary of the major accomplishments of the Department of Taxation for the fiscal year ending June 30, 2005.

I wish to highlight the success of the tax compliance program that collected $234.3 million in delinquent taxes during the 2005 fiscal year, almost $80 million more than our $155 million goal. Additionally, the Department had several one-time large settlements of delinquent taxes resulting in an additional $36 million, or $270 million collected for the fiscal year. Further, because of improved technology and efficiencies, the cost to collect $100.00 of tax declined by 9.5% from $0.42 in fiscal year 2004 to $0.38 in fiscal year 2005.

Collections for general excise, corporation income, and individual income increased by 12.4%, 51.1%, and 18.2% respectively, from the previous fiscal year. These increases were mainly due to the strong growth of the economy, as well as the increases in delinquent tax collections. For individual income tax collections, a significant part of the increase in collections was due to the one-time impact of a new law that requires most businesses to conform to federal payment deadlines for remitting Hawaii withholding tax on wages.

During the fiscal year, the department continued work on the business taxes component for the department's Integrated Tax Information Management System (ITIMS). The ITIMS project began in 1999 and has gradually enabled us to more efficiently collect delinquent taxes, and to provide improved services to our taxpayers. This final system component, along with the third phase of our reorganization, brings additional improvements. Integrating income tax and business taxes into a single system (imagine all your tax records, including notes, being in one file folder), will enable us to administer our taxpayers' accounts more timely, efficiently, and effectively.

Of the total $4.6 billion in tax revenues collected during fiscal year 2005, $4.0 billion, or 87% was deposited into the State General Fund. This is an increase of 16% over the previous fiscal year. In closing, I would like to acknowledge the diligent and excellent work of all department employees throughout the past fiscal year. With the growing economy, our challenges are to find adequate personnel and continue to improve services to taxpayers. We are confident that the 2006 delinquent tax collection goal will be achieved.

Respectfully submitted,

KURT KAWAFUCHI
Director of Taxation

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THE YEAR IN REVIEW

TAX SERVICES AND PROCESSING DIVISION

The Tax Services and Processing Division (TSP) consist of three branches: 1) Document Processing, 2) Taxpayer Services, and 3) Revenue Accounting. Each branch's objectives are unique to their specific functions, with an overall division objective to perform all functions relating to the centralized processing, editing, and controlling of tax information through paper documents or electronic data; receives, secures, deposits, and accounts for tax payments; and functions relating to account management, licensing, and providing taxpayer services to the public.

Document Processing Branch

The major objective of the Document Processing Branch (DPB) is to orderly process and control all tax returns and documents; receive, secure, deposit and account for tax payments; and store, file, and retrieve such documents.

The DPB processed approximately 1.23 million payments during the year; with the electronic funds transfer (EFT) program, collecting payments of over $2.32 billion dollars.

The Joint Electronic Filing Program (JELF) with the Internal Revenue Service ended its fourth year on October 20, 2004, and began its fifth year in mid-January of 2005. The program allowed certain taxpayers who file the N-11 form to file their Hawaii State returns electronically. A marked improvement in participation was observed this year, with an increase of 14.92% being realized. We increased our participation from 135,922 returns being filed last year to 156,199 returns filed electronically this year.

Taxpayers may also file their returns through the department's website. Taxpayers have filed over 41,000 returns on our website this year alone. In addition, an average of 193 new taxpayers register to use our website each month. Electronically-filed returns allow the data to flow into internal systems with a minimal amount of manual contact, which enhances operational efficiency.

The maintenance of a statewide centralized filing system was implemented in October 2004. The File Maintenance Section is now a statewide operation maintaining the files for all districts and filling retrieval requests for all documents.

Taxpayer Services Branch

As a result of the final phase of the Integrated Tax Information Management System (ITIMS) project, the Taxpayer Services Branch (TPS) was expanded to include two new sections: Account Management and Licensing. With the addition of these two new sections, the major objective of the Taxpayer Services Branch has become three-fold:

1) to provide efficient customer assistance and information on all taxes administered by the department (Customer Inquiry); 2) to perform expedient computer-based error correction activities to allow for the processing, posting or updating of tax returns, payments, and other documents (Account Management); and 3) to process, issue and update all license and permits issued by the Department in a timely and efficient manner. The final phase of ITIMS also substantially increased the number of daily automatic billing notices. The respective taxpayer inquiries related to these automated billing notices were handled by TPS, which has a direct contribution to the increased revenue realized by the Department.

Customer Inquiry: 2005 Tax Season Telephone Call Statistics:

During the January to June 2005 income tax filing season, the total number of calls received was at an all-time high at 346,972, of which 42,003 calls or 12% were handled by the IVR's automated responses, and 69,843 calls or 20% were handled by tax representatives. As a result, the overall call answer rate for the 2005 tax season was 32%, which was significantly lower than the 72% call answer rate for the same period in 2004, but higher than the 23% for the same period in 2003.

The primary reason for the extreme variance in our call answer rate during the 2003, 2004 and 2005 tax seasons is directly related to the implementation of the two major components of our new Integrated Tax Information Management System. The income tax component was implemented in November 2002, and the integration of the business tax component was implemented in October 2004. As a direct result of these two major system implementations, the 2003 and 2005 tax seasons, which immediately followed the system implementations, were very heavily impacted with tremendous spikes in call volume as shown below.

Year	Total Calls Received	Total Calls Answered	Overall Call Answer Rate
2005*	346,972	111,846	32%
2004*	147,514	106,146	72%
2003*	332,399	76,392	23%

* represents the six month period of January through June of years shown.

Account Management: Error Correction Statistics

From the inception date of October 2004 through June 2005, the staff of 10 in the new Account Management Section were able to correct and post (to accounts) over 120,000 returns and payments that were "worklisted" or removed from the processing cycle due to critical errors. As this is still the first year for this new section, comparative statistics are unavailable at this time. However, based on their very high productivity, Account Management shows great promise in managing their workload successfully. In the upcoming months, they will be focusing on the business tax returns and payments that are worklisted, and hope to find satisfactory solutions to clearing some of this backlog by proposing changes to the processing and posting of these documents in our new computer system.

Licensing: Statistics on Processing Business License Applications/Cancellations

From this new section's inception date of October 2004 to the end of June 2005, Licensing processed over 25,000 Basic Business Applications and over 18,000 cancellations. Initially, Licensing struggled with their new workload due to staff shortages and adapting to the new processes. However, under the guidance of a seasoned supervisor and additional temporary staffing, they were able to overcome their heavy backlog and are now seeking new and creative ways to streamline and become even more timely, efficient, and effective.

Revenue Accounting Branch

The major objective of the Revenue Accounting (RA) Branch is the maintenance of revenue control and subsidiary ledgers. This requires control and responsibility for all adjustments, error resolutions, accounting and reconciliation functions of all tax revenues statewide. This objective also includes the preparation of the Preliminary Report and Statement of Tax Operations and related reports. Secondary functions of this branch include statewide processing and manual accounting activities of all Miscellaneous taxes (except Estate & Transfer tax); control and accounting for all tax refunds statewide which are created by either overpayment or adjustment; responsibility for maintenance of the accounting system for statewide protested payments and tax appeals; corrects all rejected electronic funds transfer payments statewide; and handles all refund exception activities statewide (e.g., returned checks, tracers, forgeries, etc.).

Each month, the RA branch prepares the Preliminary Report, which is a monthly statewide summary of all the revenues received by the department net of tax refunds. The Preliminary Report must be prepared by the 5th working day of each month. The RA branch also prepares the Statement of Tax Operations (STO), which is a formal and detailed statewide report based on the Preliminary Report. The STO must be prepared by the 10th working day of each month. The RA branch has met these urgent goals each month.

COMPLIANCE DIVISION

The objective of the Compliance Division is to maximize taxpayer compliance with the Hawaii tax laws through a consistent , uniform, and fair manner. The Compliance Division is composed of the Oahu Office Audit Branch, Field Audit Branch, and Oahu Collections Branch on Oahu, and the District Offices of Maui, Hawaii and Kauai. There are three programs established in the division to meet the objectives of our voluntary compliance, self-assessment system. These three programs are: auditing/examination, collection, and taxpayer services and information dissemination.

Returns Processing Exception Handling/Error Correction

On October 1, 2004, after completion of the final phase of implementation of the Integrated Tax Information Management System (ITIMS) the exception handling/error correction functions for Net Income, General Excise/Use, and Miscellaneous Taxes were transferred to Account Management Section of the Tax Services and Processing Division.

However, Oahu Office Audit Branch still retains a small portion of this function and work is transferred from Account Management based on specific issues that need to be addressed by an Office Examiner. The number of exception handling documents processed for fiscal year ending June 30, 2005 was 19,988.

Auditing/Examination

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

	Office Audit		Field Audit	
	Number Audits Completed	Dollars Assessed	Number Audits Completed	Dollars Assessed
Oahu	4,790	$ 7,833,008	188	$ 81,455,420
Maui	1,008	2,767,112	17	2,393,686
Hawaii	1,053	1,718,767	13	768,675
Kauai	881	1,629,297	25	8,619,529
Total FY 2005	7,732	13,948,184	243	93,237,310
Total FY 2004	2,595	6,201,659	242	69,773,813
Difference	5,137	$20,065,412	1	$ 23,463,497

Both the Office and Field Audit units reflected increases in their audit cases closed and dollars assessed. The exceptional increase in assessments by the Office Audit Branch is due to the transfer of exception handling/error correction function to Account Management. The Field Audit branch was able to maintain its audit productivity even with the loss of staff and training of new staff. In addition, our Oahu Office, Field Audit and Collection Branch and Sections provided support services to both the District and Oahu Taxpayer Services Area when requested.

The Office and Field Audit units collected $38.5 million upon the closing of their audits prior to any billing notices being sent.

Criminal Tax Unit

This unit increased its activities during the fiscal year and was able to obtain indictments and complaints against 34 individuals and 8 corporations. These activities resulted in $78,000 in judicial fines, $1.3 million in tax assessments, and $1.7 million in collections (taxes, penalties, interests, and fines) for criminal cases.

Taxpayer Assistance Provided

During the fiscal year, the neighbor island district office personnel helped taxpayers in the proper filing of numerous tax returns and other documents through telephone assistance, and over the counter service (which included tax return preparation and correspondence). Our Oahu Office, Field Audit and Collection Branches and Sections provided support services to both the District and Oahu Taxpayer Services Areas when requested. The following summarizes the activities of our branches.

Tax Services and Processing Statistics for Districts (Maui, Hawaii, and Kauai)

	Year to date as of Jun 2005	Year to date as of Jun 2004	Difference	% Change
Counter	69,398	64,027	5,371	8.39%
Phone Services	66,901	64,839	2,062	3.18%
Tax Clearances	7,254	5,562	1,692	30.42%
Correspondence	21,294	26,257	(4,963)	(18.90%)

The shift to a one-stop service concept and centralization of processing on Oahu resulted in a significant decrease in correspondence received from taxpayers.

The assistance provided to taxpayers is part of our continuing emphasis on taxpayer education and problem resolution in all of our contacts with taxpayers. The division continues to feel that it is important to maintain taxpayer willingness to accurately and voluntarily comply with the State tax laws. This "taxpayer enabling and empowering activity" will continue to be emphasized.

Delinquent Tax Collections

The operations of the Compliance Division Tax Enforcement Program which consists of the Oahu Collections Branch and the Collections Sections in each of the district offices on Maui, Hawaii and Kauai resulted in several positive increases in key performance measurements. The most notable increase was in the amount of cash collected for delinquent taxes, which rose $77.9 million from $156.4 million in FY 2004 to $234.3 million in FY 2005. This represents a 49.8% increase in cash collections of delinquent taxes. Total delinquency balance increased by 1.9% as compared to 3.4% in fiscal year 2004. A table of major performance measurements is presented below.

Measurement	FY 2005	FY 2004	Change Amount	Change %
Total delinquent tax balance ($millions)	$347.5	$340.9	6.6	1.9
Total new delinquent referrals ($millions)	247.1*	176.1	71.0	40.3
Total cash collected ($millions)	234.3	156.4	77.9	49.8
Uncollectible tax write-offs ($millions)	6.2	8.4	(2.2)	(26.2)
Payment plans initiated	12,245	12,386	(141)	(1.1)
Tax liens filed	4,892	4,467	425	9.5
Levies served	1,813	3,236	(1,423)	(44.0)

* An additional $36 million in several large one-time settlements were collected during the fiscal year, or a total of $283.1 million.

Special Projects

The Oahu Field Audit branch continued the following ongoing special projects:

- Federal Contractors Project - During the fiscal year, 14 audits were completed and resulted in $931,331in assessments.
- Mainland Audit Project – During this fiscal year, 5 cases were completed and resulted in $4 million in assessments.
- Referral Cases from Criminal Investigation Unit – During this fiscal year, 32 cases were completed and resulted in $1.9 million in assessments.

STAFF OFFICES

Administrative Services Office

Fiscal Office

The Administrative Services Office submitted the biennium budget for fiscal years 2006 and 2007 to the 2005 legislature. For fiscal year 2006, the Department was appropriated $21.7 million.

In discharging its duties and responsibilities, the Department of Taxation incurred operating expenses of $18.6 million for fiscal year 2005. Total taxes collected and administered by the Department rose by $534 million from fiscal year 2004 to fiscal year 2005. As a result, the cost to collect $100.00 of taxes declined 9.5% from $0.42 in fiscal year 2004 to $0.38 in fiscal year 2005.

Personnel Management

For fiscal year 2005, the Department was authorized 332 positions. Employees were geographically distributed as follows: Oahu, 270; Hawaii, 26; Maui/Molokai, 22; and Kauai, 14.

Personnel actions included 26 new civil service hires, 14 retirements, 68 temporary hires, 29 promotions, 6 transfers, and 4 resignations. Other personnel actions included temporary assignments of employees to higher levels to substitute for employees temporarily assigned to the ITIMS project.

STAFFING PATTERN
(Number of Authorized Permanent Positions)

By Organization/Operating Program	2005	2004	2003
Headquarters Administration	57.0	57.0	36.0
Tax Services and Processing Division	88.5	88.5	97.5
Compliance Division	186.5	186.5	196.5
TOTAL	332.0	332.0	330.0

Rules Office

The Rules Office is currently comprised of the Rules staff 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, analyzing, and researching Hawaii tax proposals, the Rules staff develops Hawaii tax policy through drafting administrative rules.

For the 2005 legislative session, the Rules staff drafted and submitted 9 administration-sponsored bills. Prior to the start of the legislative session, the Rules staff also reviewed and commented on proposed tax legislation submitted by other executive departments.

After reviewing 3,690 bills introduced in the House (1,786 House bills) and Senate (1,904 Senate bills), the Rules staff determined that approximately 300 measures proposed tax law changes and analyzed them in depth. These measures were also tracked throughout the legislative session. The Rules staff prepared 202 written testimonies for measures scheduled for public hearings by legislative committees, 113 for the House and 89 for the Senate. Administrative rules specialists assisted the Director by attending many of the hearings to assist in the presentation of the prepared testimony and to answer questions raised by the various legislative committees. Letters to legislative committee chairs were also drafted after the public hearings to respond to specific questions or to address certain concerns of committee members. In addition, the Rules staff was asked to submit comments and recommendations to the Governor on 19 bills passed by the Legislature with possible impact on the Department.

Also, during the fiscal year, the Rules staff prepared letters for the Governor and the Director, announcements, tax information releases, directives, and other publications.

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 numerous workshops for practitioners.

Technical Section

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 217 tax forms and 48 instructions; developed 5 new tax forms and one new set of instructions. Additionally, one tax form was determined to be obsolete.

The Technical Section is also responsible for reviewing applications for certain tax exemptions. Staff members approved 185 nonprofit (general excise tax) applications and 3,483 conveyance tax exemptions.

External Training and Outreach

External Training and Outreach is the administrative title of an office attached to the Director of Taxation that has four major functions. The primary function of the office is to be an operations-oriented tax training resource for the Department. Secondary, the office promotes voluntary compliance by updating and distributing plain language tax information. Third, the office supports the Department's outreach efforts by hosting the Department's summer and year-end workshops and making other external presentations. Fourth, the office facilitates the Department's media relations function by serving as a focal point to receive media contacts and compile responses. During fiscal year 2005, the office responded to an average of one and one-half media inquiries per week.

During fiscal year 2005, the office focused primarily on external presentations, to the exclusion of internal training development. Summer and year-end workshops were hosted in Honolulu, Lihue, Kona, Hilo and Kahului for approximately 400 attendees. Additional speaking engagements were cultivated for television and radio appearances.

In November 2004, the Department appointed a committee to review and facilitate execution of External Training and Outreach's primary function, which is to serve as an operations-oriented tax training resource for the Department.

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. This fiscal year ITSO completed several projects of which most of the efforts and resources were primarily focused on the Integrated Tax Information Management System (ITIMS) project.

The ITIMS project achieved its foremost milestone this year with the implementation of the integrated client/server system, which replaced the Comprehensive Net Income Tax (CNIT), and General Excise, Withholding, Transient Accommodations, and Rental Vehicle/Tour Vehicle Surcharge Tax (GEW/TAT) mainframe computer systems. The CNIT or income taxes portion of the ITIMS Tax Processing System (ITPS) was implemented in November 2002. The GEW/TAT or business taxes portion was integrated into the ITPS and all the other interfacing systems in October 2004.

The business taxes development also involved subprojects including: the overhaul and installation of server hardware; deployment and implementation of new enterprise printers; modifications to data capture interface systems; conversion/upgrade of all reports; upgrades to databases and all system software; and performance tuning. In addition, ongoing maintenance and enhancements continues to be done on both the ITIMS Collections System (ICS) and ITPS portion of the ITIMS system to improve on the accurate and timely processing of taxes.

Additional automated reporting enhancements for revenue generation were completed on Internal Revenue Service (IRS) related system projects. The CP2000 project, implemented in October 2004, and the FEDSTAR project, implemented in November 2004, provides audit assessments. Also, for IRS safeguard compliance a warning and confidentiality login banner was implemented, all old IRS tapes have been degaussed (reduction or elimination of unwanted magnetic fields), and an annual tape release process established. Other projects included: the Refund Warrants Process which automatically generates refund summary warrant vouchers; the Ko Olina tax which tracks those credits as adjustments; and Act 215 in which Information Technology guidance was provided on the administration of those credits.

The electronic filing programs continue to experience considerable growth. The Joint Electronic Filing (JELF) program filings of electronic N-11 tax returns continues its rise (from 133,911 to 156,238) compared to the previous fiscal year. The Internet Electronic Filing (ELF) program expanded in both the number of taxpayers registered with the E-filing website (25,752 to 40,452) and the number of tax filings (47,972 to 113,562).

The Department participated in the successful implementation of Hawaii Business Express in October 2004. The joint project with the Department of Commerce and Consumer Affairs, the Department of Labor and Industrial Relations, the IRS, and the Hawaii Information Consortium provides a "one-stop shop" website. The website consolidates business registration requirements of multiple government departments, which means new businesses can input data once and have it sent electronically to the state's four regulating agencies.

Also the Department's website was revamped to provide a more user-friendly experience that includes a fresh look, quicker navigation, and better-organized content.

The technical infrastructure and network resources continue to be improved in support of departmental users in all district offices. Network Internet Protocol (IP) public addresses were migrated to adhere to the state's standard IP address assignment. Core switches were reconfigured to provide additional IP addresses for network devices. The Frame-Relay termination point was relocated for better operational support. New enterprise database servers, file servers, application servers, client PCs, laptops, and network printers were procured to replace their aging counterparts. Other upgrades included: updating Frame-Relay communication devices, backup software, and network operating systems; implementing an Image Server; migrating from all Windows NT Operating Systems to Windows 2000/2003; and implementing network analyzers to monitor network traffic.

Other initiatives already in-progress are development of the ITIMS Imaging System (IIS) project, planning for the archiving and release of all old mainframe system resources; expansion of the JELF program for N-15 tax return and Schedule CR; adding Net Income payments to the Electronic Funds Transfer (EFT) program; checking refund status over the web; and the joint agency Compliance Express project, which will web-enable vendors to obtain compliance documents from each agency online and the State to check the compliance status of vendors prior to making a purchase. Planning for a cashiering system, and other technology initiatives are also underway.

System Administration Office

The System Administration Office (SAO) was created in November 2002, following the phased implementation of the first of two components of the ITIMS Tax Processing System (ITPS). Phase 1 replaced the Legacy CNIT system. It included a major conversion of income tax accounts, both individual and business, with a balance due, or credit balance as of the conversion date. Phase 2, the conversion of the Legacy GEW system, was completed in October 2004.

The SAO acts as a liaison between the business operations users and the technical support areas, providing support for ongoing system changes that are table driven, as well as the creation of system generated correspondence. The primary function this past year has been as ITPS testing resources. In addition, SAO staff were instrumental during the prioritization process for logged change requests for problems and system enhancements. SAO also takes the lead for annual Tax Law Changes, identifying the system changes that must be made based on legislation passed during the past session.

Based on Departmental needs, as of June 30, 2005, the SAO staff has been re-assigned to the operating divisions, with half the staff supporting the Tax Services and Processing Division operations, and the other half supporting Compliance Division operations.

Tax Research and Planning Office

The Tax Research and Planning Office (TR&P) analyzed over 371 tax-related proposals during the 2005 legislative session to assess the potential tax revenue impact of each bill. Monthly tax collection reports are prepared by the staff, including preliminary and final revenue data, general excise, transient accommodations, fuel, and liquor tax receipts. TR&P annually publishes statistical compilations of individual and business income tax returns and tax credits. The Department of Taxation's Annual Report is assembled and edited by the TR&P staff. The office also provides administrative and technical support to the Council on Revenues.

The Council on Revenues (COR) consists of seven economic experts who project for the State general fund tax revenues and State total personal income. This critical information is used to determine general fund expenditure limits. TR&P assists this commission as needed and requested, applying advanced econometric modeling techniques and processing raw data from the Department's electronic databases. For fiscal year 2005, the Council estimated a 14.6% increase in general fund collections; actual revenue amounted to $3,997.5 million, a 16.0% improvement over the previous year. Hawaii personal income was forecasted to grow by 5.8% in calendar year 2004; the United States Bureau of Economic Analysis reported calendar year 2004 personal income at $40.7 billion in June 2005, or 7.0% more than calendar year 2003.

TR&P staff worked concurrently on three publications: “Tax Credits Claimed by Hawaii Taxpayers - 2002" (published July, 2004), "Hawaii Income Patterns – Individuals -2002" (published July, 2004), and “Hawaii Income Patterns - Corporation, Proprietorship, Partnership - 2002” (awaiting final edits). The updated 2003 versions of the two published studies have been started, with completions expected in fiscal year 2006.

Taxpayer Advocacy Program

The Taxpayer Advocacy Program is administered by the department’s Taxpayer Advocate under the direction of the Director of Taxation. The Taxpayer Advocate assists taxpayers who were not able to resolve their problems through the normal channels. This position is a one-person operation whose main focus is on the needs of the taxpayer on a case-by-case basis.

For fiscal year 2005, the advocacy program assisted 252 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, inaccessibility to access the information/communication phone lines, appeal and general tax information. Additional cases did not require intervention from the advocate, but mainly guiding the taxpayer to the right management personnel.

The Taxpayer Advocacy Office also coordinates the department’s joint outreach venture which provides tax services to communities that do not normally have access to these services. A variety of tax services are provided, such as acceptance of the General Excise Tax license applications, explaining assessment notices, arrangement of payment plans, voluntary compliance, requests for waiver of penalties and interest amounts, preparation of individual income tax and general excise tax returns, and answering general tax questions.

During the 2005 tax season, the Department partnered with the American Association of Retired People (AARP) through their Tax Aide Program in bringing tax assistance to the island of Molokai. Under the AARP program, volunteer counselors are trained and IRS-certified to assist the elderly, low income, limited English speaking, and/or disabled taxpayers in the preparation of their Federal and State income tax returns. A representative of the Office of the Taxpayer Advocate in Hawaii was on hand to assist taxpayers with their questions and resolution of their tax concerns. The joint outreach on Molokai assisted approximately 50 taxpayers who were very appreciative of the services provided.

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

MANAGEMENT PERSONNEL

(FY 2004 – 2005)

OFFICE OF THE DIRECTOR

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

STAFF OFFICES

Rules Officer..Jayna Uyehara
Tax Research & Planning Officer..Tu Duc Pham
    Economic Research Program Manager..Vacant
Information Technology Services Officer..Clay Sato
Administrative Services Officer..Mary Ann Teshima
    Personnel Officer..Sharon Iwamura

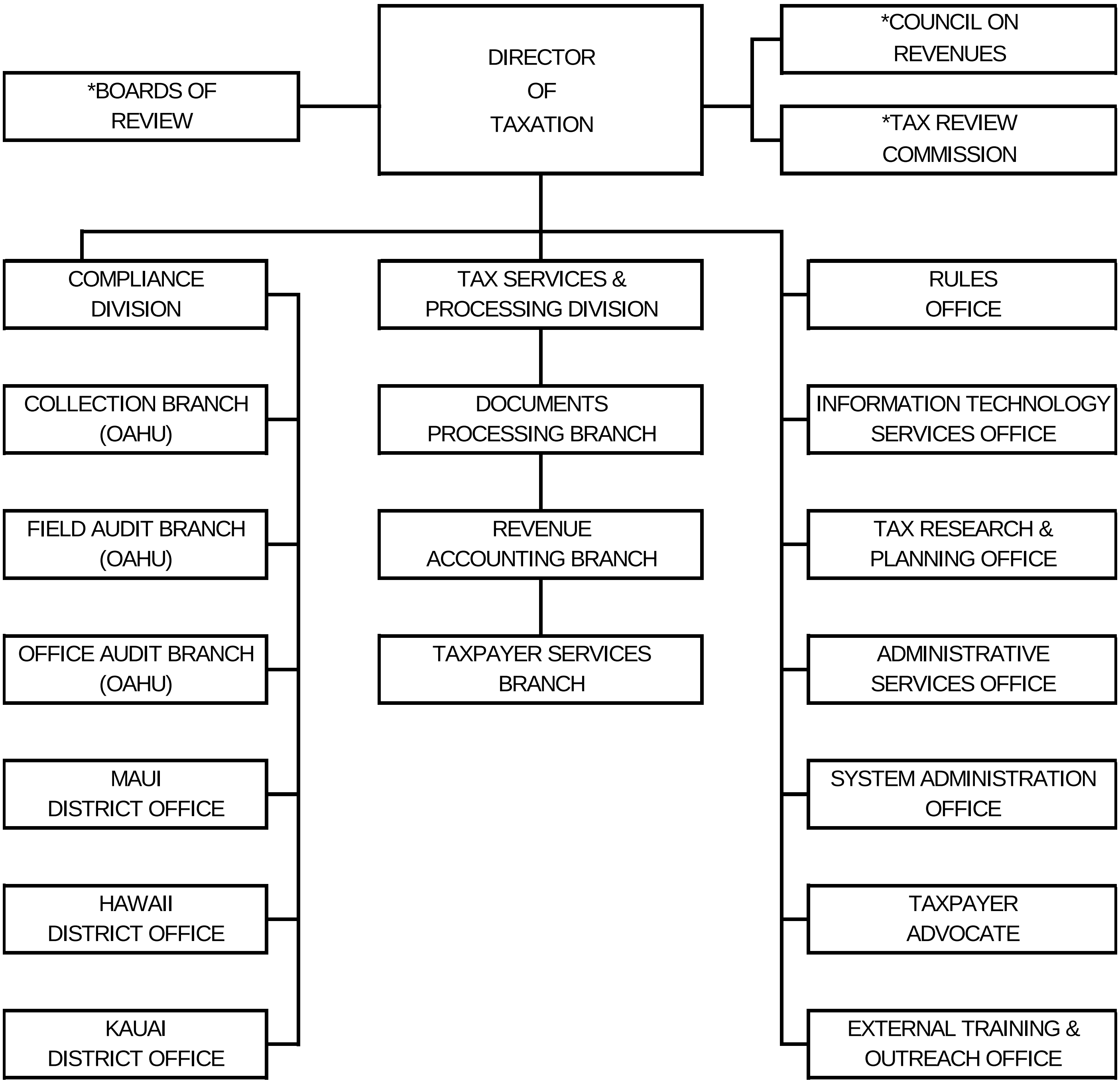
OPERATIONS STAFF

Compliance Division Chief..Ronald Randall
    Tax Audit Technical Coordinator..Richard Chiogioji
    Tax Collection Technical Coordinator..Wayne Kinoshita
    Oahu Field Audit Branch Chief..Vacant
    Oahu Office Audit Branch Chief..Kenneth Cook
    Oahu Collection Branch Chief..Lynne Kaneta
    Maui District Tax Manager..Frederick Pablo
    Hawaii District Tax Manager..Lincoln Fujimori
    Kauai District Tax Manager..Randall Goto (Acting)

Tax Services and Processing Division Chief..Joan Bolte
    Taxpayer Services Branch Chief..Annette Yamanuha
    Document Processing Branch Chief..Jerry Ebesu
    Revenue Accounting Branch Chief..Deanne Obatake

ORGANIZATION CHART

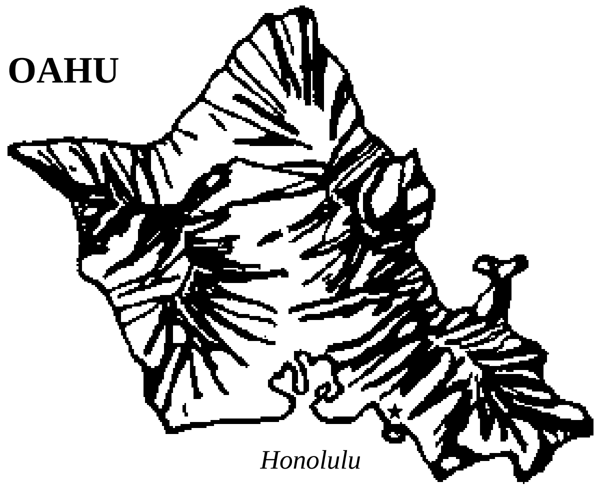
Department of Taxation
State of Hawaii



* For Administrative Purposes

FIRST TAXATION DISTRICT

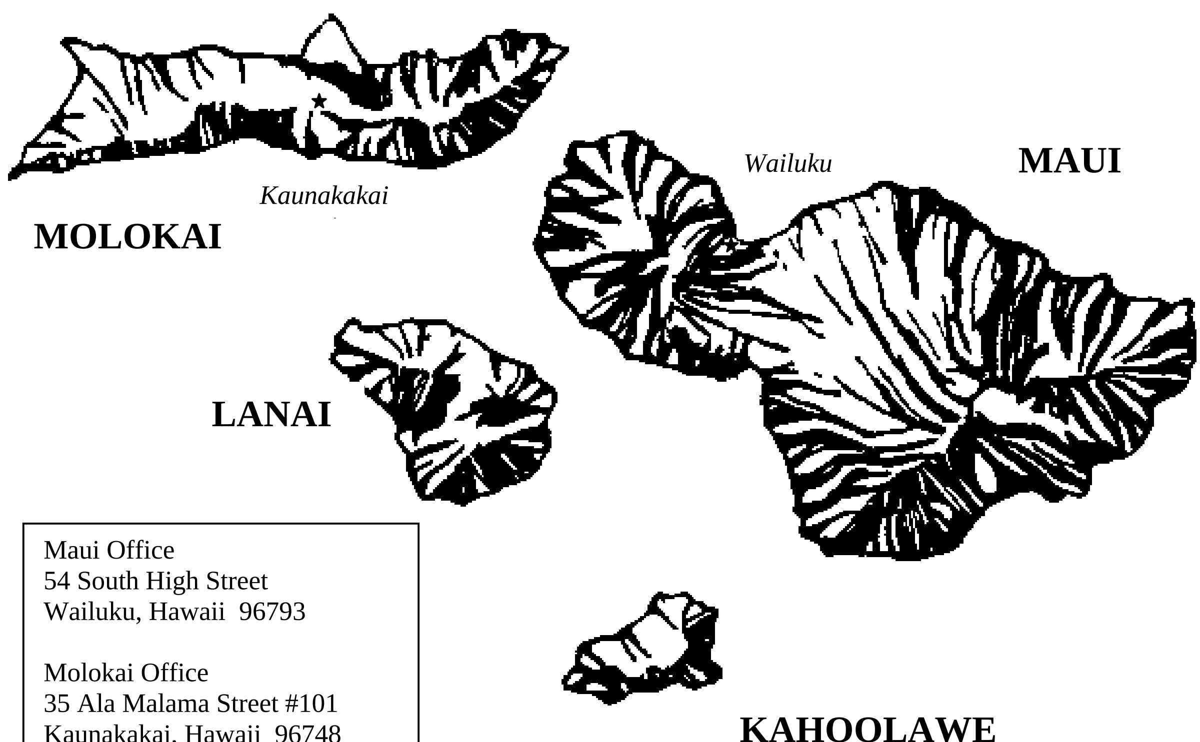
Island of Oahu



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

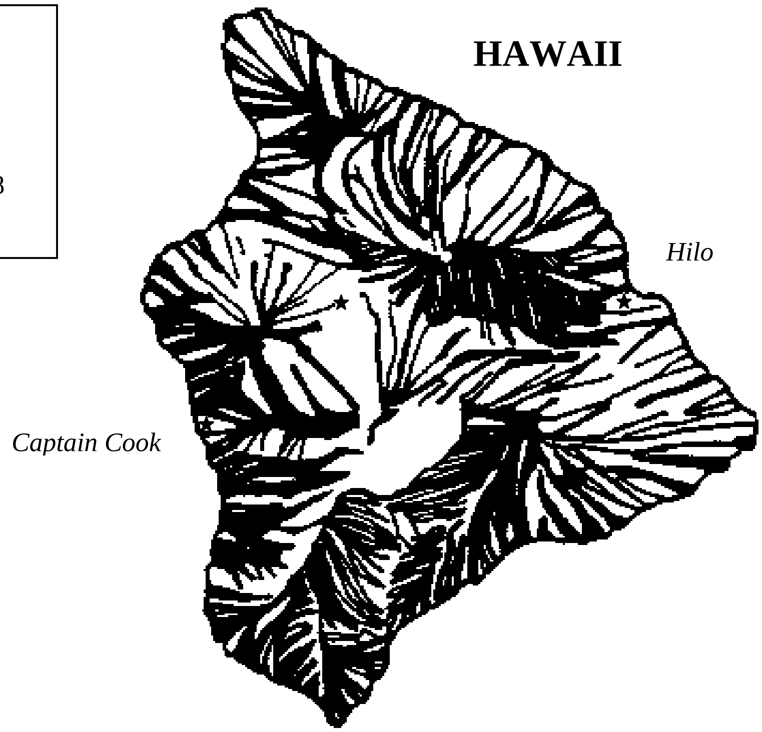
Molokai Office
35 Ala Malama Street #101
Kaunakakai, Hawaii 96748

THIRD TAXATION DISTRICT

Island of Hawaii

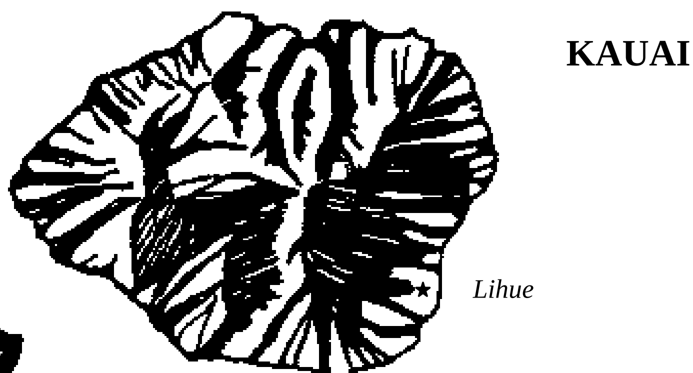
Hilo Office
75 Aupuni Street
Hilo, Hawaii 96720

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 are presented to the Board of Review. Statewide, the boards began the fiscal year with 78 pending tax appeals. A total of 28 appeals were settled, while 54 new appeals were filed, resulting in a total of 94 appeals pending at the end of the year. The following table summarizes the number of appeals before the boards by tax district:

	Oahu	Maui	Hawaii	Kauai	Total
Appeals pending (beginning)	78	0	0	0	78
New appeals	33	5	16	0	54
Appeals withdrawn	10	0	0	0	10
Appeals settled	18	2	8	0	28
Appeals pending (ending)	83	3	8	0	94

COURT DECISION

SETTLED CASES

In re ANC Rental Corp., et al., Bk. Case No. 01-11200 (Chapter 11), United States Bankruptcy Court for the District of Delaware.
The Department assessed the Debtors for unpaid general excise taxes on gross business income earned from their rent-a-car service business in Hawaii. The Debtors filed a protective appeal at the Board of Review and objected to the Department's priority and unsecured claims, asserting that the corporate structure established between and among the companies were to securitize bonds and was merely a formality. After extensive negotiations, the Department compromised its claims with the ANC Liquidating Trust, which holds only approximately $21 million to pay all claims. The Department will receive the settlement proceeds in FYE 2006.

In re Encompass Services Corporation, et al., Bk. Case No. 02-43582-H4-11 (Chapter 11, Jointly Administered), United States Bankruptcy Court for the Southern District of Texas, Houston Division.
The Department held approximately $853,000.00, with statutory interest at eight percent, in priority claims to be paid from 2006 through 2008 under a confirmed plan. The claims were based on proposed assessments for unpaid general excise taxes. The Department and the Debtors agreed to a lump sum payment in 2004.

In re Fleming, Inc. et al., Bk. Case No. 03-10944 (Chapter 11), United States Bankruptcy Court for the District of Delaware.
After three or four months of determining the Department's administrative claims, having returns properly filed, and having the administrative claims paid, the Department received a lump sum payment in full satisfaction of its priority claim. Under the confirmed plan, the Department was to receive payment over time at an interest rate of five percent.

In the Matter of the Tax Appeal of Government Technology Services, Inc., T.A. 00-0053, Tax Appeal Court, State of Hawaii.
The settlement agreed to involve the Department keeping a certain amount paid into the litigated claims fund under protest and refunding Taxpayer the balance with interest running from November 1, 2004 at the statutory rate of eight percent. The settlement allowed the Department to keep 100 percent of the general excise tax assessment with a refund to Taxpayer of the use tax assessment. The refund resulted from: (1) Taxpayer's position that the Hawaii Supreme Court's unanimous opinion in Baker & Taylor controlled this case; (2) Taxpayer's threat to seek a judicial

declaration that section 7 of Act 114 is unconstitutional because it amends Hawaii's use tax law retroactively and insofar as Act 114 overturns the Baker & Taylor decision, it violates the separation of powers doctrine; and (3) even if Act 114 could withstand challenge, proof problems—exist, i.e., the prosecution of this case would necessitate substantial discovery on all of Taxpayer's sales and contracts dating back over ten years and would divert resources from the Department's field audit division that could be better utilized on other cases.

In the Matter of the Tax Appeal of HEI Diversified and Subsidiaries, T.A. No. 03-0169, Tax Appeal Court, State of Hawaii.
Taxpayer appealed to the tax appeal court from franchise tax assessments for tax years 1999 through 2001 the effect of which was to deny Taxpayer the dividends received deduction in Haw. Rev. Stat. § 237-7 for dividends it received from a wholly owned real estate investment trust. Taxpayer challenged the assessments arguing that it was entitled to the deduction because IRC § 243 is not operative in Hawaii, and IRC § 857(c) refers to this inoperative provision, the dividends were fully deductible. The tax appeal court ruled in favor of the Department. The Department and Taxpayer reached a settlement when the case was on appeal to the Hawaii Supreme Court.

In the Matter of the Tax Appeal of JCB International, Inc., T.A. 00-0202, Tax Appeal Court, State of Hawaii.
The Department assessed Taxpayer general excise taxes upon its merchant discount income and cardmember fee income it received for tax years 1982 through 1996. Taxpayer and the Department settled the case before the tax appeal court decided the case.

In the Matter of the Tax Appeal of The Director of Taxation (Majestic Corp. of Maui), T.A. No. 01-0205, Tax Appeal Court, State of Hawaii.
The Department appealed from a Board of Review decision in favor of Taxpayer, an employee leasing company. The Department assessed Taxpayer general excise taxes on income it received from its clients that was subsequently used for the payroll of the employees it leased to its clients. Taxpayer claimed the reimbursement and common paymaster exemptions applied. After the tax appeal court issued a preliminary ruling for the Department, Taxpayer and the Department reached a settlement.

In re Sukamto Sia, Bk. Case No. 98-04912 (Chapter 7), United States Bankruptcy Court for the District of Hawaii.
To forestall the Department's filing of an administrative claim against the Debtor's estate for 2000 income taxes, the Department agreed to settle any claim with the Chapter 7 trustee for a lump sum. The settlement was based on an audit and pending settlement between the Trustee and the IRS.

PENDING APPEALS

In the Matter of the Tax Appeal of Donald Lewis, S. Ct. No. 26431, Supreme Court of the State of Hawaii.
The intermediate court of appeals affirmed the tax appeal court's decision to dismiss Taxpayer's appeal. Taxpayer is a tax protestor who contended that Oahu was not part of the State of Hawaii and that, therefore, any income earned on Oahu was not subject to state income tax. The Hawaii Supreme Court granted the Taxpayer's petition for writ of certiorari.

In the Matter of the Tax Appeal of Medical Underwriters, S. Ct. No. 27023, Supreme Court of the State of Hawaii.
The Department assessed Taxpayer the four percent general excise tax on income for providing management services to certain insurance companies. Taxpayer argued that it was exempt from the general excise tax because it was an insurance company.
After the filing of various motions for summary judgment, the tax appeal court held that Taxpayer was not exempt from the general excise tax and the income it received as commissions or compensation for services rendered as an attorney-in-fact to the insurance companies was taxable at the 0.15 percent general excise tax rate with taxes totaling $3,943.95. The Department and Taxpayer appealed to the Hawaii Supreme Court.

In the Matter of the Tax Appeal of Bobby R. Narmore, S. Ct. No. 26812, Supreme Court of the State of Hawaii.
Taxpayer filed an appeal to the Hawaii Supreme Court arguing that the tax appeal court should not have dismissed his case. Taxpayer argued that the Department could not collect the taxes owed for the years in question because the statute of limitations for the Department to assess had expired. The case is fully briefed and awaiting disposition.

In the Matter of the Tax Appeal of Subway Real Estate Corp., S. Ct. No. 26488, Supreme Court of the State of Hawaii.
The Department assessed Taxpayer for subleasing income for 1992. Taxpayer appealed the assessment to the tax appeal court. The tax appeal court determined that the Department could assess general excise taxes on the value of services Taxpayer provided pursuant to In re C. Brewer & Co., Ltd., 65 Hawaii 240 (1982), but not on Taxpayer's subleasing income. The Department appealed to the Hawaii Supreme Court and the case is currently pending.

In the Matter of the Tax Appeals of Central Pacific Bank, T.A. Nos. 02-0075, 03-0155, and 05-0041, Tax Appeal Court, State of Hawaii.
Taxpayer appealed from assessments of franchise taxes resulting from the disallowance of a deduction for dividends it received from a wholly owned real estate investment trust (REIT). Taxpayer claimed that because IRC § 857(c) (which is operative in Hawaii and denies the deduction for dividends paid by a REIT) refers to IRC § 243 (which is inoperative), it was entitled to take a deduction for $89 million in dividends it received from a REIT. We are attempting to settle this case by offering the same settlement terms used in the HEI Diversified appeal.

In the Matter of the Tax Appeal of Hale Kupuna Heritage Home, LLC, T.A. No. 04-0042, Tax Appeal Court, State of Hawaii.
The Department assessed Taxpayer for Hale Omao Inc.'s general excise tax liabilities and Benjamin and Mary Aranio's income tax liabilities pursuant to Haw. Rev. Stat. § 237-43 (2001) because no bulk sales report was obtained or filed when Taxpayer bought Hale Omao's 84-bed care home business and the Aranios' real property where the care home business is located. The case is currently in discovery.

In the Matter of the Tax Appeal of Innovation Data Processing, Case No. 05-0051, Tax Appeal Court, State of Hawaii.
Taxpayer appealed income tax assessments for tax years 1974 through 1980. Taxpayer claims that the assessment violates the Commerce Clause because Taxpayer did not have substantial nexus in Hawaii. The Notice of Appeal has not yet been properly served. We are currently considering filing a motion to dismiss the appeal on the following bases: (i) improper service; (ii) because Taxpayer is a corporation, it may not appear pro se; and (iii) although a complaint under Haw. Rev. Stat. § 40-35 may have been timely, a tax appeal is untimely.

In the Matter of the Tax Appeal of the Director of Taxation, State of Hawaii v. Donald J. Karleen and Barbara Brown-Karleen, Case No. 04-0045, Tax Appeal Court, State of Hawaii.
The Department appealed the Board of Review's decision in favor of Taxpayers. Taxpayers claimed the Residential Construction and Remodeling Tax Credit and the General Income Tax Credit for tax year 2001. However, it is unclear when Taxpayers made the claim. The Department denied the claim on the basis that the claim was untimely. The Department has no record of receiving the tax return Taxpayers alleged they submitted until after the deadline for making the claim. The matter has been scheduled for trial for the week of March 13, 2006. We are currently conducting discovery.

Make-up Arts Cosmetics Inc. v. Director of Taxation, State of Hawaii, T.A. No. 03-0259, Tax Appeal Court, State of Hawaii.
The Department assessed Taxpayer the general excise tax as follows: 0.5 percent for the wholesale of make-up products sold, four percent on services provided at its counters in the stores, and 4.5 percent on the import and sale of furniture and fixtures. The case is currently in discovery to determine the validity of Taxpayer's claims that the assessments are incorrect for the following reasons: it did not sell nor did it import any products in Hawaii and that it had sharing agreements with the stores concerning the employees at the counters.

In the Matter of the Tax Appeal of Pitney Bowes, Inc., T.A. No. 03-0182, Tax Appeal Court, State of Hawaii.
The Department assessed Taxpayer additional general excise taxes based on the difference in income reported on its net income and general excise tax returns. Taxpayer has been unable to provide the Department with any documentation explaining the difference to date. We are currently waiting for additional information from Taxpayer.

In the Matter of the Tax Appeal of Proservice Hawaii Business Development Corporation, T.A. 00-0036, Tax Appeal Court, State of Hawaii.
Taxpayer, a professional employment organization, appealed from a general excise tax assessment for tax year 1998. Taxpayer only paid twenty percent of the four percent general excise tax for that year, claiming that it was a business development company ("BDC"). The Department disallowed the special tax rate for BDCs because it determined that Taxpayer was not a BDC, which was intended to primarily make "last resort" loans as outlined and clarified by Haw. Rev. Stat. §§ 420-2(a) and (b). The Department determined that Taxpayer was actually engaged in the service business subject to general excise tax under Haw. Rev. Stat. chapter 237. Cross motions for summary judgments on the BDC issue were denied. The court reasoned the matter involved a question of fact. Trial is currently scheduled for the week of January 9, 2006. The parties are currently in settlement discussions.

In the Matter of the Tax Appeals of American Express Travel Related Services Company, Inc. T.A. Nos. 00-0083, 01-0206, Tax Appeal Court, State of Hawaii.
These cases involve assessments of general excise taxes upon the Taxpayer's merchant discount income (paid by merchants for the right to use the American Express charge card), and annual fees paid by cardmembers. The Department and the Taxpayer entered into a Closing Agreement during the month of July and these cases will be dismissed after the terms of the settlement have been implemented.

CRIMINAL CASES

During fiscal year 2005 the Criminal Justice Division of the Department of the Attorney General filed complaints or indictments against 42 taxpayers for violating Hawaii State tax laws as set out in Haw. Rev. Stat. §§ 231-34, 231-35, and 231-36. The complaints and indictments filed against the 42 taxpayers accounted for over $1,597,281in unpaid taxes (excluding civil assessments, penalties, and interest.). To date, the courts have imposed criminal fines of $78,000.[1]

During FYE 2005, Criminal Tax Collector Ms. B. Yamada collected over $1,739,206 in unpaid taxes, penalties, and interest.[2] The amount collected increased by over 410 percent from the previous fiscal year.

Eight out of the 42 taxpayers were corporations that were charged with failing to file returns. Two of the eight corporations failed to file withholding tax returns while claiming to have paid withholding taxes noted on the employees' Forms W-2. Due to the nature of withholding taxes, personal liability for unpaid taxes was attached to the individual owner/officer and theft charges were included with the failure to file charges.

The Department notched its biggest victory to date in October 2004, when three-time tax violator, Richard J. Basuel, was sentenced to the maximum ten years in prison and ordered to pay $60,000 in fines for his attempted tax evasion, aiding in the filing of false returns, and first-degree theft charges.

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[1] Criminal fines are imposed at sentencing; to date, only fifteen out of the 42 taxpayers have been sentenced.
[2] $401,583 of the $1.7 million was collected as a result of an ongoing "Realtor project" in which criminal complaints or indictments will be filed during fiscal year 2006. The "Realtor project" involves real estate agents who are making commissions totaling in the six-digits per year but fail to file (and pay) the applicable general excise taxes.

OTHER CASES

John P. Souza, a proclaimed citizen of the Hawaiian kingdom and a retired Honolulu fire captain, was sentenced to one year in jail and warned about spending another four years behind bars for his insistence that his wage income was nontaxable. A jury found John P. Souza guilty of theft and false statements for his filing of false individual income tax returns by claiming he had zero income despite his substantial Form W-2 wages.

Despite a Hawaii Supreme Court opinion that wages are taxable and the court's ruling that Neil A. Rhoads' filing was "frivolous," Taxpayer insisted on filing false returns, claiming he had zero income despite his substantial Form W-2 wages. Taxpayer's guilty conviction netted him thirty days in jail and five years of probation.

The Department received media coverage on Channel 2 News' Action Line after reporting to the station that two tax return preparers were recently indicted for preparing false and fraudulent returns. Petala Lakatani of Honolulu and Maile T. Tuionetoa, a Tongan national preparing returns on Maui, were named in the television coverage along with a warning to the public that because taxpayers received erroneous refunds, taxpayers were personally liable to pay all taxes plus applicable interest and penalties.

Along with the above-mentioned cases, projects such as the Oahu Transit Bus Drivers who had no taxes withheld from their paychecks and subsequently did not file tax returns, and "taxpayers" claiming zero income despite substantial earnings, have been coming to a close because the court indicted the last of the originally identified offenders.

OTHER MATTERS CLOSED

Appeals	-	8
Bankruptcies	-	285
Foreclosures	-	213
Subpoenas	-	7
Opinions	-	4
Contracts	-	1
Legislation	-	874
Miscellaneous	-	18

AMOUNTS COLLECTED

Tax Appeals	$31,042,821
Foreclosures	56,549
Bankruptcies	2,345,900
Trusts	0
Miscellaneous	282,263
TOTAL	$33,727,533

LEGISLATION

The 2005 legislature enacted the following tax-related measures:

Act	Brief Description
3	**Streamlined Sales and Use Tax Agreement Project.** Establishes requirements, procedures, standards, and guidelines for compliance with the Streamlined Sales and Use Tax Agreement project. Allows contractors contracted by the Legislative Auditor to support the project to inspect tax returns and other information for the purpose of conforming the State's general excise and use taxes to the Model Agreement and Act. Appropriates $50,000 to be expended by the Legislative Auditor. *Effective on July 12, 2005; provided that the appropriation section takes effect on July 1, 2005.*
9	**Taxpayer Information.** Allows the State to share taxpayer information with the counties. *Effective on July 12, 2005.*
23	**Disposition of Real Property.** Clarifies that where a Limited Liability Company (LLC) formed or registered to do business in Hawaii consists of a single member and the LLC has not elected to be taxed as a corporation, the LLC will also be disregarded for purposes of the Hawaii Real Property Tax Act and the sole member treated as the transferor. *Effective on April 22, 2005, and applies to taxable years beginning after December 31, 2004.*
27	**Income Tax Withholding.** Clarifies the State withholding tax provisions for employers with state withholding tax liabilities exceeding $40,000 annually. Also conforms state law to federal withholding provisions by defining a "semi-weekly schedule" similar to the federal provisions and incorporating the federal three-day banking rule. *Effective on April 25, 2005.*
58	**ERS.** Clarifies and corrects the Employees' Retirement System (ERS) statutes and conforms ERS statutes to current practices. Among other things, requires the ERS to comply with federal income tax limits on compensation in determining ordinary death benefits. *Effective on July 1, 2005; provided that the federal limits on annual compensation for ordinary death benefits takes effect retroactively to July 1, 1996.*
60	**IRS Conformity.** Amends Hawaii's Income Tax Law to conform with the changes to the Internal Revenue Code with exceptions. *Effective May 19, 2005; applies to taxable years beginning after December 31, 2004, except as otherwise provided.*
67	**Rental Motor Vehicle Surcharge Tax.** Permanently exempts lessors from the rental motor vehicle surcharge tax if they rent vehicles to replace a vehicle of the lessee that is being repaired. *Effective on May 23, 2005.*
82	**Mortgage Foreclosures.** Authorized nonjudicial foreclosure of timeshare interests under a power of sale if the mortgagee or the mortgagee's successor in interest gives notice of the intent to foreclose upon a mortgage. Copies of the notice shall be filed with the Director of Taxation and posted on the premises of the timeshare interest not less than 21 days before the day of the sale. *Effective on January 1, 2006.*
116	**Scholarship Program for Nurses.** Establishes a nursing scholarship program and exempts scholarship grants under the program from taxable income. *Effective on July 1, 2005.*
131	**Retail Tobacco Permit.** Requires businesses engaged in the sale of cigarettes and other tobacco products at the retail level to obtain a retail tobacco permit from the Department of Taxation beginning December 1, 2006. Makes it a criminal offense for any retailer to sell cigarettes and other tobacco products without a valid retail tobacco permit. *Effective on June 16, 2005; provided that the Act is repealed on July 1, 2009, and reenacted in the same form prior to the enactment of this Act.*

146 **Private Sewer Company or Facility.** Imposes the public service company tax on the gross income of a private sewer company or facility. *Effective on July 1, 2005.*

156 **Conveyance Tax.** Increases conveyance tax rates on property sold for $600,000 or more based on a sliding scale and, if the transferee is ineligible for a county homeowner's exemption, on all condominiums and single-family residences on a sliding scale. Requires that revenues collected from the conveyance tax be allocated as follows: 10 percent to the Land Conservation Fund, 30 percent to the Rental Housing Trust Fund, 25 percent to the Natural Area Reserve Fund, and 35 percent to the General Fund. *Effective on July 1, 2005.*

167 **Tax Refunds.** Allows taxpayers to appeal a denial of a tax refund claim by filing a written notice of appeal to the board of review or to the tax appeal court within 30 days after notice of the denial of the claim. Further allows taxpayers to file an appeal of a refund claim when the Department of Taxation fails to act on the claim within 180 days after the claim was filed. *Effective on June 28, 2005, and applies to tax refund claims filed after June 30, 2005.*

183 **Important Agricultural Lands.** Establishes State and county policies and procedures for identifying important agricultural lands. Requires the Department of Agriculture, with the assistance of the Department of Taxation, to conduct a study and develop proposals for agricultural incentives. *Effective on July 1, 2005.*

196 **Housing.** Establishes a general excise tax exemption for developers of certified housing projects when: (1) at least 50 percent of the available units are for households with incomes at or below 80 percent of the median family income; and (2) at least 20 percent are for households with incomes at or below 60 percent of the median family income. Authorizes the Housing and Community Development Corporation of Hawaii to establish and collect a service fee in connection with the certification process. *Effective on July 1, 2005.*

Increases the low income housing tax credit from 30 to 50 percent of the applicable percentage of the qualified basis of each building located in Hawaii. Creates the Hawaii Housing Finance and Development Administration and designates it as the state housing credit agency to administer the low income housing tax credit. *Effective on July 1, 2005.*

211 **Procurement.** Eliminates the requirement that small purchase contracts awarded (less than $25,000) by the State must obtain tax clearances, certificates of good standings, and certificates of compliance. *Effective on July 8, 2005.*

235 **Transient Accommodations Tax (TAT).** Increases the TAT allocation to the Tourism Special Fund to 34.2 percent to provide a dedicated source of funding for the Hawaii Tourism Authority. Requires excess TAT revenues to be deposited into the general fund. Repeals the TAT Trust Fund. Removes the requirement that the amount deposited into the Tourism Special Fund exceed $62,292,000 before up to $1,000,000 can be allocated to the State Parks Special Fund and the Special Land and Development Fund. *Effective on July 1, 2005; provided that the sections of the Act amending Chapter 237D, HRS, take effect on July 1, 2007.*

247 **County Surcharge.** Allows counties the option of adding a surcharge of no more than 0.5 percent to the State's 4 percent general excise tax to be levied not earlier than January 2007 to fund public transportation systems in their respective counties. The Department of Taxation shall levy, assess, collect, and administer the county surcharge on state tax. *Effective July 12, 2005; provided that the counties adopt an ordinance to levy the surcharge by December 31, 2005, and the surcharge is repealed on December 31, 2022.*

INCOME ASSESSMENT AND AUDIT

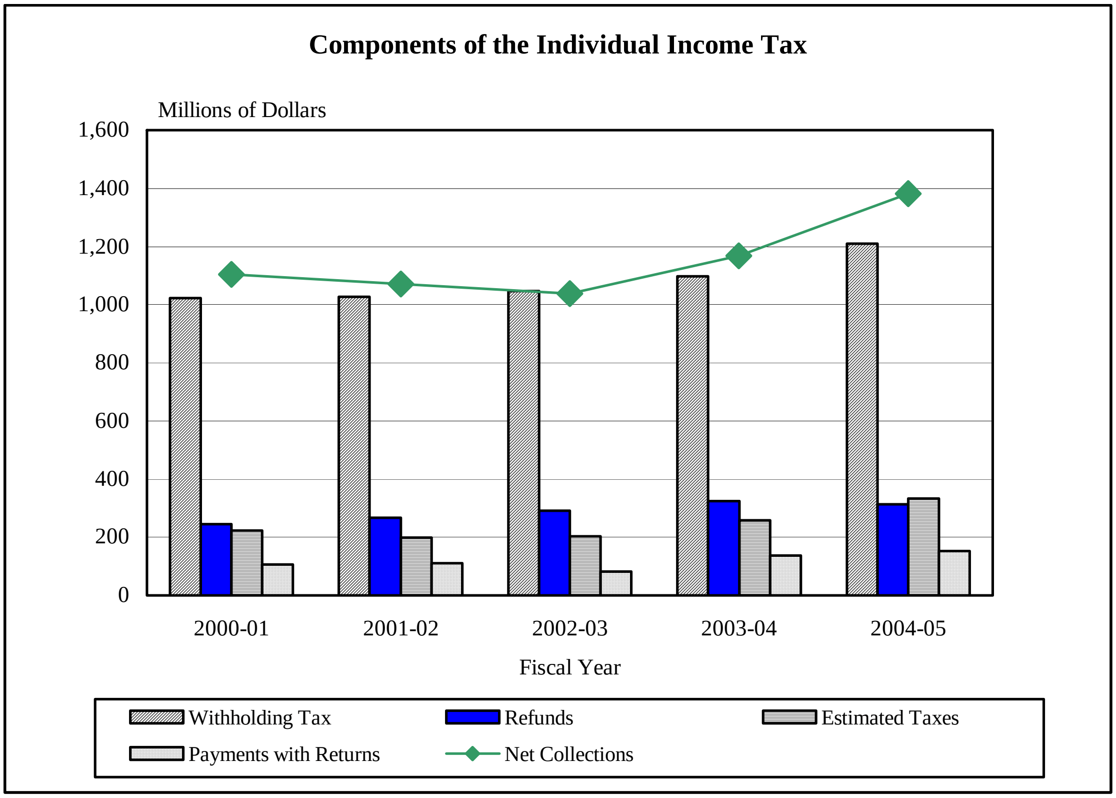
INDIVIDUAL INCOME TAX

Increased amounts of estimated taxes, payments with returns and withheld taxes over last year contributed to a $199.7 million growth in individual income taxes; furthermore, decreased refunds increased this sum by $12.8 million. Overall, net individual income tax increased by 18.2% from $1.2 billion in fiscal year 2004, to $1.4 billion in fiscal year 2005, mainly due to the strong growth of the economy, as well as increases in delinquent tax collections. A significant part of the increase was also due to the one-time impact of a new law that requires most businesses to conform to federal payment deadlines for remitting Hawaii payroll. As shown in the following chart, this was the highest net in the past five fiscal years.

TAXES PAID BY INDIVIDUALS
(In Thousands of Dollars)

			Difference	
	FY 2005	FY 2004	Amount	%
Declaration of Estimated Taxes	$ 332,808	$ 258,143	$ 74,665	28.9
Payment with Return	152,919	136,553	16,366	12.0
Withholding Tax on Wages	1,209,740	1,101,043	108,697	9.9
Subtotal	$1,695,467	$1,495,739	$ 199,728	13.4
Refunds	313,987	326,786	(12,799)	(3.9)
NET	$1,381,480	$1,168,953	$ 212,527	18.2

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



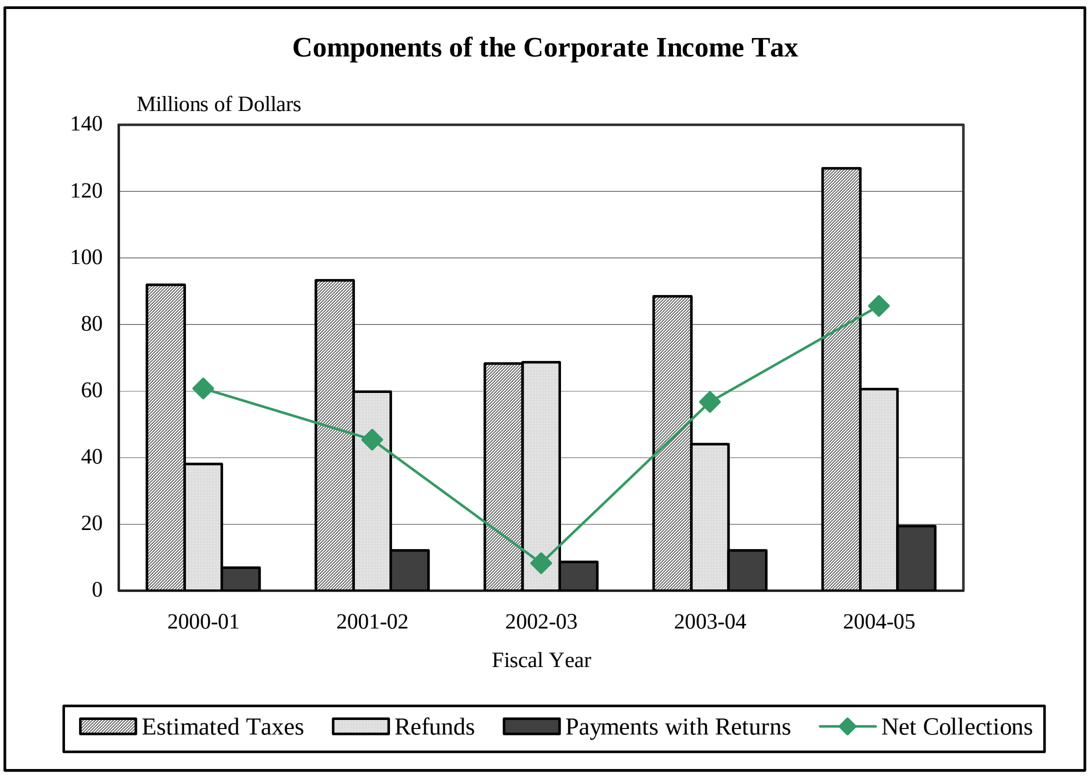
CORPORATE INCOME TAX

Net corporate tax collections totaled $85.6 million for fiscal year 2005, increasing a sizable $29.0 million over the previous year's total of $56.7 million. The increase was mainly due to strong economic growth, as well as increases in delinquent tax collections. This was the highest net over the last five fiscal years, as shown in the following chart. In fact, fiscal year 2005 set the new record high since the $68.2 million net in fiscal year 2000.

TAXES PAID BY CORPORATIONS
(In Thousands of Dollars)

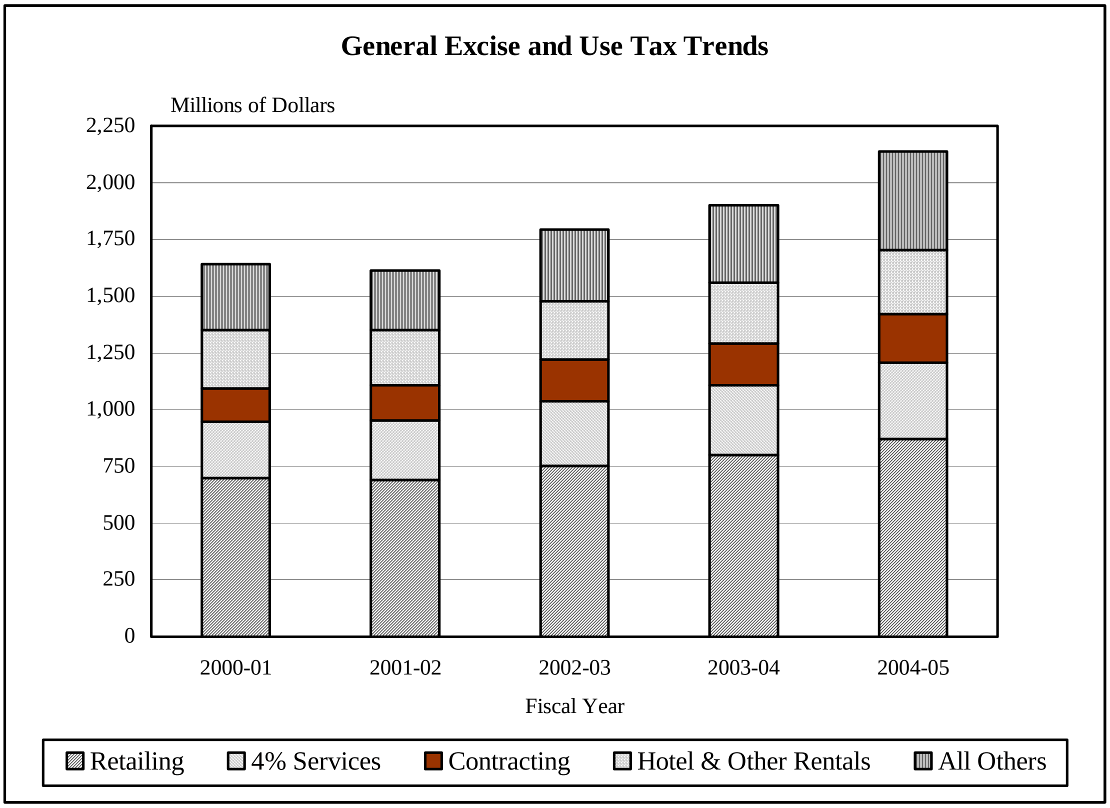
			Difference	
	FY 2005	FY 2004	Amount	%
Declaration of Estimated Taxes	$ 126,863	$ 88,554	$ 38,309	43.3
Payment with Return	19,413	12,100	7,313	60.4
Subtotal	$ 146,276	$ 100,654	$ 45,622	45.3
Refunds	60,672	44,001	16,671	37.9
NET	$ 85,605	$ 56,653	$ 28,952	51.1

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



GENERAL EXCISE AND USE TAXES

General excise and use taxes made up 46.5% of total tax collections. The total $2.1 billion collected represents a 12.4% growth over the prior fiscal year. Contracting activities were especially strong and rose 18.5%. Other major components of the general excise taxes also showed healthy increases over the last fiscal year--retailing rose 8.7%, services 8.8%, hotel rentals 6.1% and all other rentals 4.1%.



GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 2005 AND 2004
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2005	FY 2004	Difference Amount	Difference % Change
TAX BASE					
Retailing		$ 21,747,790	$ 20,007,185	$ 1,740,605	8.7
Services		8,408,796	7,729,157	679,639	8.8
Contracting		5,384,758	4,544,061	840,696	18.5
Hotel Rentals		2,593,054	2,444,112	148,942	6.1
All Other Rentals		4,458,742	4,284,372	174,370	4.1
All Others (4%)		4,176,458	3,763,951	412,507	11.0
Subtotal		$ 46,769,598	$ 42,772,838	$ 3,996,760	9.3
Sugar Processing		$ 1,037	$ 1,701	$ (664)	(39.0)
Pineapple Canning		3,035	5,047	(2,012)	(39.9)
Producing		565,046	532,799	32,248	6.1
Manufacturing		660,025	651,433	8,591	1.3
Wholesaling		11,205,509	10,426,011	779,498	7.5
Use (1/2%)		5,868,988	6,020,471	(151,483)	(2.5)
Intermediary Services		316,661	326,612	(9,951)	(3.0)
Insurance Commissions		487,929	900,836	(412,907)	(45.8)
Subtotal		$ 19,108,230	$ 18,864,911	$ 243,320	1.3
TOTAL – ALL ACTIVITIES		$ 65,877,828	$ 61,637,749	$ 4,240,079	6.9
TAX					
Retailing	4.00%	$ 869,912	$ 800,287	$ 69,624	8.7
Services	4.00%	336,352	309,166	27,186	8.8
Contracting	4.00%	215,390	181,762	33,628	18.5
Hotel Rentals	4.00%	103,722	97,764	5,958	6.1
All Other Rentals	4.00%	178,350	171,375	6,975	4.1
All Others (4%)	4.00%	167,058	150,558	16,500	11.0
Subtotal		$ 1,870,784	$ 1,710,914	$ 159,870	9.3
Sugar Processing	0.50%	$ 5	$ 9	$ (3)	(39.0)
Pineapple Canning	0.50%	15	25	(10)	(39.9)
Producing	0.50%	2,825	2,664	161	6.1
Manufacturing	0.50%	3,300	3,257	43	1.3
Wholesaling	0.50%	56,028	52,130	3,897	7.5
Use (1/2%)	0.50%	29,345	30,102	(757)	(2.5)
Intermediary Services	0.50%	1,583	1,633	(50)	(3.0)
Insurance Commissions	0.15%	732	1,351	(619)	(45.8)
Subtotal		$ 93,833	$ 91,172	$ 2,662	2.9
Unallocated*		$ 171,986	$ 98,292	$ 73,694	75.0
TOTAL – ALL ACTIVITIES		$ 2,136,603	$ 1,900,377	$ 236,226	12.4

*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

Increases in average hotel room rate and visitor arrivals contributed to the 9.3% jump in transient accommodations tax (TAT). All TAT funds are distributed as follows: approximately 44.8% to the counties, 17.3% to the Convention Center Fund, 32.6% to the Tourism Special Fund, and 5.3% to the TAT Trust Fund. After these allocations, $12.4 million remained in the general fund for fiscal year 2005.

TRANSIENT ACCOMMODATIONS TAX
(In Thousands of Dollars)

	FY 2005	FY 2004	Difference Amount	Difference %
Trans. Accom./Time Share Occ. Tax	$ 198,774	$ 181,848	$ 16,927	9.3
Trans. Accom./Time Share Occ. Fees	10	12	(2)	(16.7)
Total	$ 198,784	$ 181,860	$ 16,924	9.3
Counties Share	$ 89,051	$ 81,468	$ 7,583	9.3
Convention Center Fund	32,534	31,460	1,074	3.4
Tourism Special Fund	64,800	63,292	1,508	2.4
General Fund	12,399	5,641	6,759	119.8
Total	$ 198,784	$ 181,860	$ 16,924	9.3

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

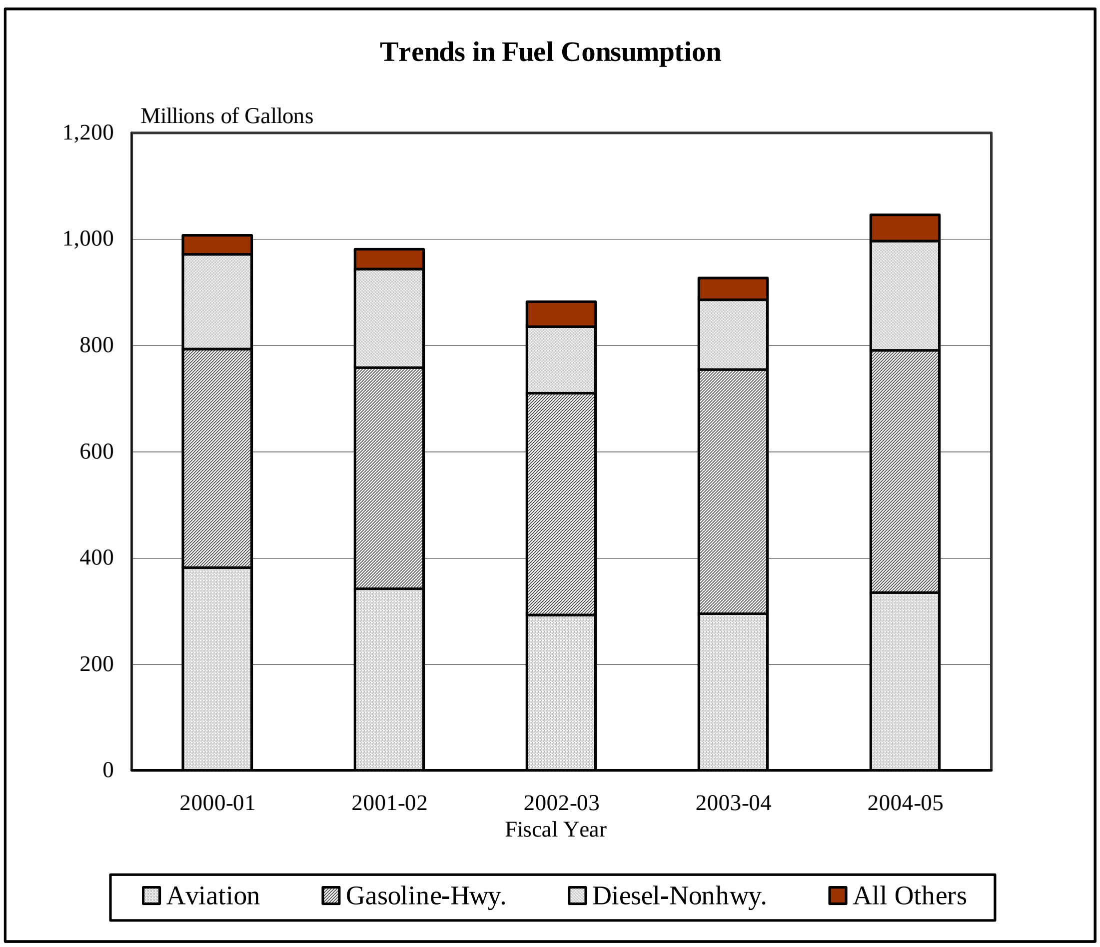
FUEL AND MOTOR VEHICLE TAXES

Fuel consumption increased 12.8% to 1.0 billion gallons in fiscal year 2005. As seen in the table below, diesel oil (on and off highway) consumption increased dramatically by 79.1 million gallons. Aviation fuel also increased by 39.8 million gallons. With the rising concern for the environment, other fuels (ethanol, methanol and biodiesel) increased more than double from 657,000 gallons to 1.7 million gallons. The largest drop was seen in liquid petroleum gas used on highway by 21.3%, or 74 thousand gallons. Gasoline consumption also decreased by 0.7%, or 3.3 million gallons. An environmental response tax of five cents is imposed on each barrel of petroleum product sold by a distributor to any retail dealer or end user. A total of 37.3 million barrels of petroleum was subject to the environmental response tax in fiscal year 2005, representing a growth of 14.6% from last year.

GALLONS OF FUEL CONSUMED
(In Thousands of Gallons)

	FY 2005	FY 2004	Difference Amount	Difference %
Gasoline	455,835	459,130	(3,295)	(0.7)
Diesel Oil – Nonhighway	205,242	131,178	74,064	56.5
Diesel Oil – Highway	44,129	39,126	5,003	12.8
Liq. Pet. Gas - Off Highway	3,121	1,015	2,106	207.5
Liq. Pet. Gas - Highway	273	347	(74)	(21.3)
Small Boats - Gasoline	11	2	9	423.8
Small Boats - Diesel Oil	36	14	22	157.1
Aviation Fuel	334,992	295,198	39,794	13.5
Other Fuel*	1,698	657	1,040	158.2
Total Gallons	1,045,337	926,668	118,670	12.8
Environmental Tax (Barrel)	37,312	32,553	4,759	14.6

*Includes ethanol, methanol, biodiesel.
NOTE: Due to rounding, details may not add to totals.



Revenues from fuel taxes are distributed to both the State and counties, and other special funds. Aviation fuel taxes collected are deposited into the airport fund, while all other State fuel tax collections are deposited into the State highway fund, except for 1% of State and county fuel taxes which is deposited into the State boating fund. Revenues from the motor vehicle weight taxes and fees, which are administered and collected by the counties, and rental motor vehicle and tour vehicle surcharge taxes are also added to the State highway fund. Monies from the environmental response tax is deposited into the environmental response revolving fund, which is administered by the Department of Health for oil spill prevention and remediation programs.

ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

			Difference	
	FY 2005	FY 2004	Amount	%
STATE HIGHWAY FUND:				
Gasoline	$ 72,017	$ 72,608	$ (591)	(0.8)
Diesel Oil – Non-highway	2,032	1,299	733	56.5
Diesel Oil - Highway	6,990	6,198	793	12.8
Liq. Pet. Gas – Off highway	31	10	21	207.5
Liq. Pet. Gas – Highway	14	18	(4)	(22.6)
Other Fuel	72	52	20	39.1
Subtotal	$ 81,157	$ 80,185	$ 972	1.2
Motor Vehicle	56,328	50,543	5,785	11.4
Rental Vehicle	43,950	41,414	2,536	6.1
Total	$181,435	$172,142	$ 9,293	5.4
COUNTY HIGHWAY FUND:				
City & County of Honolulu	$ 51,354	$ 49,271	$ 2,083	4.2
County of Maui	11,982	12,602	(619)	(4.9)
County of Hawaii	7,484	7,755	(271)	(3.5)
County of Kauai	4,102	4,179	(76)	(1.8)
Total	$ 74,923	$ 73,807	$ 1,116	1.5
BOATING SPECIAL FUND:	$ 1,577	$ 1,555	$ 21	1.4
STATE AIRPORT FUND:				
Aviation Fuel	$ 3,350	$ 2,952	$ 398	13.5
ENVIRONMENTAL TAX FUND:	$ 1,867	$ 1,628	$ 239	14.7

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

The State legislature sets the State fuel tax rates while the county councils set the county rates. The effective rates for fiscal year 2005 are shown below:

FUEL TAX RATES PER GALLON[1]

GASOLINE AND DIESEL OIL (HWY. USE):[2]	State	County	Total
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui	16.0¢	18.0¢	34.0¢
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	5.2¢	5.4¢	10.6¢
County of Maui	5.2¢	4.3¢	9.5¢
County of Hawaii	5.2¢	2.9¢	8.1¢
County of Kauai	5.2¢	4.3¢	9.5¢
ETHANOL:			
City & County of Honolulu	2.4¢	2.4¢	4.8¢
County of Maui	2.4¢	3.8¢	6.2¢
County of Hawaii	2.4¢	1.3¢	3.7¢
County of Kauai	2.4¢	1.9¢	4.3¢
METHANOL:			
City & County of Honolulu	1.9¢	1.8¢	3.7¢
County of Maui	1.9¢	2.9¢	4.8¢
County of Hawaii	1.9¢	1.0¢	2.9¢
County of Kauai	1.9¢	1.4¢	3.3¢
BIODIESEL:			
City & County of Honolulu	4.0¢	8.3¢	12.3¢
County of Maui	4.0¢	0.0¢	4.0¢
County of Hawaii	4.0¢	2.2¢	6.2¢
County of Kauai	4.0¢	0.0¢	4.0¢
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¢ per gallon.
[2]Includes 1¢ State license tax on diesel oil.

PUBLIC SERVICE COMPANY TAXES

Public utilities paid public service company taxes totaling $108.7 million, including penalty and interest. Act 9, Third Special Session, SLH 2001, allowed motor carrier-contract carriers to pay the 4% general excise tax instead of the public service company tax, effective October 1, 2001, thus, transferring certain revenue from public service company taxes to general excise tax revenue.

PUBLIC SERVICE COMPANY TAXES
(In Thousands of Dollars)

			Difference	
	FY 2005	FY 2004	Amount	%
Public Service Company Taxes	$108,853	$ 98,340	$ 10,513	10.7
Penalty & Interest	(167)	1,165	$ (1,332)	n/m
TOTAL	$108,686	$ 99,505	$ 9,182	9.2

NOTE: Due to rounding, details may not add to totals.
n/m = not meaningful

ESTATE AND TRANSFER TAXES

During fiscal year 2005, a total of 1,400 estates were settled, of which 220 were taxable. Estate tax collections totaled $12.7 million, compared to $9.8 million the year before.

ESTATE AND TRANSFER TAXES
(In Thousands of Dollars)

			Difference	
	FY 2005	FY 2004	Amount	%
Estate Tax	$ 12,603	$ 9,726	$ 2,877	29.6
Penalty & Interest	108	104	4	4.2
TOTAL	$ 12,712	$ 9,830	$ 2,882	29.3

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

OTHER TAXES

Total revenues from other miscellaneous taxes amounted to $410.1 million, $35.1 million higher than for the previous year. Employment security contributions decreased by $23.8 million. Tobacco tax collections exceeded last year’s total by $5.9 million, while insurance tax premiums again increased by $4.9 million, and conveyance taxes rose $8.8 million. The conveyance tax is imposed at the rate of $0.10 per $100 of the actual consideration paid for the transfer of ownership or interest in real property and is collected by the Bureau of Conveyances under the Department of Land and Natural Resources. One-half of revenues from the conveyance tax are deposited into State general fund, while the natural area reserve fund and the rental housing funds each receive 25%. Liquor tax collections rose 6.0%, or $2.5 million. The fiscal year 2004 franchise tax collection figure was lower than normal due to the fact that $16.5 million was transferred from the general fund to the litigated claims fund in fiscal year 2004. In contrast, the fiscal year 2005 franchise tax figure was higher than normal. The settlement resulted in an additional payment of $12 million from the taxpayer as well as the transfer of $16.5 million from the litigated claims fund back to the general fund.

MISCELLANEOUS TAXES*
(In Thousands of Dollars)

			Difference	
	FY 2005	FY 2004	Amount	%
Banks & Other Financial Corp.	$ 38,520	$ 1,466	$ 37,054	2,526.9
Conveyance	24,583	15,767	8,816	55.9
Empl. Security Contributions	134,459	158,281	(23,822)	(15.1)
Insurance Premiums	83,077	78,142	4,935	6.3
Liquor & Permits	43,737	41,250	2,486	6.0
Tobacco & Licenses	85,245	79,387	5,858	7.4
General Excise Licenses & Fees	427	641	(214)	(33.3)
TOTAL	$410,050	$374,936	$ 35,114	9.4

*Includes allocation to special funds.
NOTE: Due to rounding, details may not add to totals.

COLLECTION AND ACCOUNTING OF TAXES

TAX COLLECTIONS

Total tax collections amounted to $4.6 billion, 13.7% more than the $4.0 billion collected in the previous year. While the Department of Taxation collected the majority of taxes, the counties collected $100.3 million in State motor vehicle weight taxes and registration fees, Department of Commerce and Consumer Affairs collected $83.1 million in insurance premium taxes, and the Department of Land and Natural Resources collected $24.6 million in conveyance taxes.

TAX COLLECTIONS
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2005 Amount Collected	FY 2005 % of Total	FY 2004 Amount Collected	FY 2004 % of Total
Banks – Financial Corps.	$ 38,520	0.8	$ 1,466	0.0
Conveyance	24,583	0.5	15,767	0.4
Employment Security Contrib.	134,459	2.9	158,281	3.9
Fuel	162,873	3.5	160,127	4.0
General Excise & Use	2,136,603	46.5	1,900,377	47.0
Income – Corporations	85,605	1.9	56,653	1.4
Income – Individuals	1,381,480	30.1	1,168,953	28.9
Inheritance and Estate	12,712	0.3	9,830	0.2
Insurance Premiums	83,077	1.8	78,142	1.9
Liquor & Permits	43,737	1.0	41,250	1.0
Motor Vehicle Tax*	100,278	2.2	91,957	2.3
Public Service Companies	108,686	2.4	99,505	2.5
Tobacco & Licenses	85,245	1.9	79,387	2.0
Trans. Accom. Fees	10	0.0	12	0.0
Trans. Accom. Tax	198,774	4.3	181,848	4.5
All Others**	770	0.0	666	0.0
TOTAL	$ 4,597,415	100.0	$ 4,044,223	100.0

*Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental vehicle registration fees, and rental vehicle surcharge tax.
** Includes fuel retail dealer permits, fuel penalty and interest, and general excise fees.
NOTE: Due to rounding, details may not add to totals.

DISTRIBUTION OF TAXES

Of the total $4.6 billion in tax revenues collected, $4.0 billion, or 87.0% was deposited into the State general fund. The counties received 3.6%, or $164.0 million, which came from county fuel taxes and a portion of the transient accommodations tax. The remaining $435.9 million was distributed among several State special funds. The State highway fund received the largest portion, or $181.4 million. All of the employment security contributions, or $134.5 million, went into the unemployment trust fund for unemployment benefits. Portions of TAT went to the next two largest special funds: $64.8 million to the tourism special fund and $32.5 million to the convention center fund. Distribution of collections is shown in the following table.

DISTRIBUTION OF COLLECTIONS
(In Thousands of Dollars)

	FY 2005		FY 2004	
	Amount Collected	% of Total	Amount Collected	% of Total
STATE FUNDS				
State General	$ 3,997,539	87.0	$ 3,446,385	85.2
State Highway	181,435	4.0	172,142	4.3
State Airport	3,350	0.1	2,952	0.1
Boating Special Fund	1,577	0.0	1,555	0.0
Environmental Fund	1,867	0.0	1,628	0.0
Cigarette Stamp Admin/Enf. Fund	1,166	0.0	987	0.0
Compliance Resolution Fund	2,000	0.0	2,000	0.1
Unemployment Trust	134,459	3.0	158,281	3.9
Election Campaign Fund	220	0.0	265	0.0
Tourism Special Fund	64,800	1.4	63,292	1.6
Rental Housing Fund	6,146	0.1	3,942	0.1
Natural Area Reserve Fund	6,146	0.1	3,942	0.1
Convention Center Fund	32,534	0.7	31,460	0.8
Public Libraries Fund	87	0.0	0	0.0
School Repair & Maint. Fund	114	0.0	118	0.0
Subtotal - State	$ 4,433,441	96.4	$ 3,888,949	96.2
REVENUES TRANSFERRED TO COUNTIES				
Fuel	$ 74,923	1.6	$ 73,807	1.8
Trans. Accom. Tax	89,051	1.9	81,468	2.0
Subtotal – Counties	$ 163,974	3.6	$ 155,275	3.8
TOTAL	$ 4,597,415	100.0	$ 4,044,223	100.0

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.

Qualified residents may claim several different tax credits. Among the most common credits claimed by Hawaii residents are the low-income credit, the renter's credit, the dependent care credit, the energy device credit, and the child passenger restraint credit. Available to individuals with adjusted gross income (AGI) of $20,000 or less, the low-income credit is a credit that is inversely related to a taxpayer's AGI. The renter's credit is a flat $50 credit per exemption, including age exemptions, which is available to qualified resident renters with AGI under $30,000. Like its federal counterpart, Hawaii's dependent care credit reimburses a portion of expenses paid for the care of 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 allowed to individuals who purchase qualifying child passenger restraint systems. Among businesses, the most commonly claimed tax credit is the capital goods excise tax credit.

Hawaii has 17 separate tax laws, of which 14 are administered by the State. The remaining 3 – real property tax, motor vehicle weight tax, and public utility franchise tax – are administered by the counties. The revenue from county motor vehicle weight taxes is vested in the counties with the revenue accruing to the State and county highway funds.

Revenues from 11 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.

STATE GENERAL FUND*
(In Thousands of Dollars)

	FY 2005		FY 2004	
SOURCE OF REVENUE	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corps.	$ 36,520	0.91	$ (534)	(0.02)
Conveyance	12,292	0.31	7,884	0.23
General Excise & Use	2,136,603	53.45	1,900,377	55.14
Income – Corporations	85,605	2.14	56,653	1.64
Income – Individuals	1,381,058	34.55	1,168,570	33.91
Inheritance and Estate	12,712	0.32	9,830	0.29
Insurance Premiums	83,077	2.08	78,142	2.27
Liquor & Permits	43,737	1.09	41,250	1.20
Public Service Companies	108,686	2.72	99,505	2.89
Tobacco & Licenses	84,079	2.10	78,400	2.27
Trans. Accom. Tax	12,389	0.31	5,628	0.16
All Others**	781	0.02	679	0.02
TOTAL	$ 3,997,539	100.00	$ 3,446,385	100.00

* Net of transfers to special funds.
** Includes fuel retail dealer permits, fuel penalty and interest, general excise fees, and trans. accom. fees.
NOTE: Due to rounding, details may not add to totals.

OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2005

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(1) Net Income Chapter 235 — Section 235-1 to 235-130	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.	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. 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.	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. For payroll periods beginning on or after December 31, 2004, Act 113, Session Laws of Hawaii 2004, amends the withholding requirements for employers who are required to pay the taxes withheld by electronic funds transfer (EFT). For more information, see Booklet A, Employer's Tax Guide.
(2) Estate and Transfer (for decedents dying after 6/30/83 and before 1/1/05) Chapter 236D — Section 236D-1 to 236D-18	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. **Note:** For estates of decedents dying after December 31, 2004, there will be no estate and transfer tax since the federal credit for state death taxes was repealed effective January 1, 2005. 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. **Note:** For generation-skipping transfers after December 31, 2004, there will be no generation-skipping transfer tax since the federal credit for state death taxes was repealed effective January 1, 2005.	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). 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)).	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. 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.
(3) General Excise (Gross Income) Chapter 237 — Section 237-1 to 237-49	This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is ½ 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.	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.	At time of filing returns.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(4) Transient Accommodations Tax Chapter 237D — Section 237D-1 to 237D-16	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, plan managers are liable for and pay to the State the transient accommodations tax of 7.25% that is imposed on the fair market rental value of time share vacation units.	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.	At time of filing returns.
(5) Use Chapter 238 — Section 238-1 to 238-16	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.	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.	At time of filing returns.
(6) Public Service Company Chapter 239 — Section 239-1 to 239-25	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. Act 146, Session Laws of Hawaii 2005, imposes the PSC tax on the gross income from the operation of a private sewer company or facility that accrues beginning July 1, 2005.	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.	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.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations Chapter 241 — Section 241-1 to 241-7	(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.	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.	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.

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: 1¢ per gallon on aviation fuel, an initial 1¢ per gallon on diesel oil, .25¢ per gallon on alternative fuels for operation of an internal combustion engine (Act 96, Session Laws of Hawaii 2004) and at the rates specified below per gallon on alternative fuels, and from 24.8¢ to 34¢ per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 23.8¢ to 33¢ per gallon on diesel oil used to operate motor vehicles upon the public highways, however, they are not required to pay the additional tax on diesel oil and the tax on alternative fuels if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways, diesel oil used for motor vehicles not operated upon the public highways, and alternative fuels used for motor vehicles and internal combustion engines 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 5¢ 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 July 1, 2004, Act 96, Session Laws of Hawaii 2004, provides that the fuel tax is adjusted to reflect the energy content of alternative fuels as follows: ethanol- 0.145 times the rate for diesel; methanol- 0.11 times the rate for diesel; biodiesel- 0.25 times the rate for diesel; liquefied petroleum gas- 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 one-quarter 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 7¢ on each cigarette sold, used, or possessed after June 30, 2004. 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. Beginning December 1, 2006, Act 131, *Session Laws of Hawaii 2005*, requires every retailer engaged in the retail sale of cigarettes and other tobacco products to obtain a $20.00 retail tobacco permit that must be renewed before December 1st of each year.	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.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(11) Conveyance Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property and is based on the actual and full consideration paid or to be paid. Minimum $1 tax for each taxable transaction. Effective July 1, 2005, Act 156, Session Laws of Hawaii 2005, increases the conveyance tax as follows: (1) 10¢ per $100 for properties with a value of less than $600,000, (2) 20¢ per $100 for properties with a value of at least $600,000, but less than $1,000,000, and (3) 30¢ per $100 for properties with a value of $1,000,000 or greater. For the sale of a condominium or single family residence for which the purchaser is ineligible for a county homeowner's exemption on property tax, the conveyance tax is imposed as follows: (1) 15¢ per $100 for properties with a value of less than $600,000, (2) 25¢ per $100 for properties with a value of at least $600,000, but less than $1,000,000, and (3) 35¢ per $100 for properties with a value of $1,000,000 or greater. (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.
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax Chapter 251 — Section 251-1 to 251-15	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.	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.	At time of filing returns.
(13) Unemployment Insurance Chapter 383 — Section 383-1 to 383-176	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.	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.	At time of filing returns.
(14) Insurance Premiums Chapter 431 — Section 431:7-201 to 431:7-209	Tax on insurance companies (Underwriters) based on premiums written 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.	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.	At time of filing statements.

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