

# DEPARTMENT OF TAXATION STATE OF HAWAII



## ANNUAL REPORT 2015–2016

# DEPARTMENT OF TAXATION

## VISION

*"The Department of Taxation will efficiently and effectively collect the revenue for funding programs and services for the people of Hawaii."*

## MISSION

*"Our mission is to administer the tax laws for the State of Hawaii in a consistent, fair and uniform manner."*

## GOALS

1. To *"Increase Voluntary Compliance"* by
  - a. Increasing oversight utilizing various branches/areas of our Compliance Division
  - b. Developing procedures and metrics to ensure a more efficient and timely audit process
  - c. Actively engage in community outreach programs to educate public in meeting tax obligations
2. To *"Reduce Tax Fraud,"* through
  - a. Utilization of screening filters and review criteria
  - b. Comprehensive review of questionable refund requests
3. To *"Improve customer service to all stakeholders"* by
  - a. Providing services to taxpayers whose issues/concerns cannot be resolved through normal channels
  - b. Providing specialized service to the tax practitioner community
4. To *"Improve technology and efficiencies through the successful implementation of the Tax System Modernization (TSM) project during this period"*
5. *"Actively address tax receivable balances"* by
  - a. Collaboration with the Attorney General's office
  - b. Utilization of an outside collection agency
6. To *"Foster and empower staff"* by
  - a. Developing each employee to his/her full potential
  - b. Reinforcing the Department's values of respect, teamwork, communication and trust
  - c. Providing training opportunities to enhance and expand their skills

**DAVID Y. IGE**  
GOVERNOR

**SHAN TSUTSUI**  
LT. GOVERNOR



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**DEPARTMENT OF TAXATION**  
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**MARIA E. ZIELINSKI**  
DIRECTOR OF TAXATION

**DAMIEN A. ELEFANTE**  
DEPUTY DIRECTOR

December 19, 2016

The Honorable David Y. Ige  
Governor, State of Hawaii  
Executive Chambers, State Capitol

Dear Governor Ige:

Thank you for the opportunity to present you with the attached Annual Report summarizing the operations of the Department of Taxation (Department) for the fiscal year (FY) ending June 30, 2016. The Department collected \$6.89 billion in tax revenue in FY2016, or 95% of the \$7.25 billion that was collected from all taxes administered by the State. The General Excise Tax (GET) is Hawaii's largest source of revenue and accounted for 44% of the State's total tax collections in FY2016. Revenue from the GET rose to \$3.21 billion in FY2016 from \$3.05 billion in FY2015, an increase of 5.2%. Revenue from Hawaii's Individual Income Tax (IIT), Hawaii's second largest tax, increased to \$2.12 billion in FY2016, up by 6.5% from \$1.99 billion in FY2015. The IIT accounted for 29.2% of the State's total tax collections in FY2016.

During FY2016, the Department continued with the Tax System Modernization (TSM) project. The TSM project is a multi-year project with five rollout phases that will completely replace the existing system. The TSM system will expand electronic services, providing taxpayers with online access to accounts and enabling full electronic filing and payment. The project will also automate the licensing, tax clearance, and compliance processes. Additionally, TSM will provide the State with critical data capture capabilities, metrics, and cross-check controls that are not available in the existing legacy system.

During FY2016, the Department completed the initial rollout of the TSM project and initiated Rollout 2. The Department completed Rollout 2 on time as of August 15, 2016. The Department remains on schedule to complete the entire project by mid-2019.

The Department continues to encourage taxpayers to transition from paper tax returns and checks to electronic tax returns and fund transfers. Electronic filing began with 140 thousand electronically filed documents in FY2004 and increased to approximately 1.98 million in FY2016. As a percentage of all documents filed, e-filing has increased from 34% in FY2012 to 48% in FY2016. The amount of total e-payments received has continued to increase, rising from \$5.0 billion in FY 2015 to over \$5.3 billion in FY2016.

The Department continues to improve service to taxpayers and tax practitioners. This is important to maintaining and improving voluntary compliance. To address this objective, the Department hired a Taxpayer Advocate, a Tax Practitioner Priority Specialist, and an Administrative Appeals Officer. Rollout 1 of the TSM project also supported this goal by updating infrastructure including scanning hardware, mail processing equipment, and a digital telephone system. Our call answer rate had fallen from 80% in FY2009 to approximately 43% in FY2015. Due to the completion of Rollout 1 of TSM and also to aggressive recruitment to fill positions, our call answer rate rose to 72% in FY2016.

The Department aggressively recruited to fill vacancies in other areas as well. As a result, the vacancy rate has fallen from 20% to 14% in FY2016. Vacancies in the Compliance Division have fallen by 45% while those in the Tax Services & Processing and in the Staff Offices have fallen by 14%.

The Compliance Division increased the amount of taxes assessed significantly in FY2016. The amounts assessed grew by 68.6% from \$119.0 million in FY2015 to \$200.6 million in FY2016. The total number of completed audit cases went down slightly by 2.7% from 17,536 cases in FY2015 to 17,065 cases in FY2016. The amount collected from assessments decreased by 7.3% from \$39.9 million in FY2015 to \$37.0 million in FY2016.

At the Department of Taxation we continue to pursue our three strategic goals of increased voluntary compliance, improved processing, and enhanced productivity. We are proud and appreciative of all that our staff has accomplished during the past year. Empowered with the tools and technological enhancements as well as significant decreases in our vacancies, our Department has increased efficiency and effectiveness in our operations to ensure the collections of revenues that our State needs for the services and programs essential for maintaining the quality of life in Hawaii.

Sincerely,

/s/

MARIA E. ZIELINSKI  
Director of Taxation

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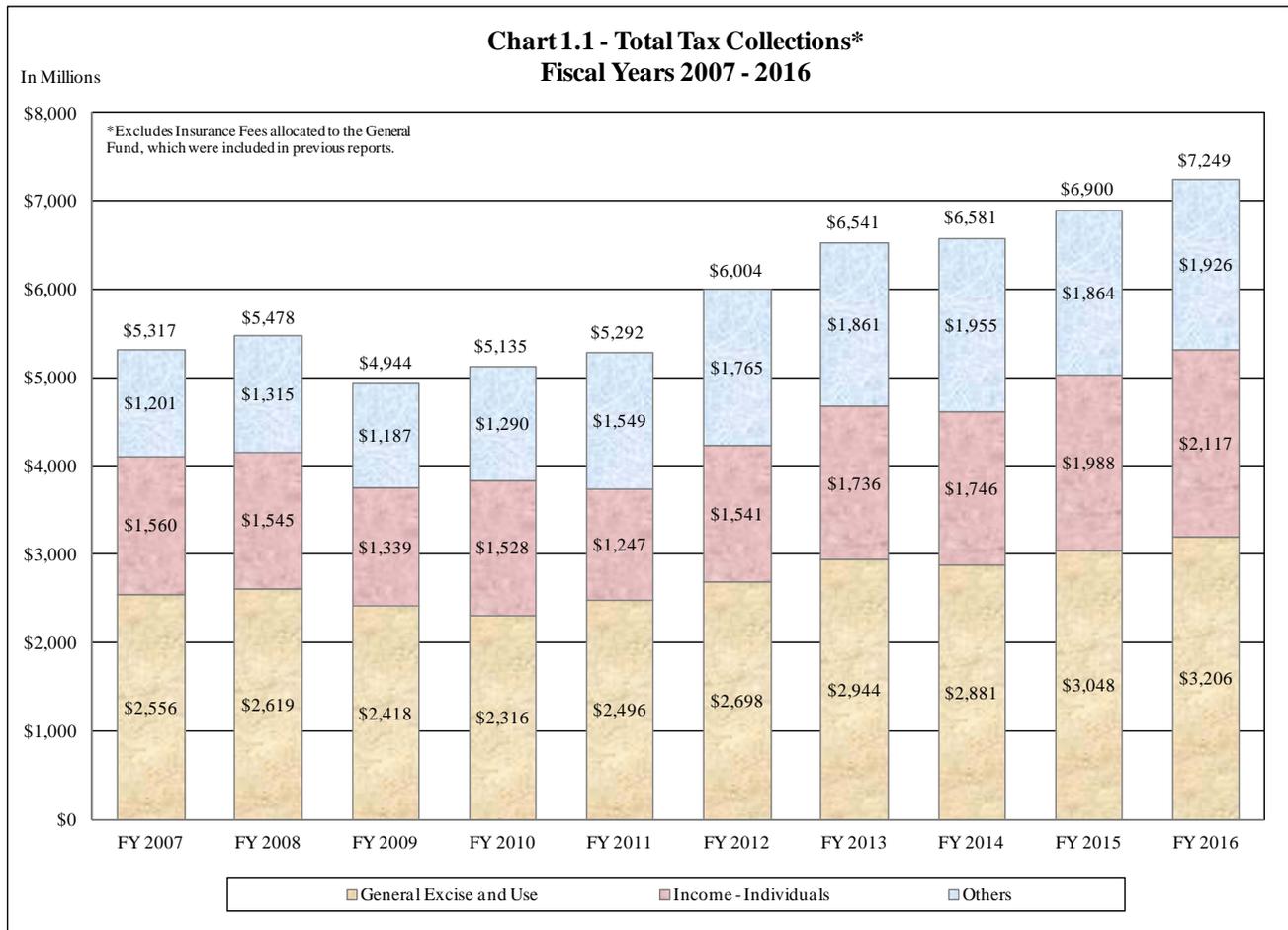
## 1.0 COLLECTION AND DISTRIBUTION OF TAXES

### 1.1 OVERVIEW

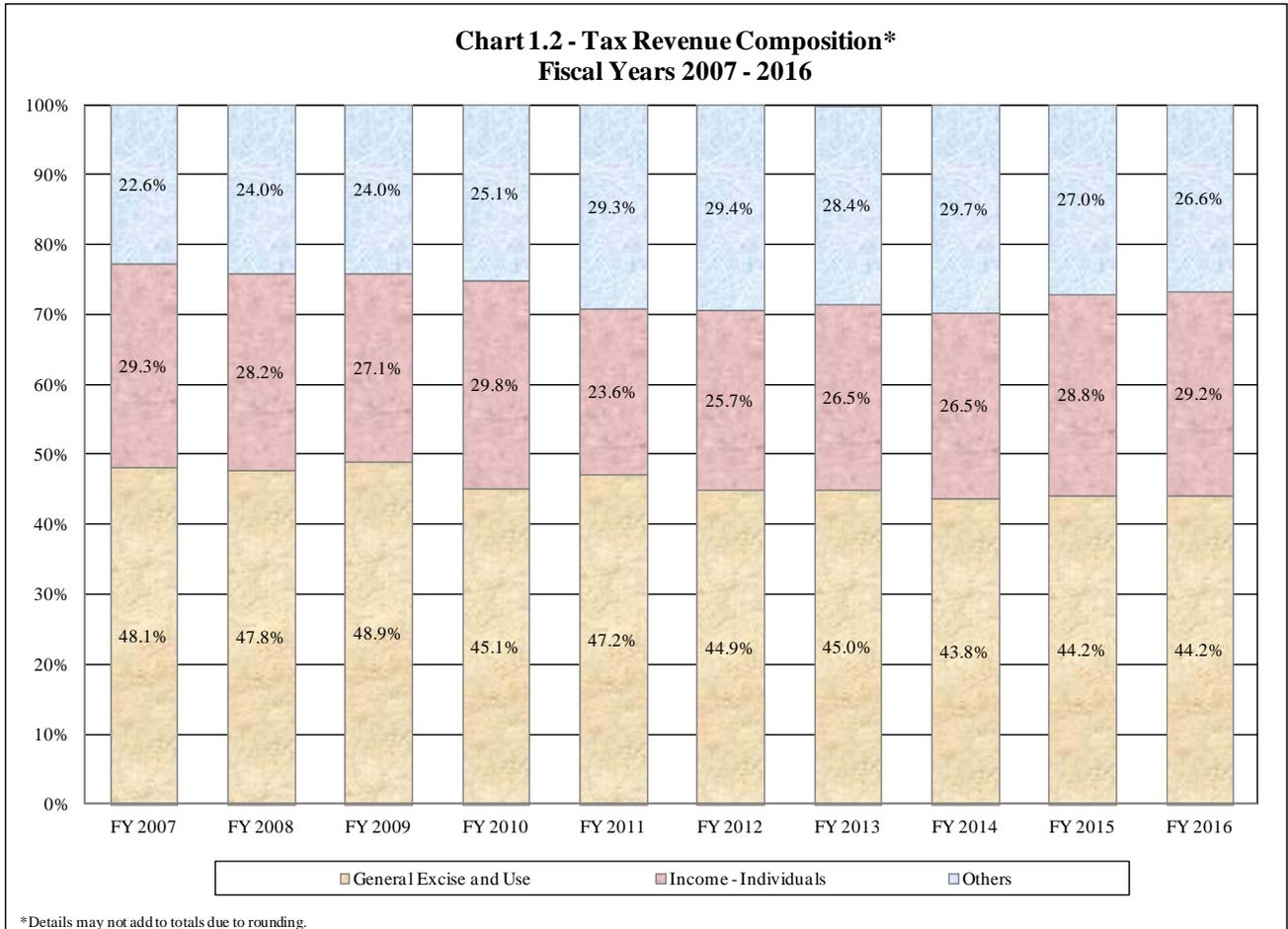
The Department of Taxation (Department) collects the revenues from most of the various taxes imposed by the State. In addition, the Department collects the county surcharge imposed by the City and County of Honolulu and fuel taxes imposed by the counties. In fiscal year (FY) 2016, the Department collected a total of \$6.89 billion in net tax revenues, up from \$6.54 billion collected in FY 2015.

The Department's Office of Tax Research and Planning (TRP) tracks revenues from taxes collected by the Department, and also from taxes that are administered and collected by other State agencies or by the counties. Henceforth, revenues from the taxes tracked by TRP will be referred to as "total tax collections."

Total tax collections were \$7.25 billion in FY 2016, up from \$6.90 billion in FY 2015. In FY 2009, Hawaii experienced a decline in total tax collections as the Great Recession reduced incomes and spending of consumers and businesses. Since then, total tax collections have risen steadily due to temporary tax measures, an improving economy, and better tax administration. Chart 1.1 shows the main components of the total tax collections for FY 2007 through FY 2016.



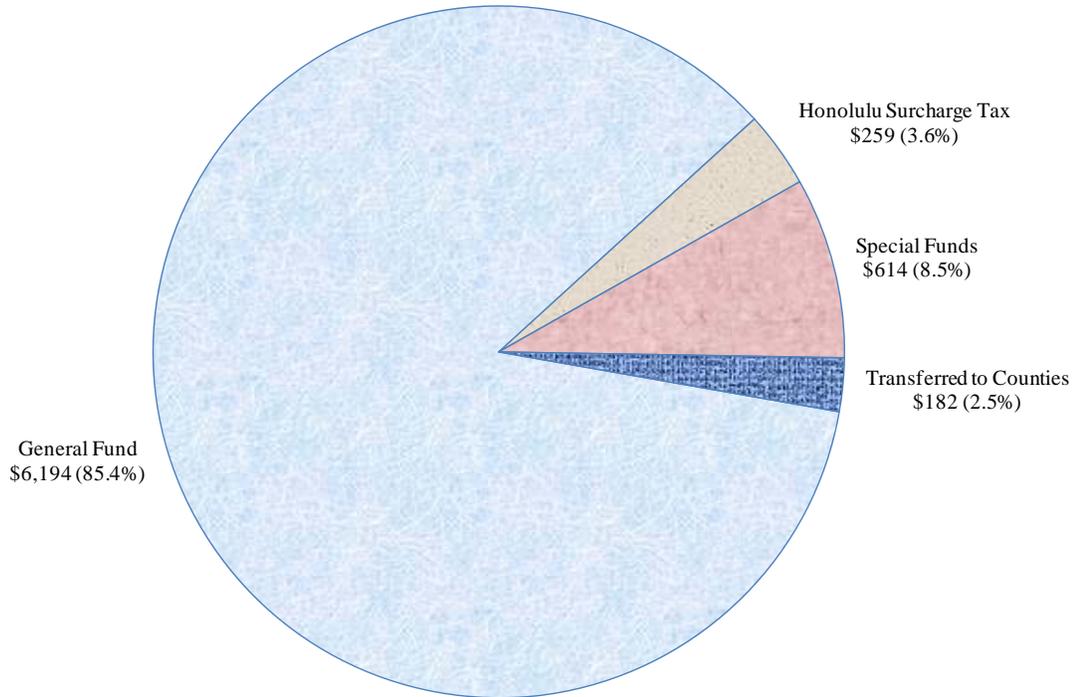
The State's biggest sources of tax revenue are the general excise tax (GET)<sup>1</sup> and the individual income tax (IIT). In FY 2016, net GET collections amounted to \$3.21 billion and accounted for 44.2% of total tax collections, and net collections of the IIT amounted to \$2.12 billion and accounted for 29.2% of total tax collections. Chart 1.2 shows the shares of total tax collections accounted for by the GET and the IIT for FY 2007 through FY 2016.



Of the total tax collections in FY 2016, \$6.19 billion, or 85.4%, was deposited into the State's General Fund. The tax revenues deposited into the General Fund are used to pay most of the State's operating expenses. An additional \$440.9 million, or 6.1% of the total tax collections, was transferred to the counties, including transfers of the county surcharge imposed by the City and County of Honolulu, fuel taxes imposed by the counties, and revenues from the transient accommodations tax that were allocated to the counties. The remaining \$613.9 million, or 8.5%, was transferred to various other State special funds. Chart 1.3 shows how the total tax collections were distributed in FY 2016.

<sup>1</sup> Throughout this report, the term "GET" will be used to include both the general excise tax and the use tax. The use tax complements the general excise tax and is levied on imports into the State from an unlicensed seller.

**Chart 1.3 - Fiscal Year 2016 Distribution of Tax Revenues\***  
(In millions of dollars)



\*Details may not add to totals due to rounding.

## 1.2 GENERAL EXCISE AND USE TAXES

### 1.2.1 Overview

Unlike the sales taxes imposed by many States and localities, Hawaii's general excise and use taxes (GET) are imposed on the business rather than on the customer. The GET covers virtually all forms of business activity, including services. Despite the relatively low tax rates, the GET generates substantial revenue because the tax base is very broad.

The GET is imposed at the rate of 0.50% on wholesaling, wholesale services, producing, sugar processing and pineapple canning; at the rate of 0.15% on insurance commissions received by general agents, subagents and solicitors; and at the rate of 4.00% on most other activities, including retailing, business and professional services, contracting, theatre, amusement, radio, interest, commissions, and rentals. The fee for a GET license is a one-time charge of \$20.

### 1.2.2 Revenue

Revenue from the GET rose from \$3.05 billion in FY 2015 to \$3.21 billion in FY 2016, a rise of 5.2%. Chart 1.4 shows the total revenues from the GET and from the tax levied on the various categories of income for FY 2007 through FY 2016. Table 1.1 shows collection of the GET in greater detail for FY 2015 and FY 2016.

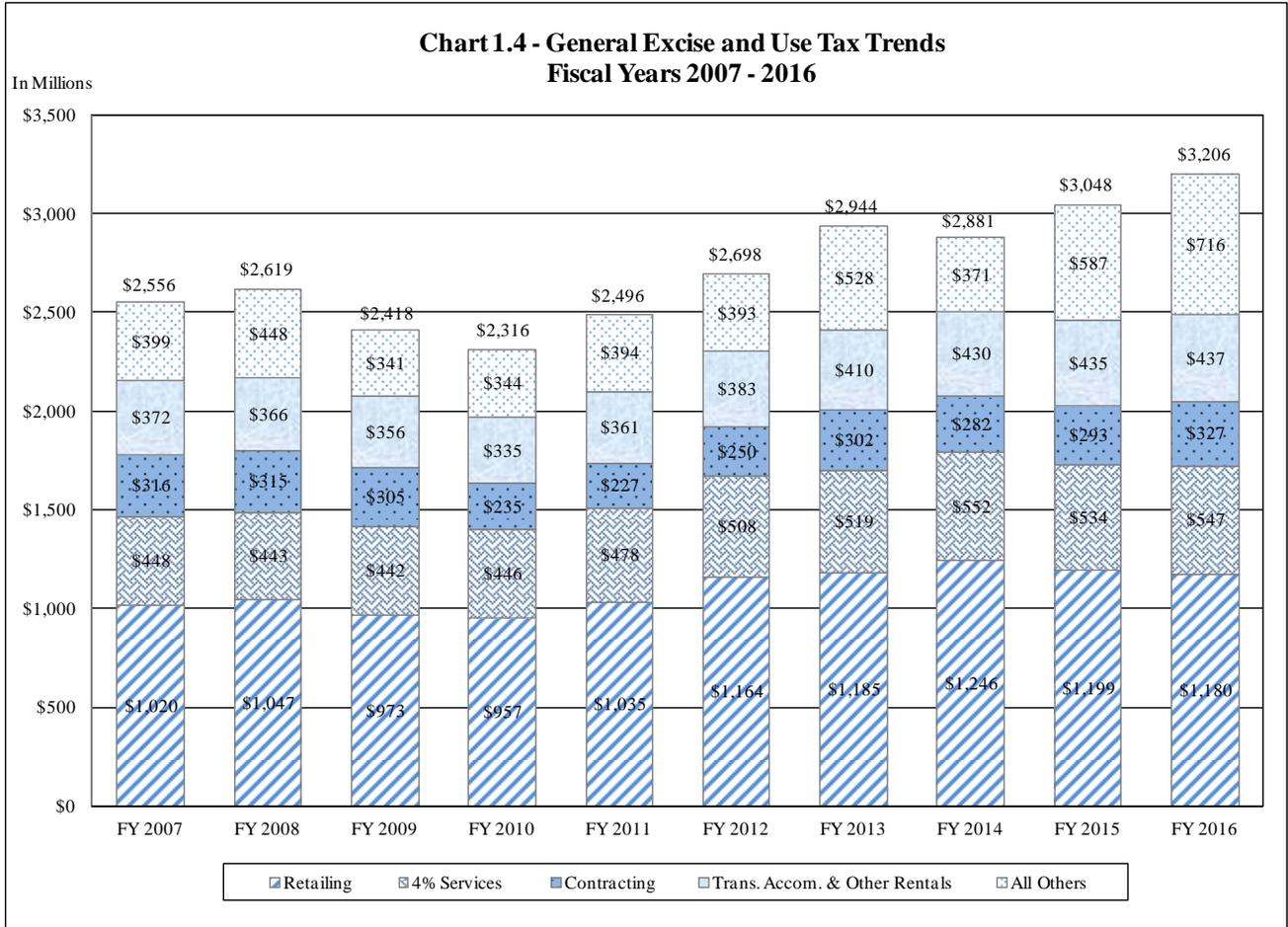


TABLE 1.1 - GENERAL EXCISE AND USE TAX BASE AND TAXES  
FOR FISCAL YEARS ENDING JUNE 30, 2016 AND 2015  
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2016	FY 2015	Difference	
				Amount	% Change
<u>TAX BASE</u>					
Retailing		\$ 29,497,784	\$ 29,987,212	\$ (489,429)	(1.6)
Services		13,667,109	13,361,061	306,048	2.3
Contracting		8,184,839	7,321,841	862,998	11.8
Trans. Accom. Rentals		4,441,787	4,327,505	114,282	2.6
All Other Rentals		6,474,425	6,543,583	(69,157)	(1.1)
All Others (4%)		5,406,921	5,486,818	(79,898)	(1.5)
Subtotal		\$ 67,672,864	\$ 67,028,020	\$ 644,844	1.0
Producing		\$ 294,609	\$ 320,986	\$ (26,378)	(8.2)
Manufacturing		733,992	716,115	17,876	2.5
Wholesaling		13,864,351	14,294,275	(429,924)	(3.0)
Use (1/2%)		7,354,311	7,126,839	227,472	3.2
Wholesale Services		707,822	715,538	(7,715)	(1.1)
Insurance Commissions		485,363	488,848	(3,485)	(0.7)
Subtotal		\$ 23,440,448	\$ 23,662,601	\$ (222,153)	(0.9)
TOTAL - ALL ACTIVITIES		\$ 91,113,312	\$ 90,690,621	\$ 422,691	0.5
<u>TAX</u>					
Retailing	4.00%	\$ 1,179,911	\$ 1,199,488	\$ (19,577)	(1.6)
Services	4.00%	546,684	534,442	12,242	2.3
Contracting	4.00%	327,394	292,874	34,520	11.8
Trans. Accom. Rentals	4.00%	177,671	173,100	4,571	2.6
All Other Rentals	4.00%	258,977	261,743	(2,766)	(1.1)
All Others (4%)	4.00%	216,277	219,473	(3,196)	(1.5)
Subtotal		\$ 2,706,915	\$ 2,681,121	\$ 25,794	1.0
Producing	0.50%	\$ 1,473	\$ 1,605	\$ (132)	(8.2)
Manufacturing	0.50%	3,670	3,581	89	2.5
Wholesaling	0.50%	69,322	71,471	(2,150)	(3.0)
Use (1/2%)	0.50%	36,772	35,634	1,137	3.2
Wholesale Services	0.50%	3,539	3,578	(39)	(1.1)
Insurance Commissions	0.15%	728	733	(5)	(0.7)
Subtotal		\$ 115,503	\$ 116,602	\$ (1,099)	(0.9)
Unallocated*		\$ 383,736	\$ 250,484	\$ 133,252	53.2
TOTAL - ALL ACTIVITIES		\$ 3,206,154	\$ 3,048,207	\$ 157,947	5.2

\*Includes collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements and business activities of disabled persons.

NOTE: Details may not add to totals due to rounding.

### ***1.2.3 Recent Legislation***

Act 160, Session Laws of Hawaii (SLH) 2013, eliminated the GET exemption for liquor, tobacco and food sold to common carriers for taxable years beginning after December 31, 2013.

Act 163, SLH 2013, made permanent the GET exemptions for common expenses paid by managers, sub-managers, and sub-operators and for hotel employee expenses paid by hotel operators and timeshare projects. The Act also eliminated the aggregate cap on the exempt amounts for taxable years beginning after December 31, 2012.

## **1.3 INDIVIDUAL INCOME TAX**

### ***1.3.1 Overview***

Hawaii's individual income tax (IIT) generally follows the federal definitions for determining net taxable income, but has its own exemptions, tax credits, and tax rates. In FY 2016, IIT had twelve brackets, with tax rates ranging from 1.40% to 11.00%, from July 1, 2015 through December 31, 2015; and nine brackets, with tax rates ranging from 1.40% to 8.25%, from January 1, 2016 through June 30, 2016.

### ***1.3.2 Revenue***

The IIT is the State's second largest source of tax revenue. The biggest part of IIT collections is taxes withheld on employee wages. In FY 2016, withholding tax collections were \$1.81 billion, an increase of 4.7% over the \$1.73 billion withheld in FY 2015. Total IIT refunds in FY 2016 were \$450.7 million, up from \$419.9 million in FY 2015. Net IIT collections in FY 2016 were \$2.12 billion, up by 6.5% over the \$1.99 billion collected in FY 2015. Chart 1.5 shows total collections of the IIT, along with wage withholding, payments with returns, estimated taxes, and refunds, for FY 2007 through FY 2016. Table 1.2 shows the figures for total collections of the IIT, broken down by its components, in FY 2015 and FY 2016.

### ***1.3.3 Recent Legislation***

Act 60, SLH 2009 (Act 60), raised the tax rates for single individuals with taxable incomes over \$150,000 and for married couples filing jointly with income over \$300,000, by adding new high-end tax brackets with marginal tax rates that range from 9.00% to 11.00%. Before Act 60, the highest income tax rate was 8.25%. The tax rate increases imposed by Act 60 are effective for taxable years beginning after December 31, 2008 and ending before January 1, 2016.

Act 97, SLH 2011 (Act 97), eliminated the deduction for state income taxes paid for individuals with federal adjusted gross income above specified thresholds, and temporarily limited claims for itemized tax deductions. The Act is effective for taxable years beginning after December 31, 2010, but the limits imposed on itemized deductions expire December 31, 2015. The Act 97 also delayed the increases in the standard deduction and personal exemption that were approved under Act 60 until taxable years beginning after December 31, 2012, and made the increases permanent.

Act 256, SLH 2013 (Act 256), removed charitable deductions from the limits on itemized deductions that were imposed by Act 97. Act 256 is effective for taxable years beginning after December 31, 2012.

Act 120, SLH 2015, provided a tax credit for converting cesspools to a septic system, or for connecting to a wastewater system, from July 1, 2015 to December 31, 2020.

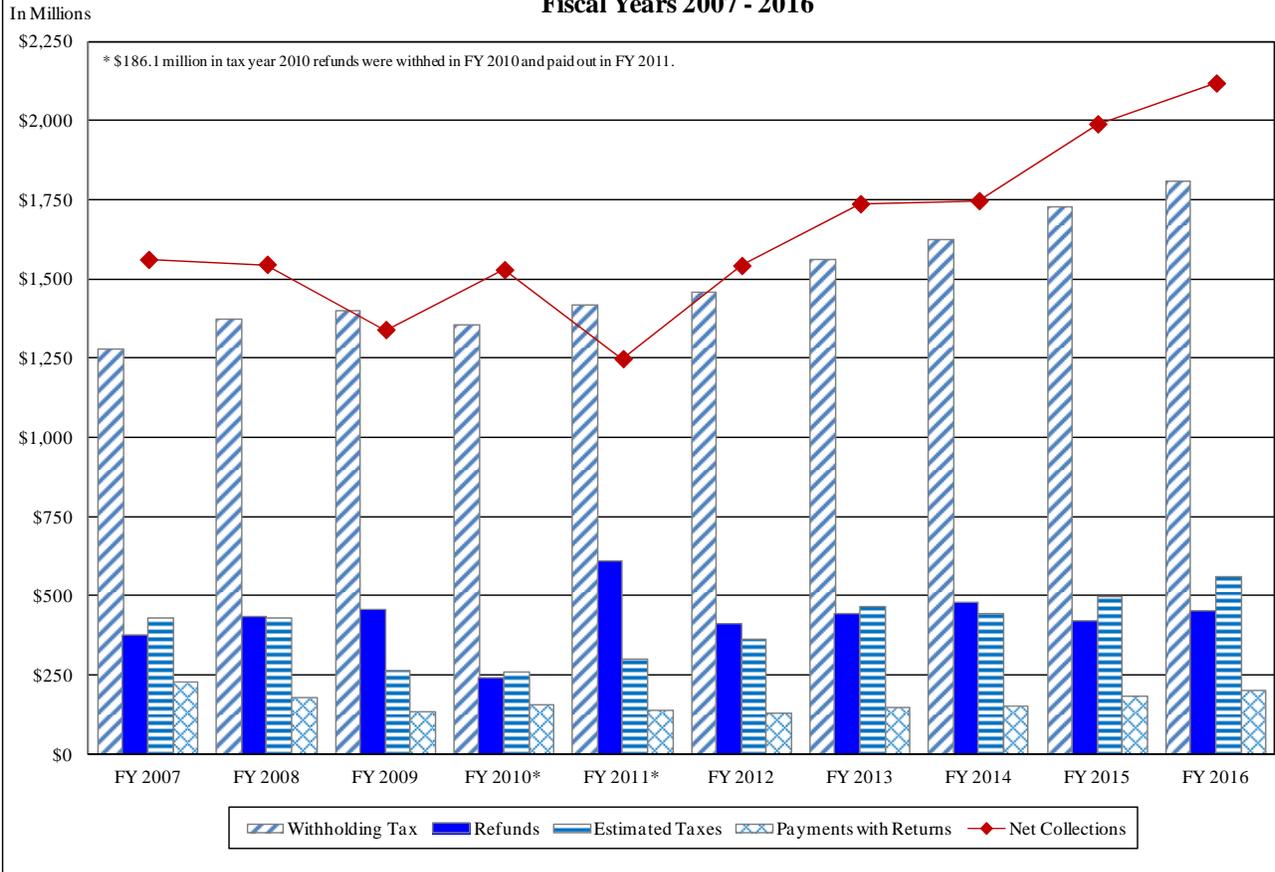
Act 223, SLH 2015, increased the food/excise tax credit, but eliminated the tax credit for single taxpayers with federal adjusted gross income (AGI) of \$30,000 or more, or other taxpayers with federal AGI of \$50,000 or more. The Act applies to tax years 2016 and 2017, and is repealed on December 31, 2017.

Act 230, SLH 2016 (Act 230), allows taxpayers engaged in medical marijuana businesses to deduct business expenses and claim tax credits on their income taxes. Act 230 is effective for taxable years beginning after December 31, 2015.

Act 235, SLH 2016 (Act 235), amends the income tax credit for dependent care expenses by increasing the amount that certain taxpayers may claim for the dependent care expenses. Act 235 is effective for taxable years beginning after December 31, 2015.

Act 258, SLH 2016, provides a new tax credit for organic food production. The tax credit applies to taxable years beginning after December 31, 2016 and is repealed December 31, 2021.

**Chart 1.5 - Components of the Individual Income Tax  
Fiscal Years 2007 - 2016**



**TABLE 1.2 - TAXES PAID BY INDIVIDUALS  
(In Thousands of Dollars)**

	FY 2016	FY 2015	Difference	
			Amount	% Change
Declaration of Estimated Taxes	\$ 558,669	\$ 498,418	\$ 60,251	12.1
Payment with Return	199,026	181,142	17,884	9.9
Withholding Tax on Wages	1,809,855	1,728,510	81,344	4.7
Subtotal	\$2,567,549	\$2,408,071	\$159,479	6.6
Refunds	450,690	419,876	30,814	7.3
NET	\$2,116,859	\$1,988,194	\$128,665	6.5

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

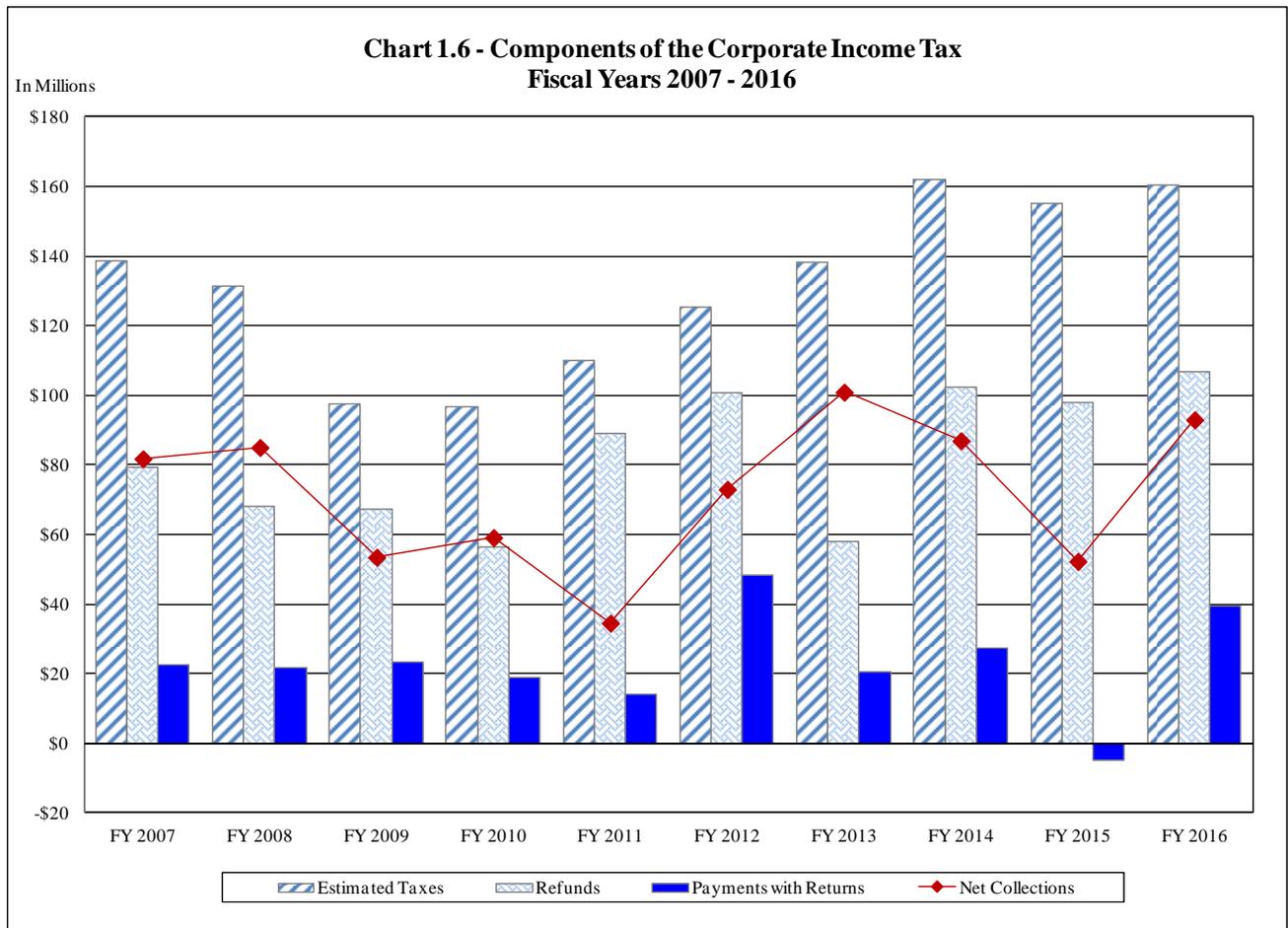
## 1.4 CORPORATE INCOME TAX

### 1.4.1 Overview

Hawaii's corporate income tax (CIT) has three tax brackets. The brackets and the corresponding tax rates are as follows: 4.4% on taxable income up to \$25,000; 5.4% on taxable income over \$25,000 but not over \$100,000; and 6.4% on taxable income over \$100,000. The tax rate for corporate capital gains is 4.0%.

### 1.4.2 Revenue

Net CIT collections totaled \$93.0 million in FY 2016, an increase of 77.8% from the previous year's total of \$52.3 million. CIT collections are highly cyclical, but they are a relatively small part of Hawaii's total tax collections. In FY 2016, the CIT accounted for just 1.3% of total tax collections. Chart 1.6 shows total collections of the CIT, broken down by its components, for FY 2007 through FY 2016. Table 1.3 shows data on collections of the CIT for FY 2015 and FY 2016.



**TABLE 1.3 - TAXES PAID BY CORPORATIONS**  
(In Thousands of Dollars)

	FY 2016	FY 2015	Difference	
			Amount	% Change
Declaration of Estimated Taxes	\$ 160,563	\$ 155,279	\$ 5,284	3.4
Payment with Return*	<u>39,459</u>	<u>(5,016)</u>	<u>44,474</u>	<u>n/m</u>
Subtotal	\$ 200,022	\$ 150,263	\$ 49,759	33.1
Refunds	<u>106,986</u>	<u>97,944</u>	<u>9,042</u>	<u>9.2</u>
NET	\$ 93,036	\$ 52,319	\$ 40,717	77.8

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

\*The negative amount is due to tax refunds, which exceeds tax collections.

n/m = not meaningful.

## **1.5 TRANSIENT ACCOMMODATIONS TAX**

### ***1.5.1 Overview***

The transient accommodations tax (TAT) is 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. The rate for the TAT has been 9.25% since July 1, 2010. 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 each registration of 6 or more units. In FY 2016, plan managers of time share units paid TAT at the rate of 7.25% on the fair market rental value of the units from July 1, 2015 through December 31, 2015 and at the rate of 8.25% from January 1, 2016 through June 30, 2016.

### ***1.5.2 Revenue***

TAT collections totaled \$446.8 million for FY 2016, an increase of 6.1% from the \$421.0 million collected in FY 2015. In FY 2016, collections from the TAT were distributed as follows: \$103.0 million went to the counties; \$26.5 million went to the Convention Center Enterprise Special Fund; \$82.0 million went to the Tourism Special Fund; \$1.5 million went to the Turtle Bay Easement Special Fund; and the remainder (\$233.8 million) went to the General Fund. Chart 1.7 shows collections of the TAT for FY 2007 through FY 2016. Chart 1.8 shows the allocations of the tax among the various funds. Table 1.4 shows TAT collections and allocations in FY 2015 and FY 2016.

### ***1.5.3 Recent Legislation***

Act 161, SLH 2013 (Act 161), made permanent the TAT rate of 9.25% and made permanent the caps on allocations of the TAT for each fiscal year as follows: \$82.0 million to the Tourism Special Fund, \$93.0 million to the counties, and \$33.0 million to the Convention Center Enterprise Special Fund. The Act also eliminated the \$10 daily TAT on each transient accommodation furnished on a complimentary basis that was imposed by Act 103, SLH 2011. Act 161 took effect July 1, 2013.

Act 81, SLH 2014, reduced allocations of the TAT to the Convention Center Enterprise Special Fund from \$33.0 million to \$26.5 million annually and allocated \$3.0 million to the Turtle Bay Easement Special Fund. However, the new allocations mandated by the Act were not made in FY 2015, owing to the pending status of the Turtle Bay purchase.

Act 174, SLH 2014, increased allocations of the TAT to the counties from \$93.0 million to \$103.0 million per year for fiscal years 2015 and 2016.

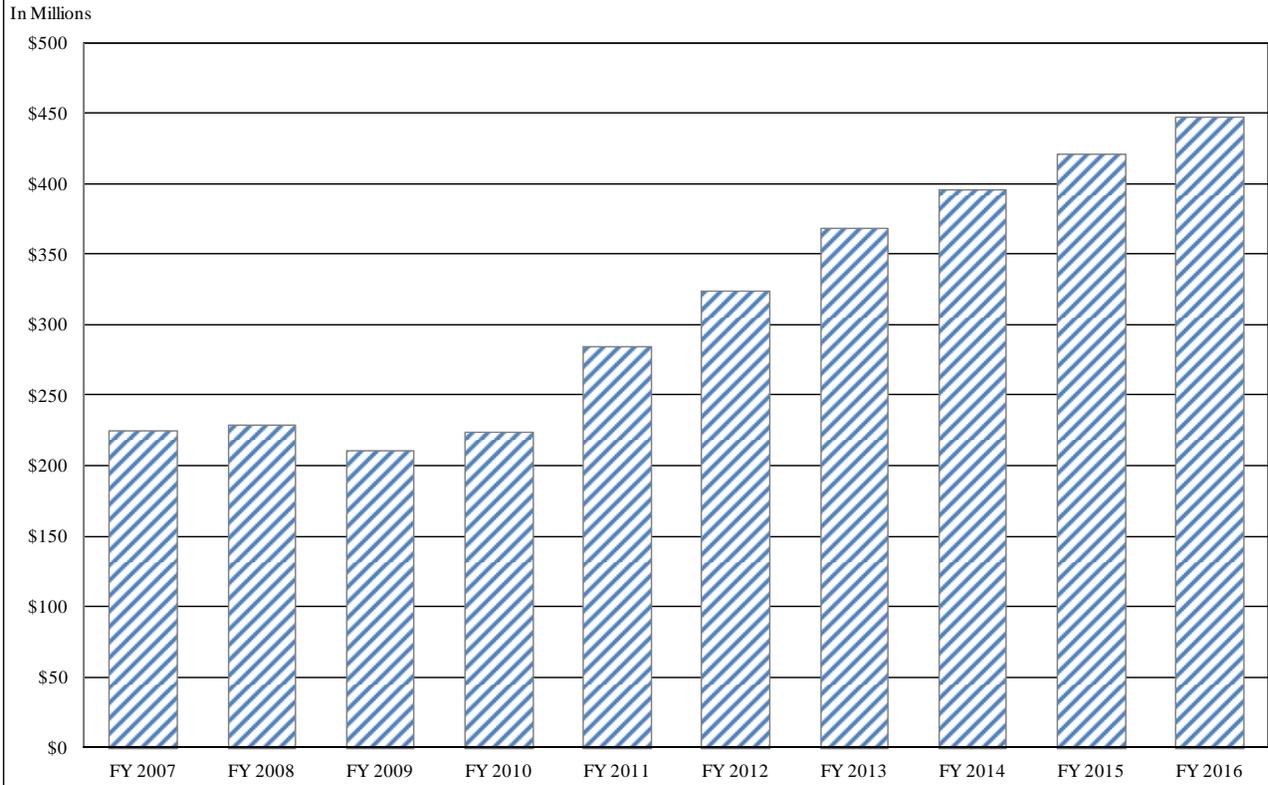
Act 93, SLH 2015, raised the tax on resort time share vacation units from 7.25% to 8.25% in calendar year (CY) 2016, and to 9.25% in CY 2017 and thereafter.

Act 117, SLH 2015, allocates \$3.0 million of the TAT annually to the Special Land Development Fund, starting in FY 2017.

Act 121, SLH 2015, allocates \$1.5 million of the TAT to the Turtle Bay Easement Special Fund, replacing the \$3.0 million annual allocation made by Act 81, SLH 2014.

Act 223, SLH 2016, extends the TAT allocation of \$103.0 million to the counties to FY 2017.

**Chart 1.7 - Transient Accommodations Tax  
Fiscal Years 2007 - 2016**



**Chart 1.8 - Transient Accommodations Tax Distributions  
Fiscal Years 2007 - 2016**

In Millions

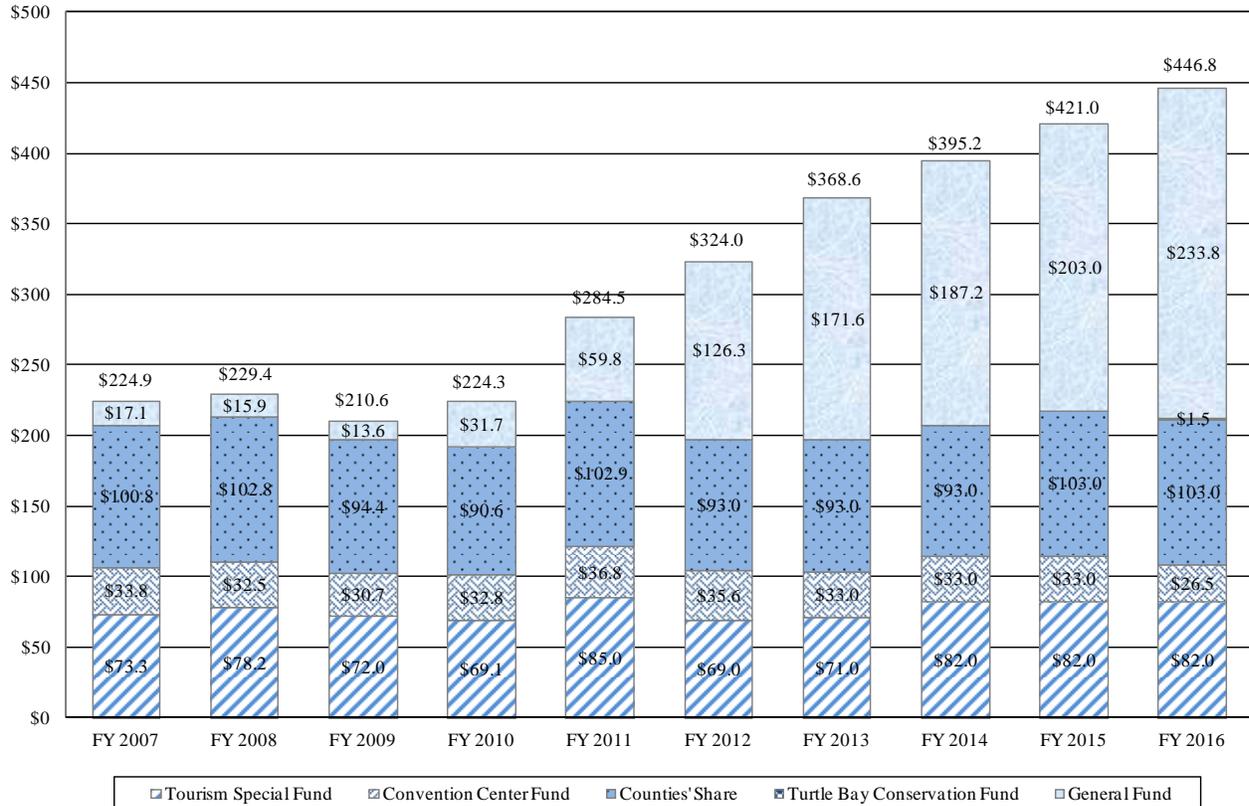


TABLE 1.4 - TRANSIENT ACCOMMODATIONS TAX  
(In Thousands of Dollars)

	FY 2016	FY 2015	Difference	
			Amount	% Change
<b>Collection</b>				
Trans. Accom./Time Share Occ. Tax	\$ 446,781	\$ 420,970	\$ 25,811	6.1
Trans. Accom./Time Share Occ. Fees	13	12	1	12.1
<b>Total</b>	<b>\$ 446,794</b>	<b>\$ 420,981</b>	<b>\$ 25,812</b>	<b>6.1</b>
<b>Distribution*</b>				
Counties Share	\$ 103,000	\$ 103,000	\$ -	0.0
Convention Center Fund	26,500	33,000	(6,500)	(19.7)
Tourism Special Fund	82,000	82,000	-	0.0
Turtle Bay Special Fund	1,500	-	1,500	n/m
General Fund	233,794	202,981	30,812	15.2
<b>Total</b>	<b>\$ 446,794</b>	<b>\$ 420,981</b>	<b>\$ 25,812</b>	<b>6.1</b>

\*For details on distribution see section 237D-6.5, HRS.

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

n/m = not meaningful.

## 1.6 FUEL TAXES

### 1.6.1 Overview

The State and county fuel taxes are imposed on the distributors. The State Legislature sets the State fuel tax rates, whereas county councils set the county rates. There is also an environmental response tax (officially renamed as the "environmental response, energy and food security tax" by Act 73, SLH 2010) that is levied on each barrel of petroleum products and each million British thermal units (MMBtu) of non-petroleum fossil fuels sold by a distributor to any retail dealer or end user. The effective rates for the fuel taxes and for the environmental response tax are shown on page 16.

### 1.6.2 Revenue

Fuel tax collections (including the environmental response tax) amounted to \$198.1 million in FY 2016, an increase of 2.6% from the \$193.1 million collected in FY 2015. Total taxable fuel consumption declined from 887.1 million gallons in FY 2015 to 882.0 million gallons in FY 2016. The biggest consumption of taxable fuel was gasoline (467.6 million gallons) and the second biggest consumption was aviation fuel (176.4 million gallons). Together, gasoline and aviation fuel accounted for 73.0% of the total consumption of taxable fuel in FY 2016.

Collections of the environmental response tax amounted to \$27.0 million in FY 2016, an increase of 3.8% from the \$26.0 million collected in FY 2015. The environmental response tax rate on each barrel of petroleum product was \$1.05. The tax was levied on 24.8 million barrels of petroleum in FY 2016, up slightly from 24.7 million barrels in FY 2015. The environmental response tax rate on each MMBtu of non-petroleum fossil fuels was nineteen cents. The tax was levied on 4.8 million MMBtu of non-petroleum fossil fuels in FY 2016. Chart 1.9 shows collections of the fuel taxes and the gallons consumed of the various fuel types, for FY 2007 through FY 2016. Data for taxable gallons consumed for FY 2015 and FY 2016 are given in Table 1.5.

The revenues from fuel taxes are distributed to several special funds. One percent of the fuel taxes paid on liquid fuel, not including aviation fuel, are deposited into the Boating Special Fund. Fuel taxes paid on sales of aviation fuel are deposited into the Airport Revenue Fund. Remaining revenues from the State fuel taxes are deposited into the State Highway Fund, whereas remaining revenues from county fuel taxes are deposited into the counties' highway funds.

Revenues from the environmental response tax were distributed as follows in FY 2016: For each barrel taxed at \$1.05, five cents went to the Environmental Response Revolving Fund administered by the Department of Health for oil spill prevention and remediation programs; fifteen cents went to the Energy Security Special Fund administered by the Department of Business, Economic Development, and Tourism to support the Hawaii clean energy initiative program; fifteen cents went to the Agricultural Development & Food Security Special Fund administered by the Department of Agriculture to fund activities intended to increase agricultural production or processing that may lead to reduced importation of food, fodder, or feed from outside the state; ten cents went to the Energy Systems Development Special Fund, and the remainder (sixty cents) went to the General Fund. For each MMBtu taxed at nineteen cents, one cent went to the Environmental Response Revolving Fund; three cents went to the Energy Security Special Fund; three cents went to the Agricultural Development & Food Security Special Fund; two cents went to the Energy Systems Development Special Fund, and the remainder (ten cents) went to the General Fund.

Table 1.6 shows how the fuel taxes and the environmental response tax were allocated in FY 2015 and FY 2016. The table also shows allocations of the motor vehicle taxes and fees to the State Highway Fund.

### ***1.6.3 Recent Legislation***

Act 107, SLH 2014, reestablished the Energy Systems Development Special Fund and extended the \$1.05 per barrel rate for the environmental response tax through fiscal year 2030. (The tax rate was scheduled to go back to \$0.05 per barrel at the end of fiscal year 2015.)

Act 185, SLH 2015, applies the environmental response tax to non-petroleum fossil fuels at nineteen cents per million British thermal units effective July 1, 2015, and removes the sunsets to various funds related to the tax.

SCHEDULE OF FUEL TAX RATES PER GALLON <sup>4</sup>  
(Effective January 1, 2016)

TYPE OF FUEL	STATE TAX	COUNTY TAX	TOTAL TAX
<b>GASOLINE AND DIESEL OIL (HIGHWAY):</b>			
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	17.0	33.0
<b>LIQUEFIED PETROLEUM GAS (HIGHWAY):</b>			
City & County of Honolulu	5.2 ¢	5.4 ¢	10.6 ¢
County of Maui	5.2	4.7	9.9
County of Hawaii	5.2	2.9	8.1
County of Kauai	5.2	5.6	10.8
<b>ETHANOL (HIGHWAY):</b>			
City & County of Honolulu	2.4 ¢	2.4 ¢	4.8 ¢
County of Maui	2.4	4.2	6.6
County of Hawaii	2.4	1.3	3.7
County of Kauai	2.4	2.5	4.9
<b>METHANOL (HIGHWAY):</b>			
City & County of Honolulu	1.9 ¢	1.8 ¢	3.7 ¢
County of Maui	1.9	3.2	5.1
County of Hawaii	1.9	1.0	2.9
County of Kauai	1.9	1.9	3.8
<b>BIODIESEL (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.3 ¢	12.3 ¢
County of Maui	4.0	9.0	13.0
County of Hawaii	4.0	0.0	4.0
County of Kauai	4.0	0.0	4.0
NAPHTHA <sup>3</sup> (Power-Generating Facility)	2.0 ¢	0.0 ¢	2.0 ¢
<b>COMPRESSED NATURAL GAS (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.2 ¢	12.2 ¢
County of Maui	4.0	8.9	12.9
County of Hawaii	4.0	4.4	8.4
County of Kauai	4.0	8.4	12.4
<b>LIQUEFIED NATURAL GAS (HIGHWAY):</b>			
City & County of Honolulu	4.0 ¢	8.2 ¢	12.2 ¢
County of Maui	4.0	8.9	12.9
County of Hawaii	4.0	4.4	8.4
County of Kauai	4.0	8.4	12.4
<b>ENVIRONMENTAL RESPONSE, ENERGY, &amp; FOOD SECURITY TAX</b>			
All Counties, per barrel of petroleum products <sup>1</sup>	105.0 ¢	0.0 ¢	105.0 ¢
All Counties, per million BTU of fossil fuels <sup>2</sup>	19.0	0.0	19.0

<sup>1</sup> Does not include aviation fuel.

<sup>2</sup> Does not include petroleum products. BTU = British thermal unit.

<sup>3</sup> Effective retroactive to January 1, 2016, pursuant to Act 76, SLH 2016.

<sup>4</sup> Gasoline used for agricultural equipment off highways, aviation fuel, and diesel oil used off highways are taxed by the State at 1 cent per gallon.

**Chart 1.9 - Fuel Tax and Trends in Fuel Consumption  
Fiscal Years 2007 - 2016**

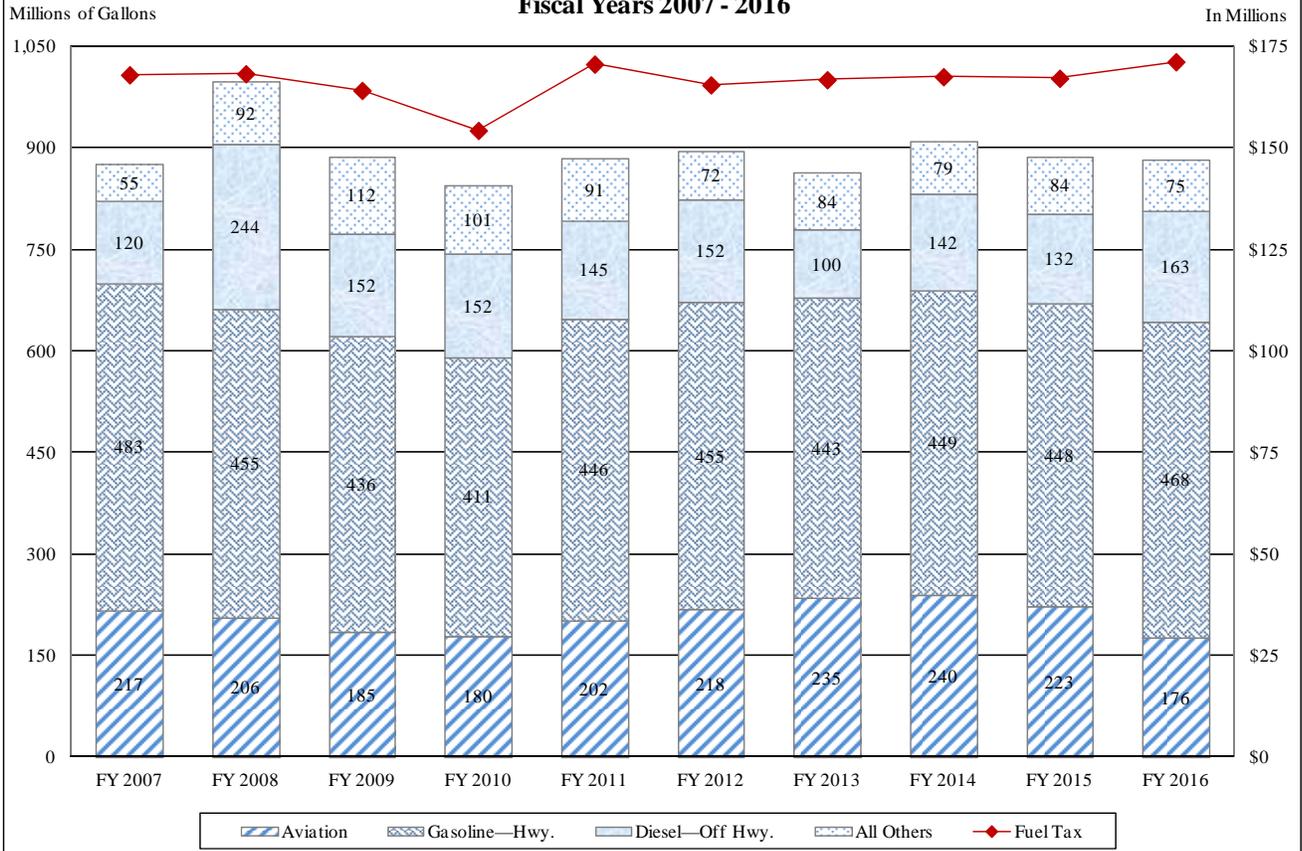


TABLE 1.5 - TAXABLE GALLONS OF FUEL CONSUMED  
(In Thousands of Gallons)

	FY 2016	FY 2015	Difference	
			Amount	% Change
Gasoline	467,645	448,148	19,497	4.4
Diesel Oil - Off Highway	162,813	132,142	30,671	23.2
Diesel Oil - Highway	48,013	46,601	1,412	3.0
Liq. Pet. Gas - Highway	14	17	(3)	(15.4)
Small Boats - Gasoline	1,369	1,541	(172)	(11.2)
Small Boats - Diesel Oil	2,591	3,005	(415)	(13.8)
Aviation Fuel	176,390	222,666	(46,276)	(20.8)
Other Fuel <sup>1</sup>	23,173	32,977	(9,804)	(29.7)
Total Gallons	882,008	887,097	(5,089)	(0.6)
Environmental Tax				
Petroleum Products (Barrel) <sup>2</sup>	24,792,278	24,721,301	70,977	0.3
Fossil Fuels (MMBtu) <sup>3</sup>	4,835,187	-	4,835,187	n/m

<sup>1</sup> Other fuel includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

<sup>2</sup> Barrel = 42 U.S. gallons of petroleum products.

<sup>3</sup> MMBtu = 1 million British thermal units.

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

n/m = not meaningful.

TABLE 1.6 - ALLOCATION OF FUEL TAXES <sup>1</sup>  
(In Thousands of Dollars)

	FY 2016	FY 2015	Difference	
			Amount	% Change
<b>STATE HIGHWAY FUND</b>				
Gasoline	\$ 76,915	\$ 75,584	\$ 1,331	1.8
Diesel Oil - Off Highway	2,678	\$ 2,676	3	0.1
Diesel Oil - Highway	7,883	\$ 7,843	41	0.5
Liq. Pet. Gas - Highway	1	\$ 1	(0)	(15.4)
Other Fuel <sup>2</sup>	540	\$ 718	(178)	(24.8)
Subtotal	\$ 88,018	\$ 86,822	\$ 1,196	1.4
Motor Vehicle	132,831	\$ 128,814	4,016	3.1
Rental Vehicle	54,872	\$ 51,940	2,933	5.6
TOTAL	\$ 275,721	\$ 267,576	\$ 8,145	3.0
<b>COUNTY HIGHWAY FUNDS</b>				
City & County of Honolulu	\$ 52,765	\$ 50,503	\$ 2,261	4.5
County of Maui	12,522	10,900	1,622	14.9
County of Hawaii	7,931	7,650	281	3.7
County of Kauai	5,459	5,169	290	5.6
TOTAL	\$ 78,677	\$ 74,223	\$ 4,454	6.0
BOATING SPECIAL FUND	\$ 1,684	\$ 1,627	\$ 57	3.5
<b>STATE AIRPORT FUND</b>				
Aviation Fuel	\$ 2,807	\$ 4,453	\$ (1,646)	(37.0)
ENVIRONMENTAL RESPONSE REVOLVING FUND	\$ 1,288	\$ 1,236	\$ 52	4.2
ENERGY SECURITY FUND	\$ 3,864	\$ 3,708	\$ 156	4.2
ENERGY SYSTEMS DEVELOPMENT FUND	\$ 2,576	\$ 2,472	\$ 104	4.2
AGRICULTURAL DEVELOPMENT & FOOD SECURITY FUND	\$ 3,864	\$ 3,708	\$ 156	4.2
GENERAL FUND	\$ 15,359	\$ 14,833	\$ 526	3.5

<sup>1</sup> Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available.

<sup>2</sup> Other fuel includes ethanol, methanol, biodiesel, naphtha, compressed natural gas, and liquefied natural gas.

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

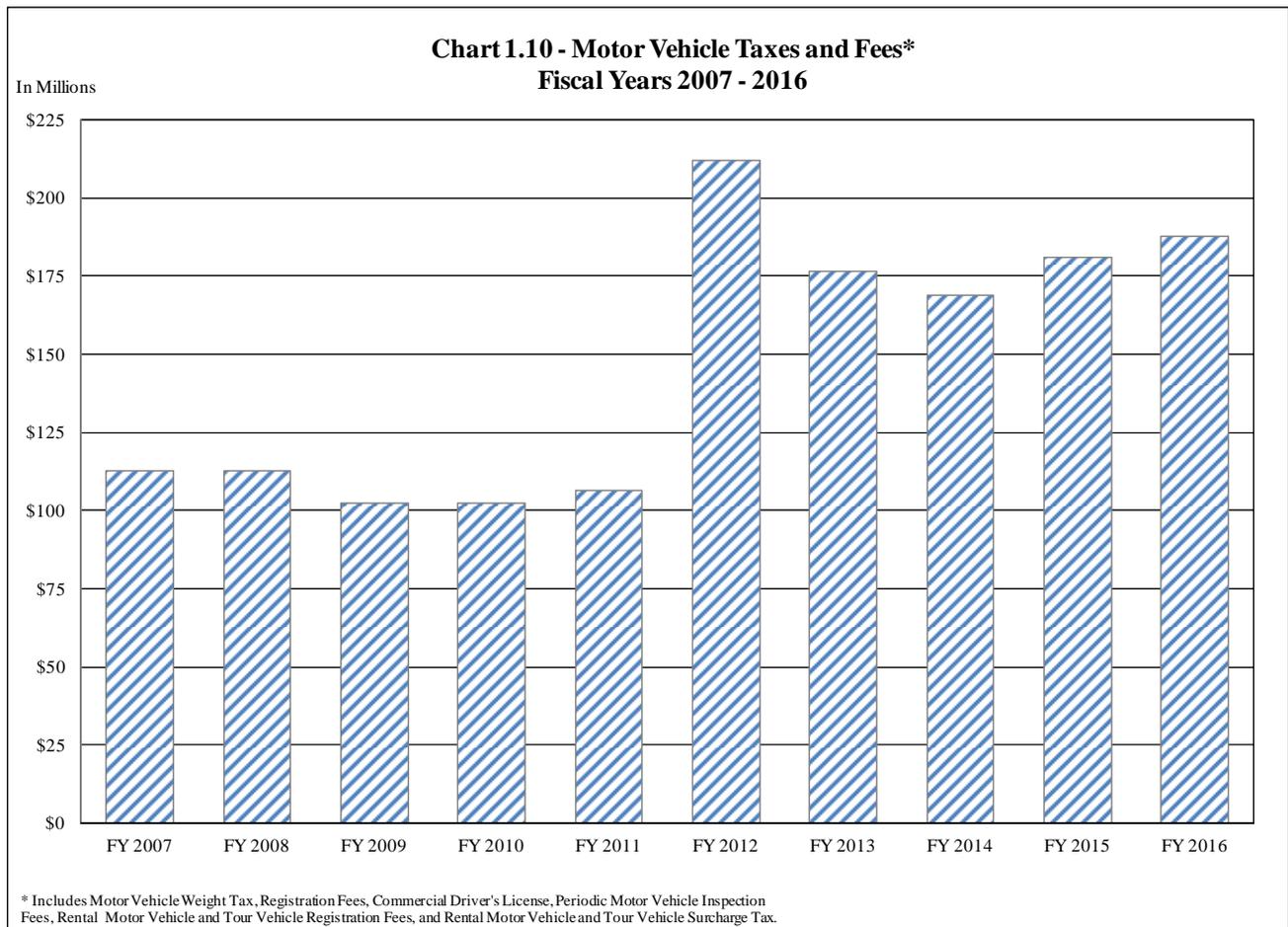
## 1.7 MOTOR VEHICLE TAXES AND FEES

### 1.7.1 Overview

The State levies an annual registration fee per vehicle and a tax based on vehicle weight. The State also levies the rental motor vehicle surcharge (RMVS) tax for motor vehicles that are rented or leased. The tax is imposed on the lessor. Effective July 1, 2012, the rate of the RMVS tax is \$3.00 per day. 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 for those subject to the taxes on rental or tour vehicles.

### 1.7.2 Revenue

For FY 2016, the State's motor vehicle taxes and fees (including the RMVS) totaled \$187.7 million, compared to \$180.8 million in FY 2015, an increase of 3.8%. Chart 1.10 shows the total motor vehicle taxes and fees for FY 2007 through FY 2016. The large increase in FY 2012 was caused by a temporary increase in the rate of the RMVS to \$7.50 per day, which was in place for the period from July 1, 2011 to June 30, 2012. The collections for FY 2013 also reflect one month of collections at the higher tax rate, since the collections lag the liabilities incurred by one month.



### ***1.7.3 Recent Legislation***

Act 101, SLH 2014, levied a new car-sharing vehicle surcharge tax of 25 cents per half hour, beginning January 1, 2015.

## **1.8 CIGARETTE AND TOBACCO TAX**

### ***1.8.1 Overview***

Wholesalers and dealers, as those terms are defined in section 245-1, Hawaii Revised Statutes (HRS), must pay an excise tax on the sale or use of tobacco products and on each cigarette or little cigar sold, used, or possessed. The tax per cigarette or little cigar was increased to 16 cents for sales on and after July 1, 2011. The excise tax on large cigars is 50% of the wholesale price and the excise tax on all other tobacco products (tobacco in any form except cigarettes, little cigars or large cigars) is 70% of the wholesale price. A \$2.50 tobacco tax license is required and must be renewed before July 1 each year. Cigarette wholesalers and dealers are required to affix a stamp to each individual cigarette package as proof that the tax has been paid. Every retailer engaged in the retail sale of cigarettes and other tobacco products is required to obtain a \$20 retail tobacco permit that must be renewed before December 1 each year.

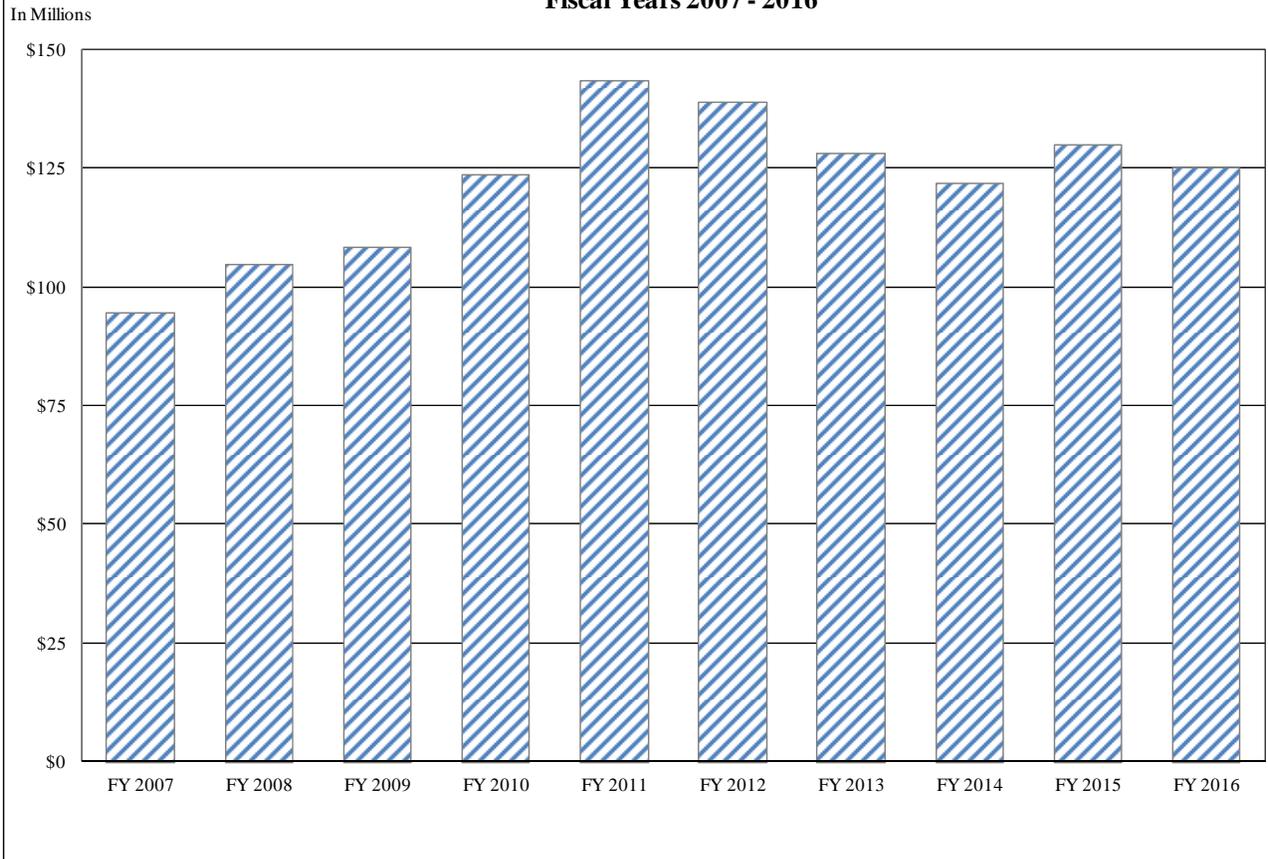
### ***1.8.2 Revenue***

During FY 2016, collections of the cigarette and tobacco tax (including tobacco licenses) totaled \$125.1 million, compared to \$129.9 million in FY 2015, or a decrease of 3.7%. Chart 1.11 shows the total collections of the tax for FY 2007 through FY 2016. The 16 cent tax per cigarette was distributed as follows in FY 2016: 2.00 cents went to the Hawaii Cancer Research Special Fund, 1.50 cents went to the Trauma System Special Fund, 1.25 cents went to the Community Health Centers Special Fund, and 1.25 cents went to the Emergency Medical Services Special Fund. Additionally, a total of \$2.0 million went to the Cigarette Stamp Administrative Fund and the Cigarette and Stamp Enforcement Fund. The remainder of the cigarette and tobacco tax went to the General Fund. Table 1.7 shows collections of the tobacco taxes and how the revenues were allocated in FY 2015 and FY 2016.

### ***1.8.3 Recent Legislation***

Act 238, SLH 2015, reduces the allocation of the tax on cigarettes to the Trauma System Special Fund from 1.250 cents per cigarette to 1.125 cents per cigarette, and caps the allocations to the Emergency Medical Services Special Fund and the Community Health Center Special Fund, effective July 1, 2015.

**Chart 1.11 - Cigarette and Tobacco Tax & License  
Fiscal Years 2007 - 2016**



**TABLE 1.7 - CIGARETTE & TOBACCO TAX  
(In Thousands of Dollars)**

	FY 2016	FY 2015	Difference	
			Amount	% Change
<b>Collection</b>				
Tobacco & Licenses	\$ 125,093	\$ 129,851	\$ (4,758)	(3.7)
<b>Distribution*</b>				
Hawaii Cancer Research Fund	\$ 14,445	\$ 14,995	\$ (550)	(3.7)
Trauma System Fund	7,400	11,243	(3,843)	(34.2)
Emergency Medical Services Fund	8,800	9,373	(573)	(6.1)
Community Health Centers Fund	8,800	9,373	(573)	(6.1)
Cigarette Stamp Administrative & Enforcement Funds	1,964	2,038	(75)	(3.7)
General Fund	83,685	82,829	855	1.0
<b>Total</b>	<b>\$ 125,093</b>	<b>\$ 129,851</b>	<b>\$ (4,758)</b>	<b>(3.7)</b>

\*Details on distributions of the revenues are given in section 245-15, HRS.  
NOTE: Due to rounding, details may not add to totals.

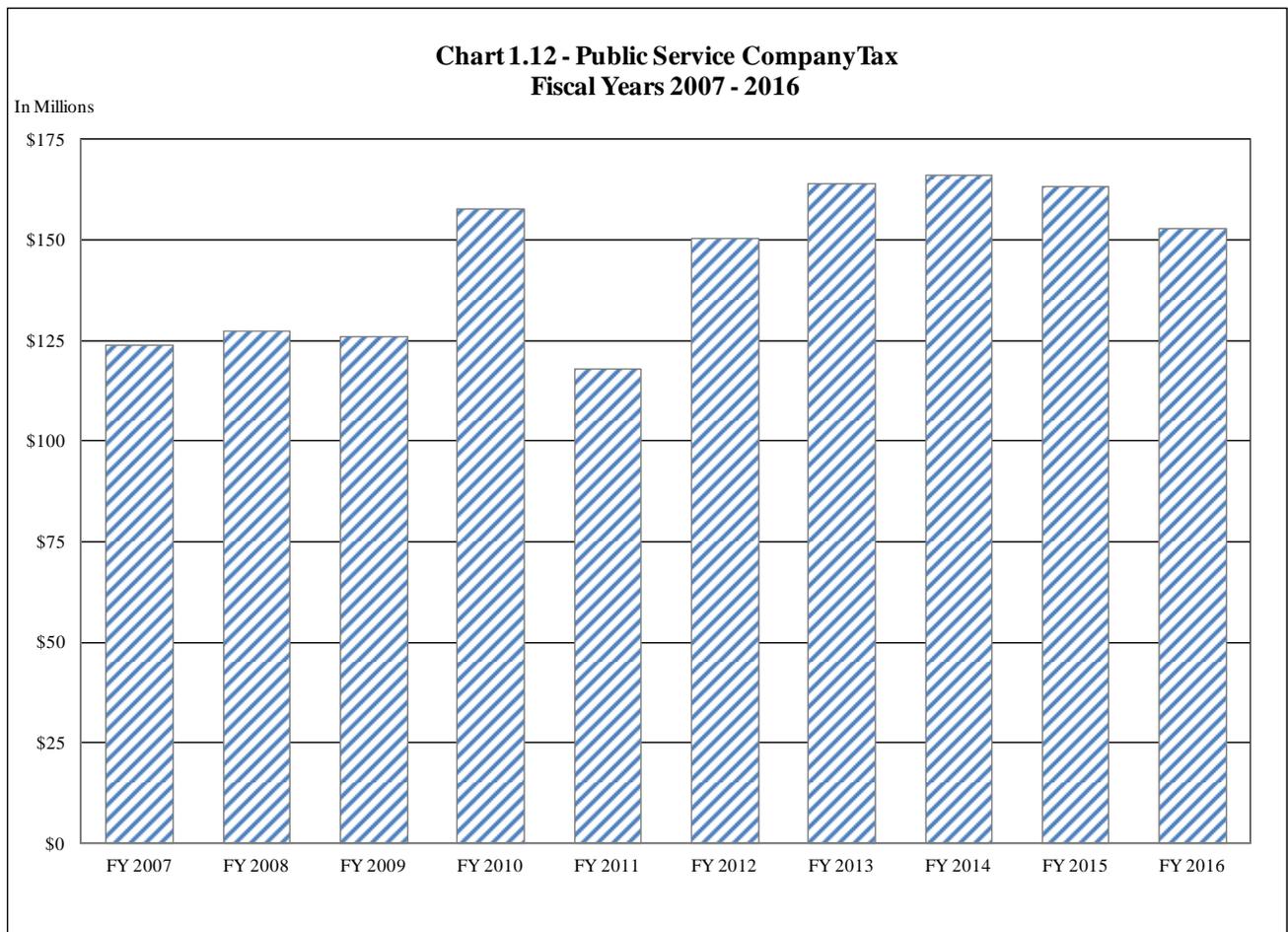
## 1.9 PUBLIC SERVICE COMPANY TAX

### 1.9.1 Overview

The public service company (PSC) tax is levied on public utility businesses in lieu of all taxes except income taxes, vehicular taxes imposed under chapter 249, HRS, the franchise tax on public utilities imposed under chapter 240, HRS, and the use tax imposed under chapter 238, HRS. Generally, the tax is applied to gross income from the business of public utilities for the preceding calendar year. The tax rates on the PSC's range from 0.50% (levied on sales for resale) to 8.20%. For a public utility, only the first 4.0% is realized by the State; any excess over 4.0% is distributed to counties that provide a real property tax exemption for property used by the public utility in its business. For a carrier of passengers by land between points on a scheduled route, the gross income from passenger fares is taxed at 5.35%, all of which is realized by the State.

### 1.9.2 Revenue

The PSC tax yielded \$152.8 million in tax, penalty, and interest in FY 2016, a decrease of 6.6% from the \$163.5 million collected in FY 2015. All of the revenues from the PSC tax are allocated to the General Fund. Chart 1.12 shows the total collections of the tax for FY 2007 through FY 2016.



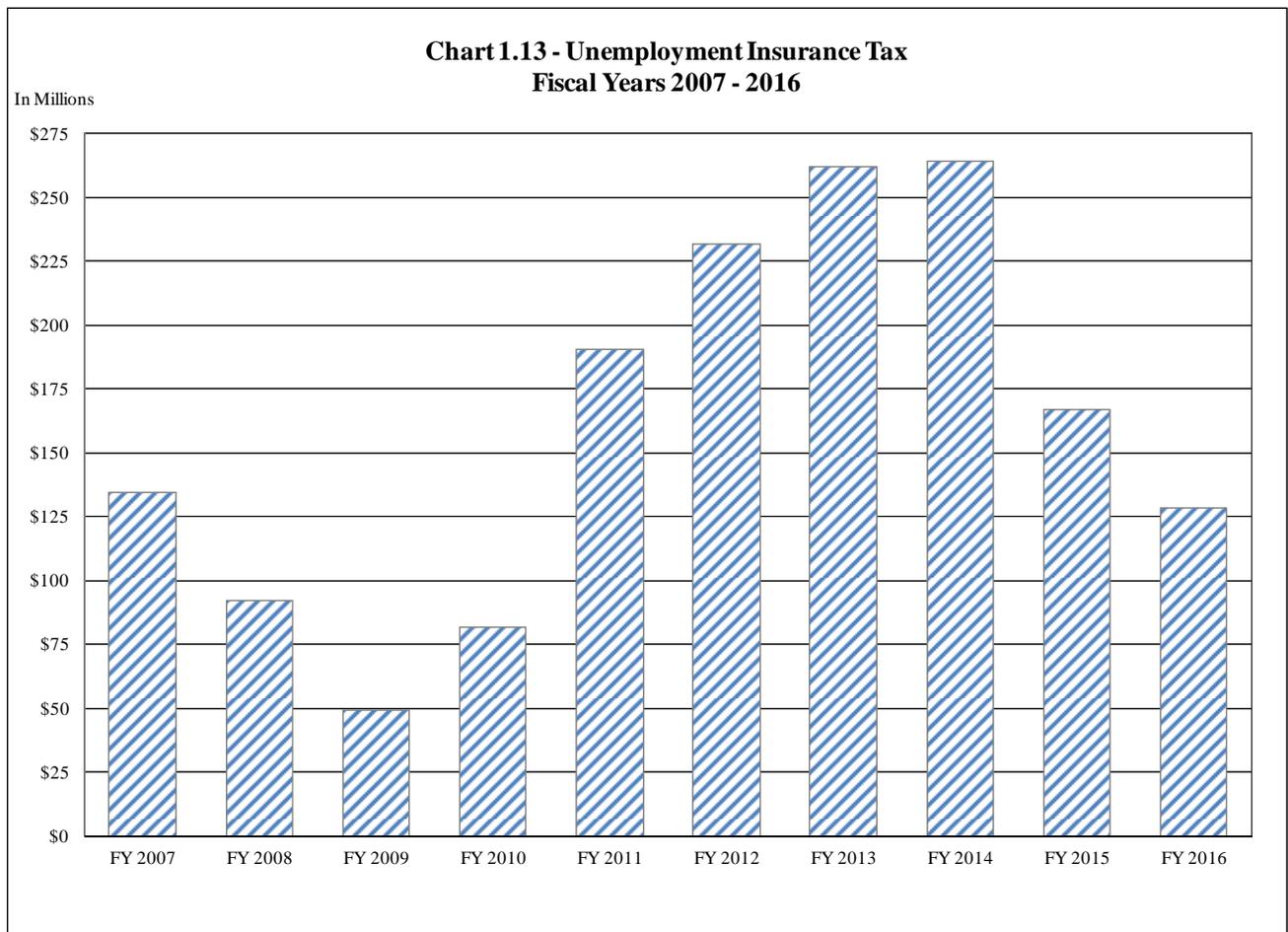
## 1.10 UNEMPLOYMENT INSURANCE TAX

### 1.10.1 Overview

The unemployment insurance (UI) tax (officially "employment security contributions") is imposed on wages paid by employers with one or more employees, with certain exemptions. The tax is experience rated. The UI tax rate for each year depends on the condition of the UI Trust Fund. The tax base represents the state's average annual wages reported by employers contributing to the Unemployment Trust Fund. For FY 2016, the tax base ranged from \$40,900 in CY 2015 to \$42,200 in CY 2016 and the contribution rate for new employers ranged from 3.0% in CY 2015 to 2.4% in CY 2016. Revenues from the tax go to the Unemployment Trust Fund. The Department of Labor and Industrial Relations administers the UI tax and the Department of Taxation collects the tax.

### 1.10.2 Revenue

For FY 2016, revenue from the UI tax totaled \$128.6 million, down by 23.1% from \$167.2 million collected in FY 2015. Chart 1.13 shows collections of the UI tax for FY 2007 through FY 2016.



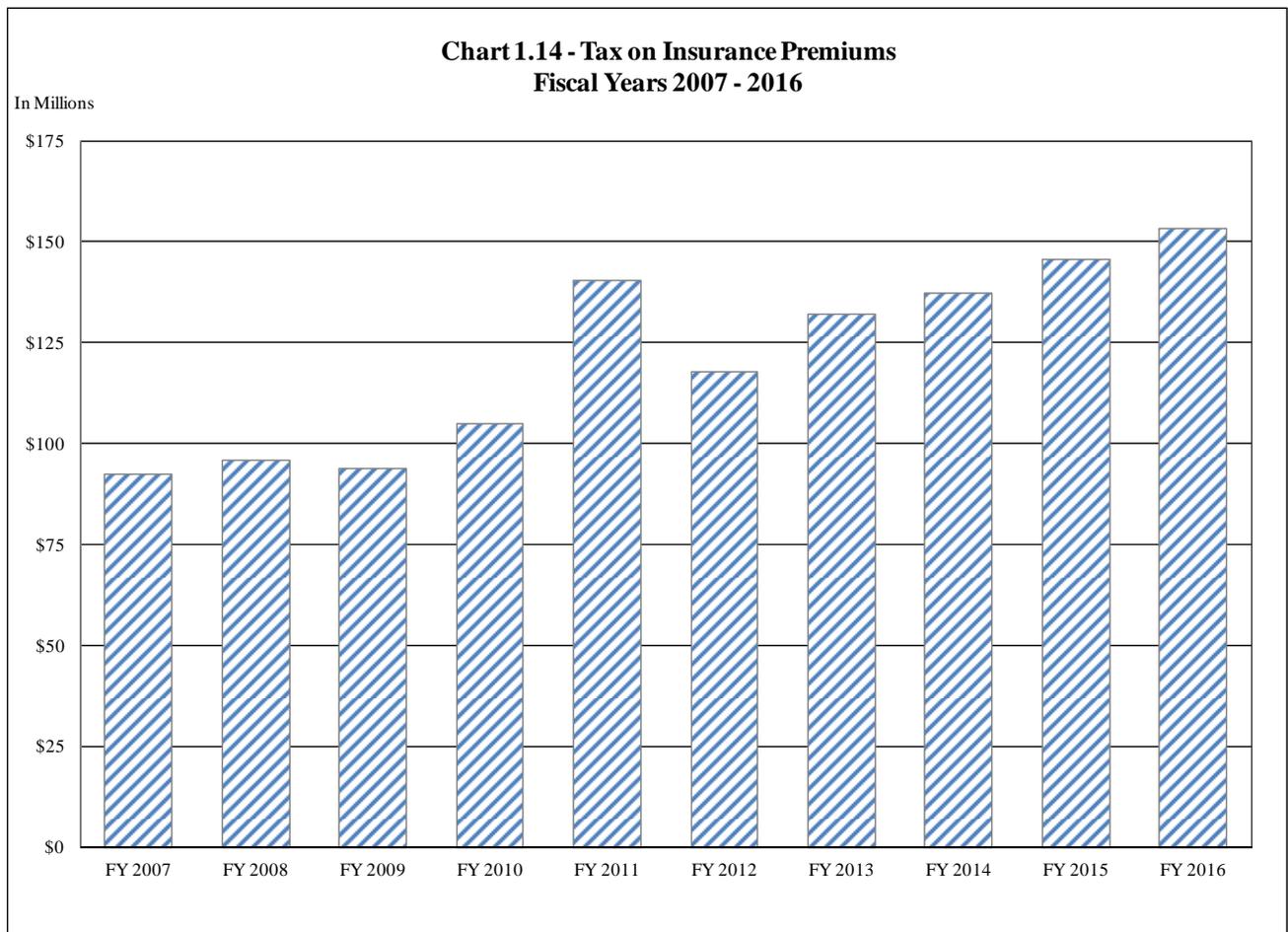
## 1.11 INSURANCE PREMIUM TAX

### 1.11.1 Overview

The tax on insurance premiums applies to insurance companies (underwriters) based on premiums written in Hawaii. The insurance premium tax is in lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. The tax rates are as follows: (1) Life Insurance, 2.75%; (2) Surplus Lines, 4.68%; (3) Ocean Marine, 0.8775% on gross underwriting profit; and (4) Other Insurance, 4.265%. To insurers who qualify, there is a 1.0% tax credit to facilitate regulatory oversight. The tax is administered and collected by the Insurance Commissioner, who is required to report to the Director of Taxation the amounts of all taxes collected under chapter 431, HRS.

### 1.11.2 Revenue

For FY 2016, the tax on insurance premiums totaled \$153.2 million, compared to \$145.7 million in FY 2015, an increase of 5.1%. Chart 1.14 shows collections of the tax for FY 2007 through FY 2016.



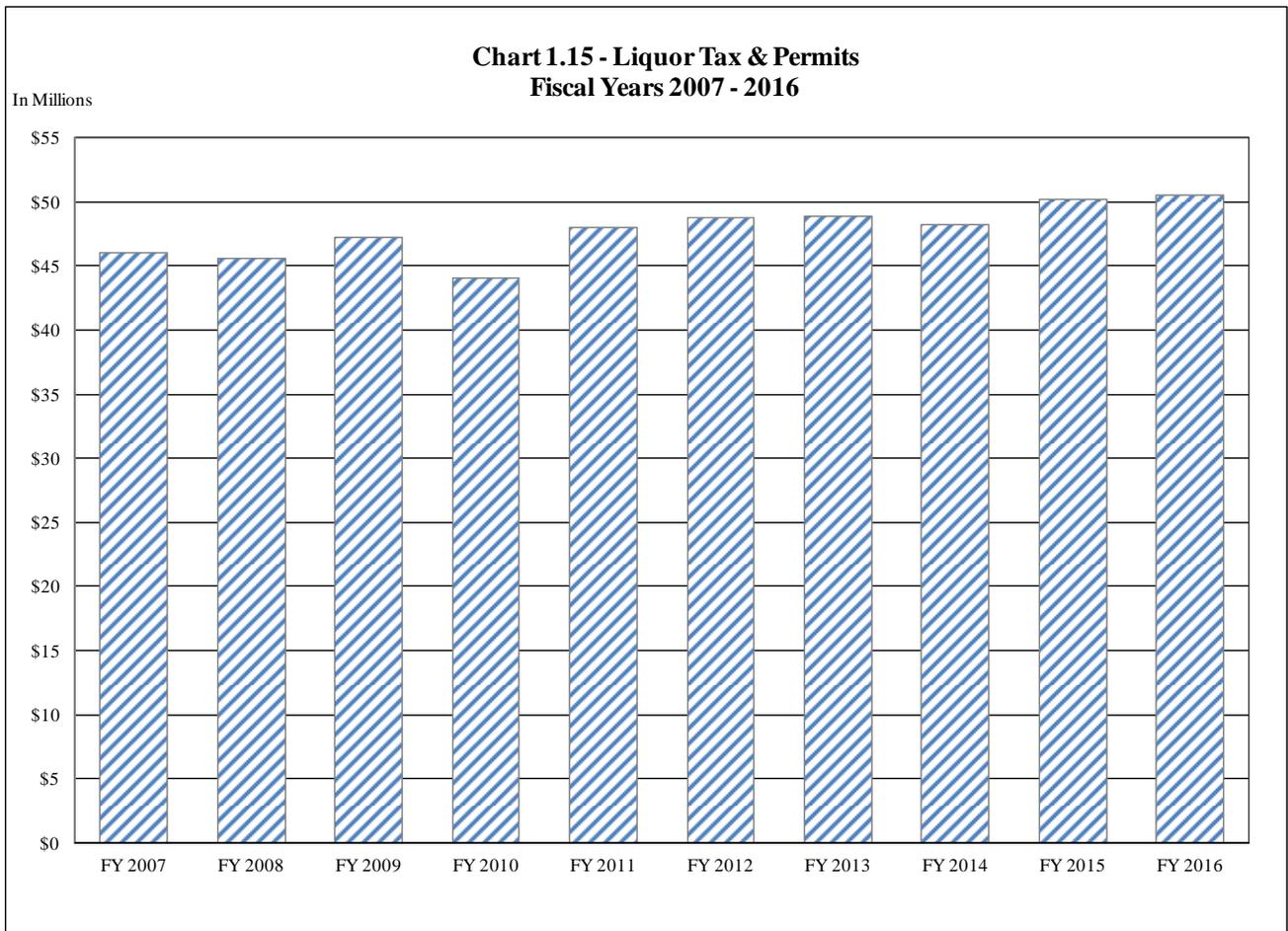
## 1.12 LIQUOR TAX

### 1.12.1 Overview

The tax on liquor is a gallonage tax imposed on dealers as defined in section 244D-1, HRS, and upon certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1 each year. See section 244D-4, HRS, for exemptions from the tax. The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$0.85 on cooler beverages, \$0.93 on beer other than draft beer, and \$0.54 on draft beer.

### 1.12.2 Revenue

For FY 2016, the liquor tax and permit fees totaled \$50.6 million, an increase of 0.6% from the \$50.3 million collected in FY 2015. Chart 1.15 shows collections of the liquor tax and permit fees for FY 2007 through FY 2016.



## **1.13 CONVEYANCE TAX**

### ***1.13.1 Overview***

The conveyance 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. For a sale of a condominium or single family residence, the rate of the conveyance tax depends on whether the purchaser is eligible for a county homeowners' exemption from the real property tax. If the purchaser is eligible for the exemption, or if the sale is of real property other than a condominium or single family residence, then the tax rate ranges from 10 cents per \$100 for properties with a value of less than \$600,000 to \$1 per \$100 for properties with a value of \$10 million or more. If the purchaser is ineligible for the exemption, the tax rate for a sale of a condominium or single family residence ranges from 15 cents per \$100 for properties with a value of less than \$600,000 to \$1.25 per \$100 for properties with a value of \$10,000,000 or more. The conveyance tax is administered by the Department of Taxation, but it is collected by the Bureau of Conveyances in the Department of Land and Natural Resources.

### ***1.13.2 Revenue***

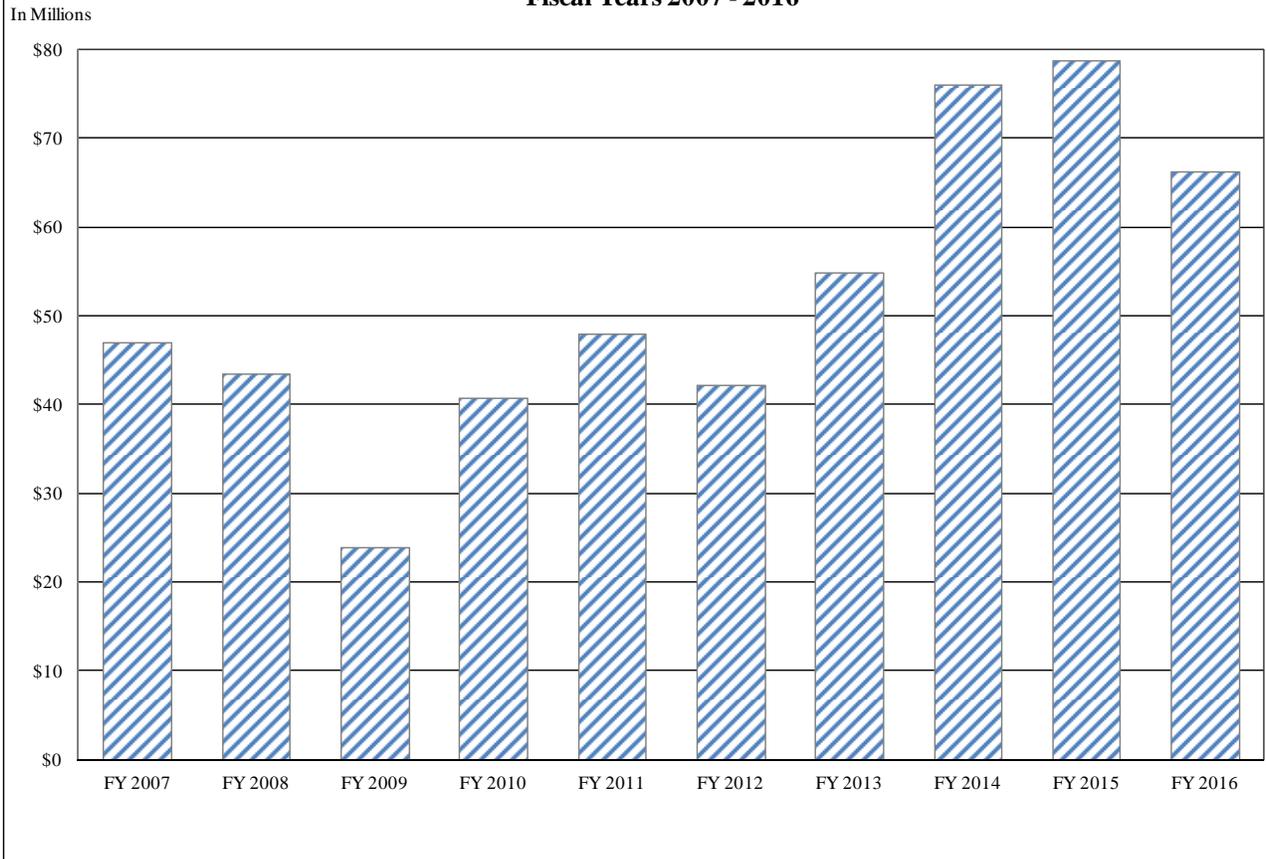
For FY 2016, revenue from the conveyance tax totaled \$66.1 million, compared to \$78.7 million in FY 2015, a decrease of 16.0%. The revenues for FY 2016 were distributed as follows: 10% went to the Land Conservation Fund, provided that the amount in excess of \$6.8 million in any fiscal year is deposited into the General Fund; 50% went to the Rental Housing Trust Fund, provided that the amount in excess of \$38.0 million in any fiscal year is deposited into the General Fund; and the remaining 40% went to the General Fund. Chart 1.16 shows collections of the conveyance tax for FY 2007 through FY 2016.

### ***1.13.3 Recent Legislation***

Act 163, SLH 2014, increases allocations of the conveyance tax to the Rental Housing Trust Fund from 30% to 50% beginning July 1, 2014.

Act 84, SLH 2015, eliminates the contributions of the conveyance tax to the Natural Area Reserve Fund, effective July 1, 2015, and caps the allocations to the other special funds.

**Chart 1.16 - Conveyance Tax  
Fiscal Years 2007 - 2016**



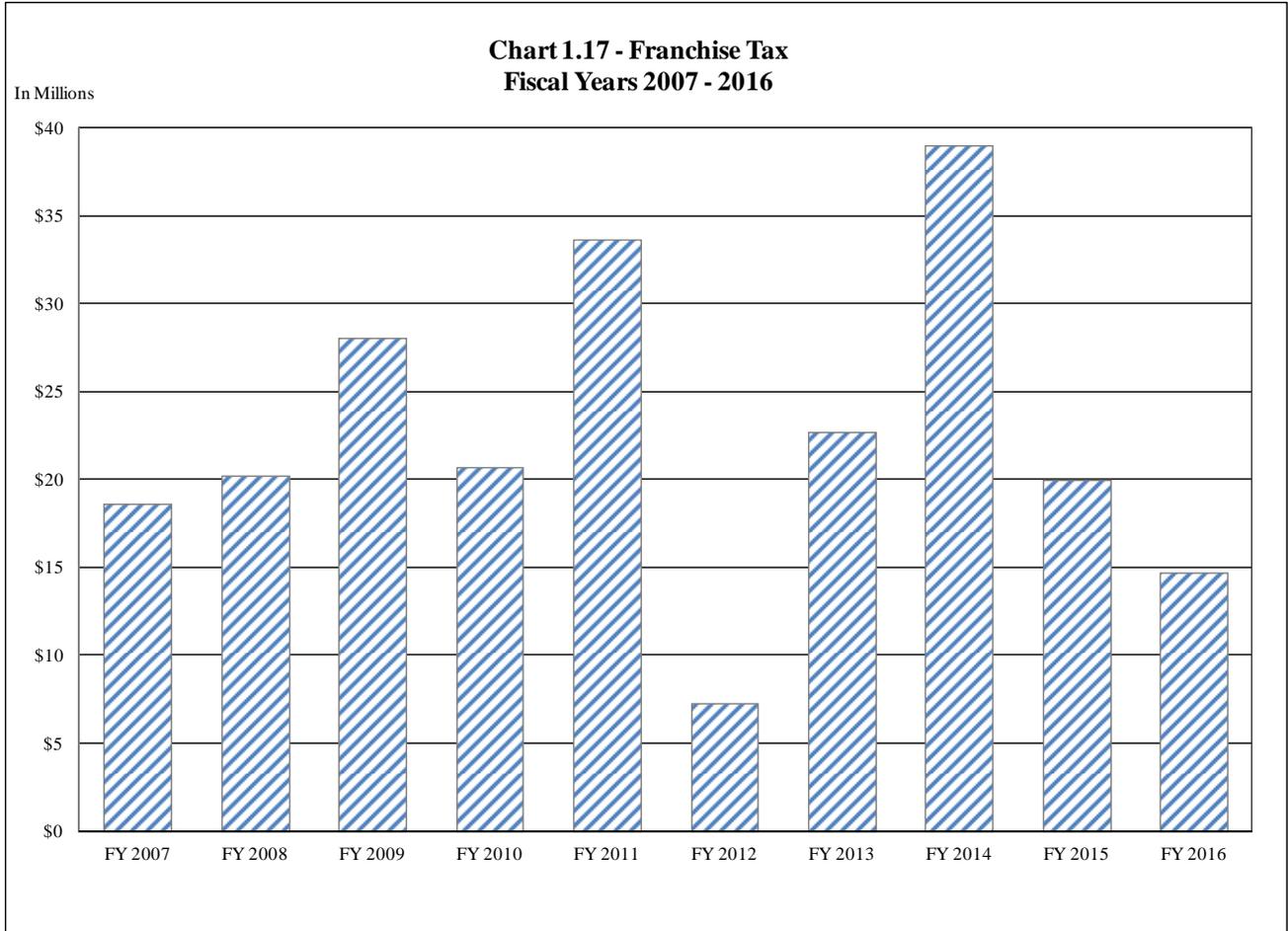
## **1.14 TAX ON BANKS AND OTHER FINANCIAL CORPORATIONS**

### ***1.14.1 Overview***

The tax on banks and other financial corporations (the franchise tax) is levied on net income of 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, and subsidiaries not subject to the tax imposed by chapter 235, HRS. The tax is in lieu of the net income tax imposed under chapter 235, HRS, and of the GET, but it uses the definition of net income from chapter 235, with modifications. The tax is levied on net income at the rate of 7.92%. The assessment date is January 1 of each year.

### ***1.14.2 Revenue***

For FY 2016, franchise tax collections totaled \$14.7 million, compared to \$19.9 million in FY 2015, a decrease of 26.3%. Chart 1.17 shows collections of the franchise tax for FY 2007 through FY 2016. Collections of the tax were low in FY 2012, due partly to a one-time transfer of \$16.5 million to the Litigated Claims Fund.



## **1.15 ESTATE AND TRANSFER TAX**

### ***1.15.1 Overview***

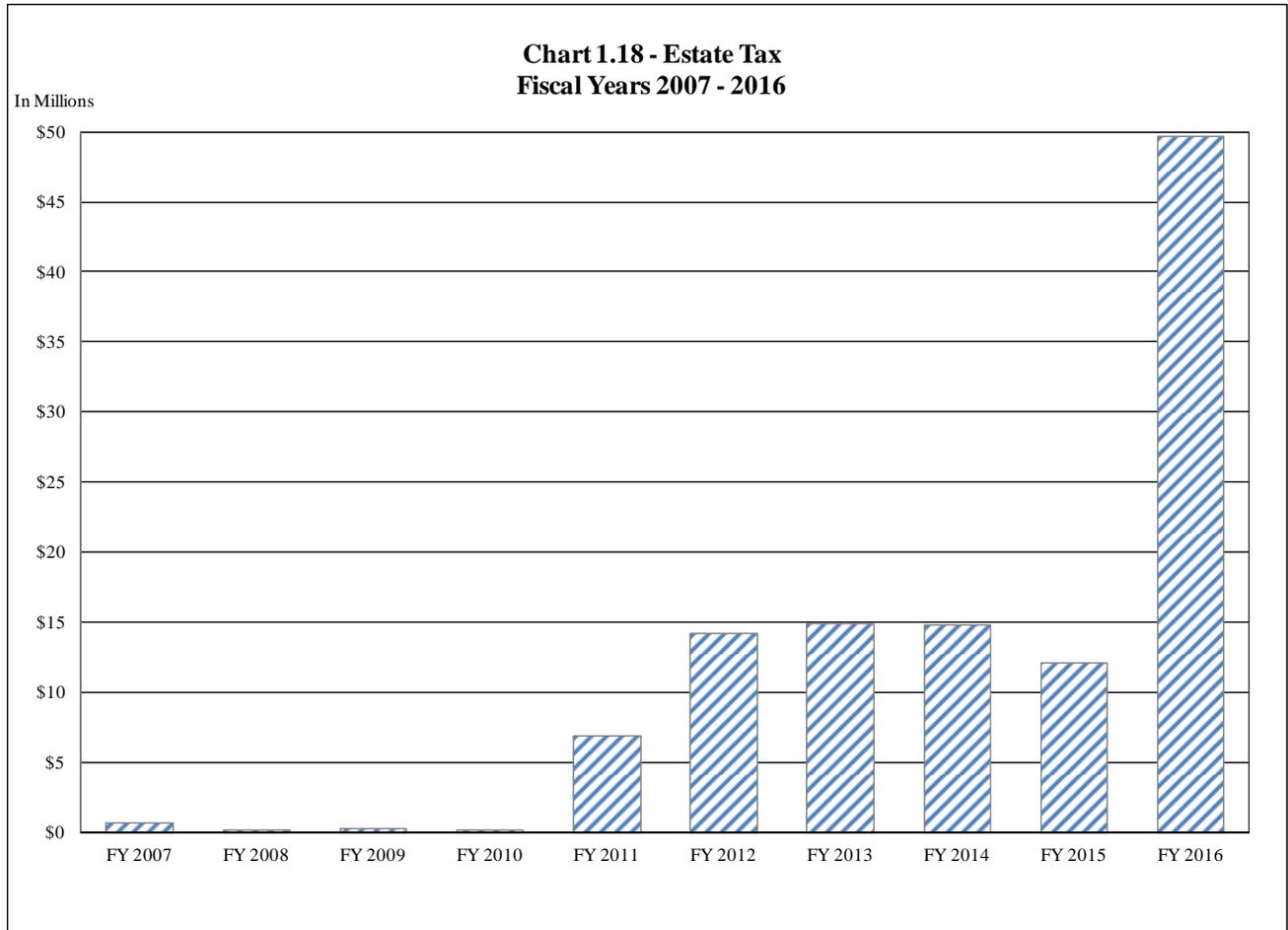
Hawaii's estate and transfer tax is levied on the transfer of a taxable estate. The taxable estate is based on the federal definition (with adjustments for nonresidents), but the State has its own tax rate schedule, with tax rates varying from 10.0% to 15.7%. The generation skipping tax is also based on the federal taxable transfer, but has its own tax rate (currently 2.25%).

### ***1.15.2 Revenue***

For FY 2016, estate tax collections totaled \$49.6 million, compared to \$12.1 million collected in FY 2015. Chart 1.18 shows collections of the estate and transfer tax for FY 2007 through FY 2016.

### ***1.15.3 Recent Legislation***

Act 44, SLH 2014, conformed Hawaii's estate tax to the Internal Revenue Code and closed a loophole in the tax for decedents dying after December 31, 2013.



## 1.16 CITY AND COUNTY OF HONOLULU SURCHARGE TAX

### 1.16.1 Overview

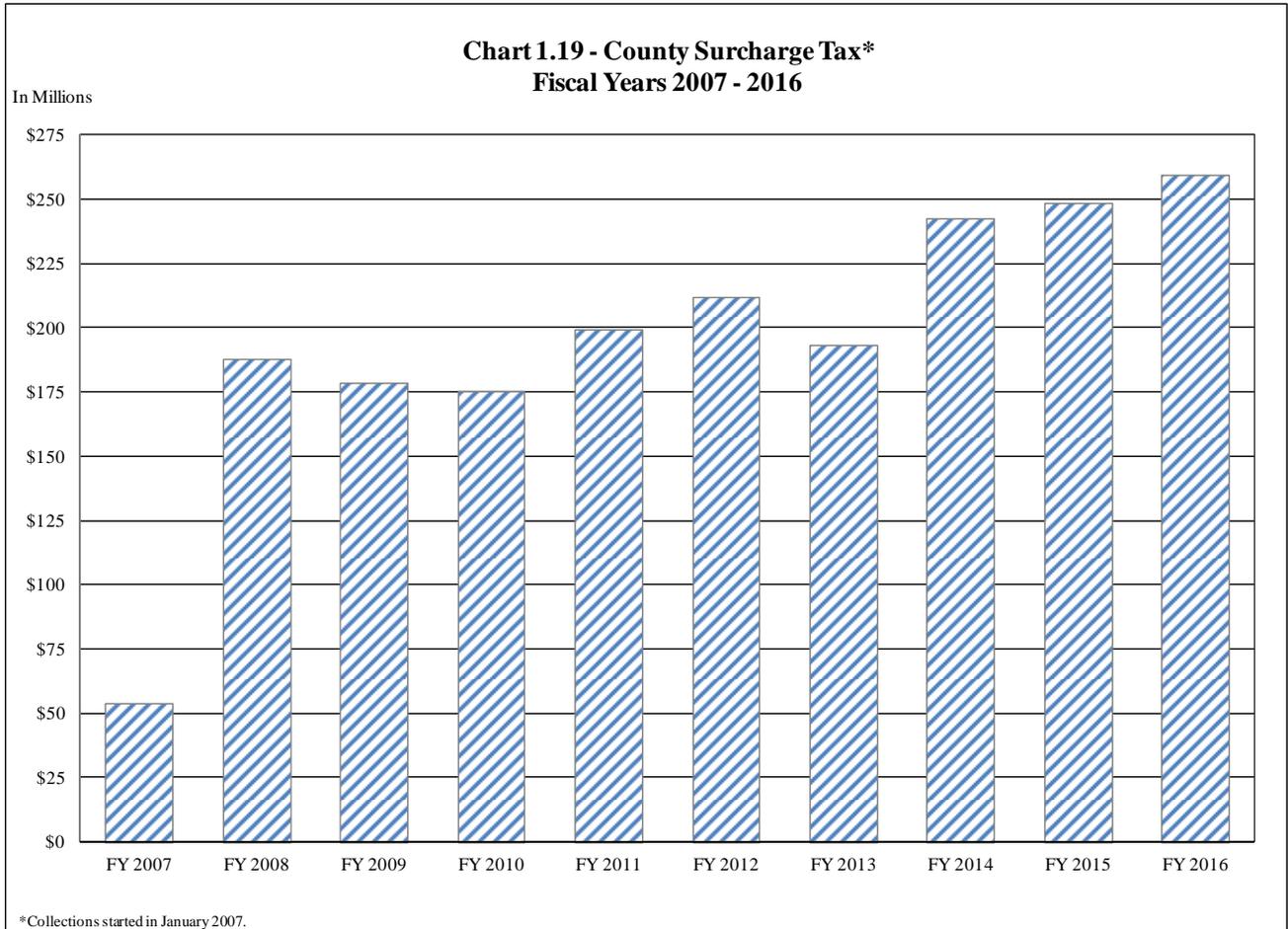
Act 247, SLH 2005, granted counties the authority to impose a county surcharge of no more than 0.5% on gross income that is subject to the State's GET at the rate of 4.0% to fund county public transportation systems. The Act specified that the surcharge be levied no earlier than January 1, 2007 and that it be automatically repealed on December 31, 2022. The Department of Taxation is required to administer and collect the surcharge for the counties. The City and County of Honolulu was the only county to adopt the surcharge, which took effect on January 1, 2007. The State keeps 10.0% of the collections from the county surcharge as administrative costs, and Honolulu County receives the remaining 90.0% of the collections.

### 1.16.2 Revenue

For FY 2016, collections of Honolulu's county surcharge totaled \$259.2 million, an increase of 4.3% from the \$248.5 million collected in FY 2015. Chart 1.19 shows collections of the county surcharge for FY 2007 through FY 2016.

### 1.16.3 Recent Legislation

Act 240, SLH 2015, allows the counties to establish new county surcharges or to extend an existing surcharge through December 31, 2027, as long as the action is taken by July 1, 2016. Any new county surcharge would take effect January 1, 2018.



### 1.17 TOTAL TAX COLLECTIONS

Total tax collections in FY 2016 amounted to \$7.25 billion, up by 5.1% from the \$6.90 billion collected in FY 2015. The Department collected the great majority of the total taxes (\$6.89 billion), but the counties collected \$132.8 million in State motor vehicle weight taxes and registration fees, the Insurance Commissioner (in the Department of Commerce and Consumer Affairs) collected \$153.2 million in insurance premium taxes, and the Bureau of Conveyances (in the Department of Land and Natural Resources) collected \$66.1 million in conveyance taxes. The total collections are shown in Table 1.8.

TABLE 1.8 - TAX COLLECTIONS  
(In Thousands of Dollars )

SOURCE OF REVENUE	FY 2016		FY 2015	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 14,691	0.20	\$ 19,930	0.29
Conveyance	66,083	0.91	78,702	1.14
Employment Security Contributions	128,577	1.77	167,248	2.42
Fuel & Environmental <sup>3</sup>	198,136	2.73	193,082	2.80
General Excise & Use	3,206,154	44.23	3,048,207	44.18
Honolulu County Surcharge	259,248	3.58	248,518	3.60
Income - Corporations	93,036	1.28	52,319	0.76
Income - Individuals	2,116,859	29.20	1,988,194	28.81
Inheritance and Estate	49,613	0.68	12,071	0.17
Insurance Premiums	153,173	2.11	145,679	2.11
Liquor & Permits	50,590	0.70	50,281	0.73
Motor Vehicle Tax <sup>1</sup>	187,704	2.59	180,755	2.62
Public Service Companies	152,760	2.11	163,481	2.37
Tobacco & Licenses	125,093	1.73	129,851	1.88
Trans. Accom. Fees	13	0.00	12	0.00
Trans. Accom. Tax	446,781	6.16	420,970	6.10
All Others <sup>2</sup>	693	0.01	742	0.01
<b>TOTAL</b>	<b>\$ 7,249,205</b>	<b>100.00</b>	<b>\$ 6,900,042</b>	<b>100.00</b>

<sup>1</sup> Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental motor vehicle and tour vehicle registration fees, and rental motor vehicle and tour vehicle surcharge tax.

<sup>2</sup> Includes fuel retail dealer permits, fuel penalty and interest, permitted transfers tax, and general excise fees.

<sup>3</sup> Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available.

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

## 1.18 DISTRIBUTION OF TAXES

Of the \$7.25 billion in total tax collections in FY 2016, \$6.19 billion or 85.4% was deposited into the State's General Fund. The four counties received \$181.7 million from county fuel taxes and the TAT. In addition, \$259.2 million of county surcharge was collected for the City and County of Honolulu (before deducting the 10% administrative fee imposed by the State). The remaining tax revenues not deposited into the General Fund or transferred to the counties were distributed among various State special funds. The State Highway Fund received the largest portion, \$275.7 million. All of the unemployment insurance tax (the employment security contributions) went into the Unemployment Trust Fund for unemployment benefits. Table 1.9 shows allocations of taxes to the State's General Fund in FY 2015 and FY 2016. The distributions of the total tax collections among all funds in FY 2015 and FY 2016 are shown in Table 1.10.

TABLE 1.9 - STATE GENERAL FUND  
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2016		FY 2015	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 12,691	0.20	\$ 17,930	0.31
Conveyance	26,415	0.43	11,534	0.20
General Excise & Use	3,206,154	51.76	2,992,707	52.18
Income - Corporations	93,036	1.50	52,319	0.91
Income - Individuals	2,116,392	34.17	1,987,752	34.66
Inheritance and Estate	49,613	0.80	12,071	0.21
Insurance Premiums	153,173	2.47	145,679	2.54
Liquor & Permits	50,590	0.82	50,281	0.88
Public Service Companies	152,760	2.47	163,481	2.85
Tobacco & Licenses	83,685	1.35	82,829	1.44
Trans. Accom. Tax	233,781	3.77	202,970	3.54
Environmental Tax	15,359	0.25	14,833	0.26
All Others *	708	0.01	755	0.01
<b>TOTAL</b>	<b>\$ 6,194,356</b>	<b>100.00</b>	<b>\$ 5,735,141</b>	<b>100.00</b>

\* Includes fuel retail dealer permits, fuel penalty and interest, permitted transfers tax, general excise fees, trans accom fees and rental vehicle fees.

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

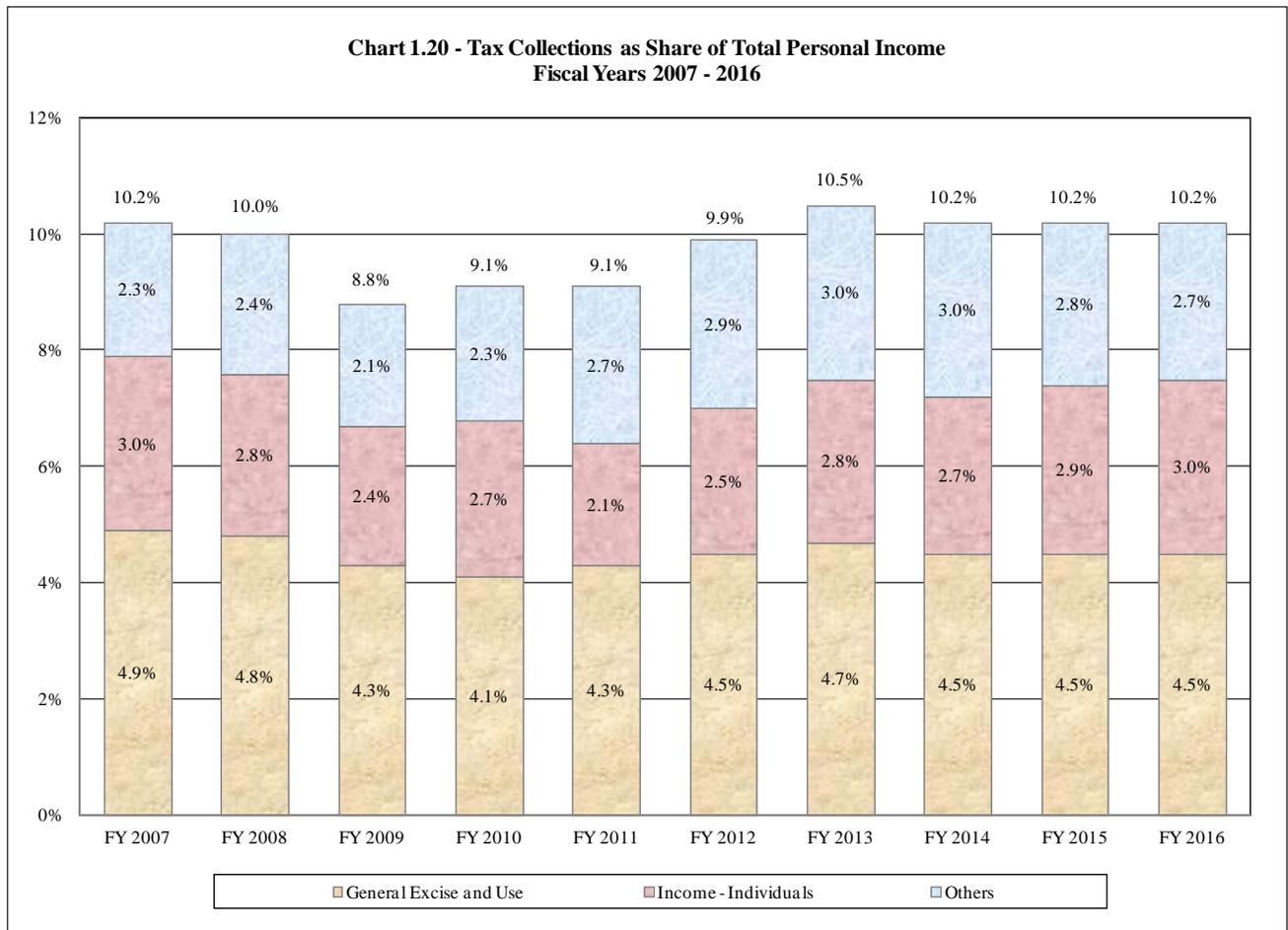
TABLE 1.10 - DISTRIBUTION OF COLLECTIONS  
(In Thousands of Dollars)

	FY 2016		FY 2015	
	Amount Distributed	% of Total	Amount Distributed	% of Total
<u>STATE FUND</u>				
State General	\$ 6,194,356	85.45	\$ 5,735,141	83.12
State Highway	275,721	3.80	267,576	3.88
State Airport	2,807	0.04	4,453	0.06
Boating Special Fund	1,684	0.02	1,627	0.02
Environmental Fund	1,288	0.02	1,236	0.02
Cigarette Stamp Admin/Enf. Fund	1,964	0.03	2,038	0.03
Compliance Resolution Fund	2,000	0.03	2,000	0.03
Unemployment Trust Fund	128,577	1.77	167,248	2.42
Election Campaign Fund	180	0.00	162	0.00
Tourism Special Fund	82,000	1.13	82,000	1.19
Rental Housing Fund	33,057	0.46	39,511	0.57
Natural Area Reserve Fund	-	-	19,755	0.29
Convention Center Fund	26,500	0.37	33,000	0.48
Public Libraries Fund	66	0.00	66	0.00
School Repairs & Maintenance Fund	72	0.00	69	0.00
Land Conservation Fund	6,611	0.09	7,902	0.11
Domestic Violence\Child Abuse Neglect Fund	149	0.00	145	0.00
Cancer Research Fund	14,445	0.20	14,995	0.22
Trauma System Fund	7,400	0.10	11,243	0.16
Emergency Medical Service Fund	8,800	0.12	9,373	0.14
Community Health Centers Fund	8,800	0.12	9,373	0.14
Energy Security Fund	3,864	0.05	3,708	0.05
Energy Systems Development Fund	2,576	0.04	2,472	0.04
Agricultural Development & Food Security Fund	3,864	0.05	3,708	0.05
Hurricane Relief Fund	-	-	55,500	0.80
Turtle Bay Conservation Easement Fund	1,500	0.02	-	-
Subtotal - State	\$ 6,808,280	93.92	\$ 6,474,302	93.83
<u>HONOLULU COUNTY SURCHARGE</u>	\$ 259,248	3.58	\$ 248,518	3.60
<u>REVENUES TRANSFERRED TO COUNTIES</u>				
Other County Revenues				
Fuel Tax	\$ 78,677	1.09	\$ 74,223	1.08
Trans. Accom. Tax	103,000	1.42	103,000	1.49
Subtotal - Counties	\$ 181,677	2.51	\$ 177,223	2.57
<b>TOTAL</b>	<b>\$ 7,249,205</b>	<b>100.00</b>	<b>\$ 6,900,042</b>	<b>100.00</b>

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

## 1.19 TRENDS IN TAX COLLECTIONS

Table 1.11 provides data on total tax collections for FY 2007 through FY 2016. Chart 1.20 shows total tax collections relative to total personal income (TPI) in the State for FY 2007 through FY 2016.<sup>2</sup> From FY 2007 to FY 2009, the ratio declined, with big declines in collections of both the GET and the IIT relative to TPI. The ratio grew from FY 2009 to FY 2013, but fell from FY 2013 to FY 2014. The ratio stayed the same from FY 2014 to FY 2016.



<sup>2</sup> The chart uses the most recent figures from the Bureau of Economic Analysis (BEA) for TPI. The Bureau periodically updates TPI figures and the updates often extend back for a number of years.

TABLE 1.11 - HISTORICAL COLLECTIONS FOR SELECTED TAXES  
(In Thousands of Dollars)

SOURCE OF REVENUE	Fiscal Year				
	2007	2008	2009	2010	2011
General Excise and Use	\$2,555,762	\$2,618,787	\$2,417,580	\$2,316,434	\$2,495,807
Income - Individuals	1,560,286	1,544,835	1,339,056	1,528,110	1,247,153
Transient Accom. Tax & Fees	224,942	229,388	210,622	224,252	284,472
Unemployment Insurance	134,612	92,279	49,071	82,017	190,511
Motor Vehicle Tax <sup>1</sup>	112,412	112,448	101,991	102,319	106,166
Fuel and Environmental <sup>4</sup>	169,712	169,927	165,717	155,703	195,336
Public Service Companies	124,017	127,481	126,069	157,661	117,940
Tobacco and Licenses	94,387	104,624	108,164	123,489	143,293
Insurance Premiums <sup>2</sup>	92,196	95,742	93,720	104,721	140,456
Income - Corporations	81,834	85,081	53,522	59,186	34,573
Liquor and Permits	46,034	45,620	47,242	44,074	48,054
Conveyance	46,887	43,421	23,772	40,634	47,906
Banks - Financial Corporations	18,599	20,212	28,075	20,666	33,677
<b>Total Collections <sup>3</sup></b>	<b>\$5,316,593</b>	<b>\$5,478,491</b>	<b>\$4,944,133</b>	<b>\$5,134,807</b>	<b>\$5,292,193</b>

SOURCE OF REVENUE	Fiscal Year				
	2012	2013	2014	2015	2016
General Excise and Use	\$2,697,951	\$2,944,487	\$2,880,541	\$3,048,207	\$3,206,154
Income - Individuals	1,541,051	1,736,007	1,745,810	1,988,194	2,116,859
Transient Accom. Tax & Fees	323,951	368,576	395,242	420,981	446,794
Unemployment Insurance	231,669	262,290	264,178	167,248	128,577
Motor Vehicle Tax <sup>1</sup>	211,742	176,295	168,726	180,755	187,704
Fuel and Environmental <sup>4</sup>	193,101	193,949	193,550	193,082	198,136
Public Service Companies	150,528	163,930	166,179	163,481	152,760
Tobacco and Licenses	138,798	127,881	121,742	129,851	125,093
Insurance Premiums <sup>2</sup>	117,617	131,906	137,179	145,679	153,173
Income - Corporations	73,026	100,988	87,021	52,319	93,036
Liquor and Permits	48,854	48,962	48,305	50,281	50,590
Conveyance	42,106	54,686	75,831	78,702	66,083
Banks - Financial Corporations	7,229	22,673	38,983	19,930	14,691
<b>Total Collections <sup>3</sup></b>	<b>\$6,004,268</b>	<b>\$6,541,300</b>	<b>\$6,581,424</b>	<b>\$6,900,042</b>	<b>\$7,249,205</b>

<sup>1</sup> Includes State Motor Vehicle Weight Tax, Registration Fees, Commercial Driver's License, Periodic Motor Vehicle Inspection Fees, Rental Vehicle Registration Fees and Rental Vehicle Surcharge Tax.

<sup>2</sup> Excludes Insurance Fees allocated to the General Fund, which were included in previous reports.

<sup>3</sup> Includes the Inheritance and Estate Tax, the Honolulu County Surcharge, fuel permits, interest and penalties on fuel taxes, general excise fees, and permitted transfers tax.

<sup>4</sup> Fuel tax collections were \$198,404 thousand for fiscal year 2016. Of the collections, \$268 thousand could not be distributed because the corresponding tax returns were not yet available.

## **2.0 TAX ADMINISTRATION**

### **2.1 OVERALL PERFORMANCE**

The Department of Taxation consists of two divisions, six staff offices, a Public Information Officer, and a Taxpayer Advocate. The two divisions are the Tax Services and Processing Division and the Compliance Division. The six staff offices are the Administrative Services Office, the Rules Office, the Tax Research and Planning Office, the Information Technology Services Office, the Administrative Appeals Office and the Tax Practitioner Priority Office.

The total number of authorized permanent positions in the Department in FY 2016 was 384, the same as in fiscal year 2015. The Department's operating budget is a small fraction of total tax revenue. In FY 2016, the Department's operating expenses were \$24 million, down from \$25.5 million in FY 2009. The Department collected \$6.89 billion in taxes in FY 2016, so the cost of collecting each \$100 dollars of taxes was about 35 cents.

The Department has continued to encourage taxpayers to use electronic transmissions rather than paper returns. Although there has been a significant increase in electronic filing of tax returns and payments, over 1 million paper checks and over 2 million paper tax returns and other documents were manually processed by the Department in FY 2016.

The total number of audit cases completed by the Compliance Division (the Office Audit Branch and Field Audit Branch combined) declined by 2.7%, from 17,536 in FY 2015 to 17,056 in FY 2016. Total assessments, however, increased by 68.6%, from \$119.0 million in FY 2015 to \$200.6 million in FY 2016. \$2.2 million of the total audit assessments were referred by the Criminal Investigation Section.

### **2.2 TAX SERVICES AND PROCESSING DIVISION**

#### ***2.2.1 Overview***

The Tax Services and Processing Division (TSP) is comprised of three branches: Taxpayer Services, Document Processing, and Revenue Accounting. The Taxpayer Services Branch (TPS) provides various services to individual and business taxpayers and performs functions relating to licensing and taxpayer account management. The Document Processing Branch (DP) receives, edits, and processes tax information and payments received from both paper and electronic filings. DP is also responsible for securing and depositing tax payments. The Revenue Accounting Branch (RA) maintains revenue control and performs reconciliation functions for all State tax revenues. RA also prepares various revenue related reports, including the monthly Preliminary Report (on revenues collected) and the Statement of Tax Operations (STO).

The TSP Division has continued its efforts to improve efficiency, effectiveness, and accountability in support of the Department's Strategic Plan. In FY 2016, the first rollout of the Tax System Modernization Project (TSM) was implemented to update the infrastructure. This included installing up-to-date scanning hardware, equipment to process incoming mail, and a digital telephone system, known as the interactive voice response (IVR). The IVR allows employees to provide timely service for incoming calls from taxpayers and helps them report the number, source, and duration of the calls and to keep descriptions of the calls.

Staff members from TSP continue to help to test and implement the TSM. The second rollout was in August 2016 and included processing of the general excise tax, the transient accommodations tax, the use tax, the rental motor vehicle and tour vehicle surcharge, and the county surcharge. These taxes account for over 40% of total State revenue collections.

The Division's strategic plan for upcoming years continues to call for initiatives to promote electronic filing and electronic payment in order to make processing more efficient and to help reduce staffing needs, particularly during peak filing periods. Using electronic data also improves accuracy and allows greater flexibility in reporting. With TSM underway, the Division looks forward to utilizing new technology and business processes to improve customer service and the accuracy of reporting in order to increase voluntary compliance and to modernize processing. The Division successfully recruited and trained candidates for vacancies in Taxpayer Services during FY 2016. The statistics below reflect the results from the additional employees in the Division.

### ***2.2.2 Taxpayer Services Branch***

The Taxpayer Services (TPS) Branch is made up of three main sections:

- (1) Customer Inquiry, which provides information and taxpayer assistance pertaining to all taxes administered by the Department.
- (2) Account Management, which performs computer-based error correction activities to expedite processing, posting, and updating of tax returns, payments, and other documents.
- (3) Licensing, which processes, issues, and updates all licenses and permits issued by the Department.

#### **Customer Inquiry**

The digital telephone system (IVR) was implemented in December 2015, so the call statistics for FY 2016 come from two systems. Yearly call statistics are reported below:

<u>FY</u>	<u>Total Incoming Calls</u>	<u>Total Calls Answered</u>	<u>Answer Rate</u>
2016	385,605	275,924	72%
2015	417,659	180,452	43%
2014	369,010	153,286	42%
2013	326,501	193,988	59%
2012	312,441	173,948	56%
2011	513,503	205,383	40%
2010	380,142	232,471	61%
2009	364,804	291,228	80%
2008	284,217	228,875	81%
2007	181,663	162,576	89%
2006	299,582	148,981	50%
2005	346,972	111,846	32%
2004	147,514	106,146	72%
2003	332,399	76,392	23%

Since the Department started to encourage electronic filing, the number of walk-in taxpayers serviced on Oahu has declined. The average number of taxpayers served each month is shown below for FY 2011 through FY 2016.

<u>FY</u>	<u>No. of Taxpayers</u>
2016	3,582
2015	3,558
2014	4,290
2013	4,451
2012	5,416
2011	6,131

### Account Management

Account Management reviews, analyzes, and corrects errors or other inconsistencies on returns and other documents that were identified by our computer system during processing and placed on a work list for manual review. In FY 2016, the team reviewed and posted 217,942 returns, payments, and other documents that the automated system was initially unable to process. The chart below shows monthly average postings of work-listed documents since FY 2011.

<u>FY</u>	<u>No. of Postings</u>
2016	18,162
2015	16,434
2014	18,222
2013	14,849
2012	14,908
2011	16,758

During the 2016 net income tax filing season, the Department received fraudulent individual income tax returns filed for tax year 2015. Account Management was instrumental in examining potentially fraudulent filings, particularly those that contained certain defined inconsistencies that required manual review. The figure for FY 2016 in the tabulation above includes filings that were reviewed because they were flagged as potentially fraudulent.

### Licensing

The Licensing section processed 36,336 business license applications in FY 2016, compared to 32,853 applications in FY 2015. In FY 2016, 56% of the applications were filed online (20,359), up from 50% in FY 2015, because of a concerted effort to encourage taxpayers to utilize the Department's online business license application option, "Hawaii Business Express." The Section also processed 10,537 cancellations in FY 2016, an increase of 20% from FY 2015.

#### ***2.2.3 Document Processing Branch***

The Document Processing Branch (DP) processes all tax returns and documents; receives, secures, accounts for, and deposits tax payments; ensures proper storage and retrieval of documents; and performs various functions relating to electronic filing. DP is comprised of six sections: Receiving and Sorting, Data Preparation, Imaging and Data Entry, Monetary Control, File Maintenance, and Electronic Processing.

Although there has been an increase in electronic tax return filings and in electronic tax payments, over 1.08 million paper checks and over 2.18 million paper tax returns and other documents were manually processed by DP in FY 2016. There were also over 1.98 million electronic tax returns processed in the year. In total, over \$7.39 billion in tax-related payments were received in FY 2016, which is an increase of about \$440 million from FY 2015. Over \$5.3 billion was received by electronic means in FY 2016, compared to \$5.0 billion in FY 2015.

#### ***2.2.4 Revenue Accounting Branch***

The Revenue Accounting Branch (RA) maintains accounting records for all tax revenues, refunds, adjustments, district transfers, and closing adjustments, and prepares all Journal Vouchers and Summary Warrant Vouchers. RA is also responsible for error resolution, reconciliation, and reporting functions for all State tax revenues. Specific tasks include the preparation of the Daily Cash Collection Report (Oahu District), the Preliminary Report, and the Statement of Tax Operations (STO).

The Preliminary Report is released by the fifth working day of each month and is a summary of all revenues received by the Department in the previous month, less the amount of tax refunds paid. The STO is a formal, detailed report of State revenues that is based on the Preliminary Report and is prepared by the tenth working day of each month. The RA Branch has consistently and diligently met the critical deadlines for these reports throughout this fiscal year, as well as in past years.

The RA Branch also performs manual accounting activities for all miscellaneous tax collections (with the exception of the estate and transfer tax); prepares journal entries for the various administratively-established trust accounts and for other legislatively mandated purposes; maintains the manual accounting system for all protested payments and tax appeals; provides allocation reports to the Department of Accounting & General Services and to the Department of Budget & Finance; accounts for all tax refunds; and handles all refund exception activities, such as returned checks, tracers, or forgeries.

## **2.3 COMPLIANCE DIVISION**

### ***2.3.1 Overview***

The objective of the Compliance Division is to maximize taxpayer compliance with Hawaii's tax laws in a consistent, uniform, and fair manner. The Compliance Division is composed of the Oahu Office Audit Branch, the Oahu Field Audit Branch, the Oahu Collections Branch, and the Maui, Hawaii, and Kauai District Tax Offices. In addition to these branches, there are also the Special Enforcement Section (SES) and the Criminal Investigation Section (CIS). The Division has the following three programs to meet the objectives of the voluntary compliance, self-assessment tax system: (1) auditing/examination, (2) collection, and (3) taxpayer services (information dissemination).

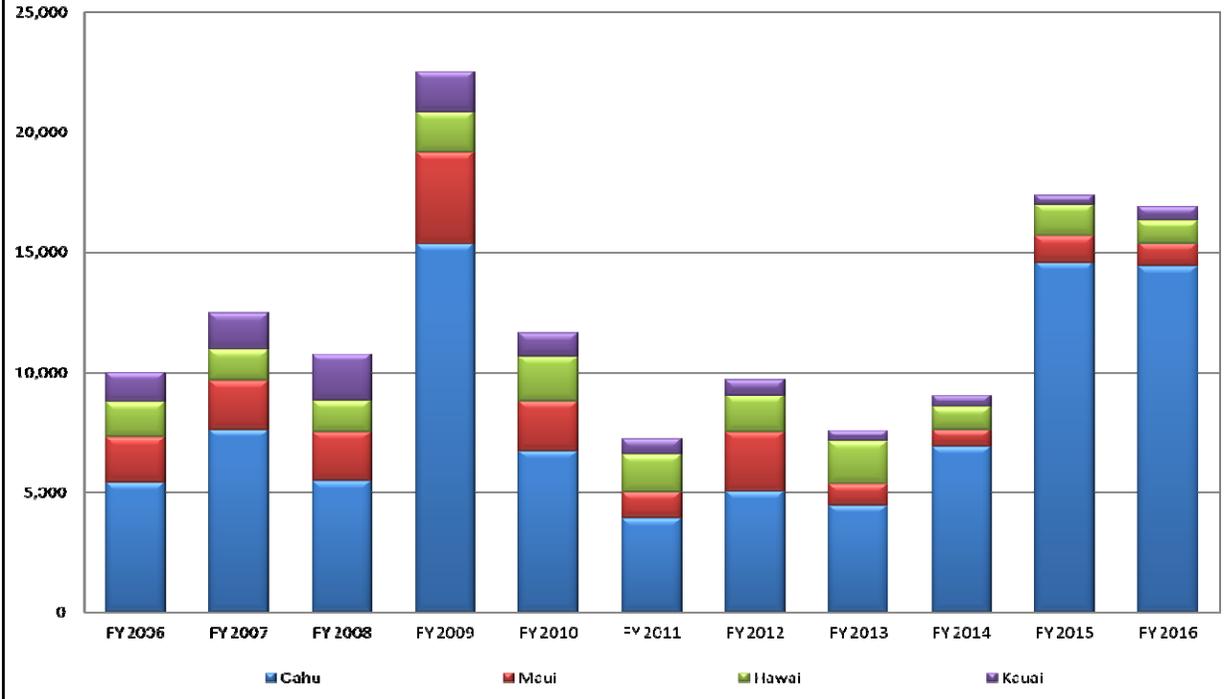
### ***2.3.2 Office Audit Branch***

The Office Audit Branch performed examinations and audits to enhance voluntary compliance. In FY 2016, the Office Audit Branch completed 16,866 cases, a decrease of 2.9% (496 cases) compared to FY 2015, but the total dollars assessed was \$77.7 million, an increase of 54.7% (\$27.5 million) compared to FY 2015. The majority of the audits were performed by Oahu Office Audit Branch, followed by the Hawaii District Office. In FY 2016, the Office Audit Branch processed the Estate and Transfer Tax returns and collected \$16.1 million for estate tax returns. Charts 2.7 and 2.8 (on the following page) show the number of audits completed and the dollars assessed by Office Audit for FY 2006 through FY 2016.

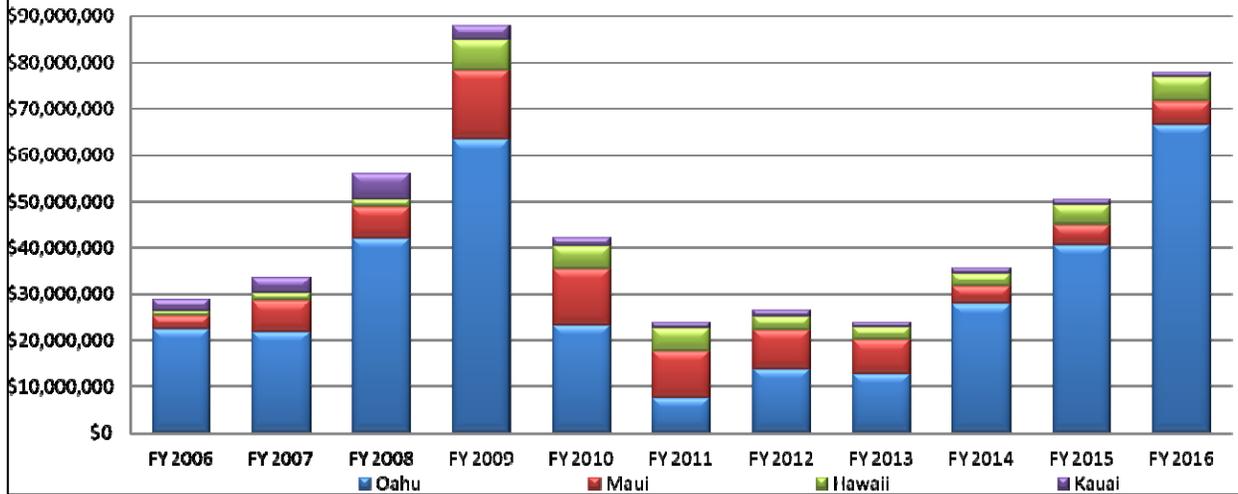
### ***2.3.3 Field Audit Branch***

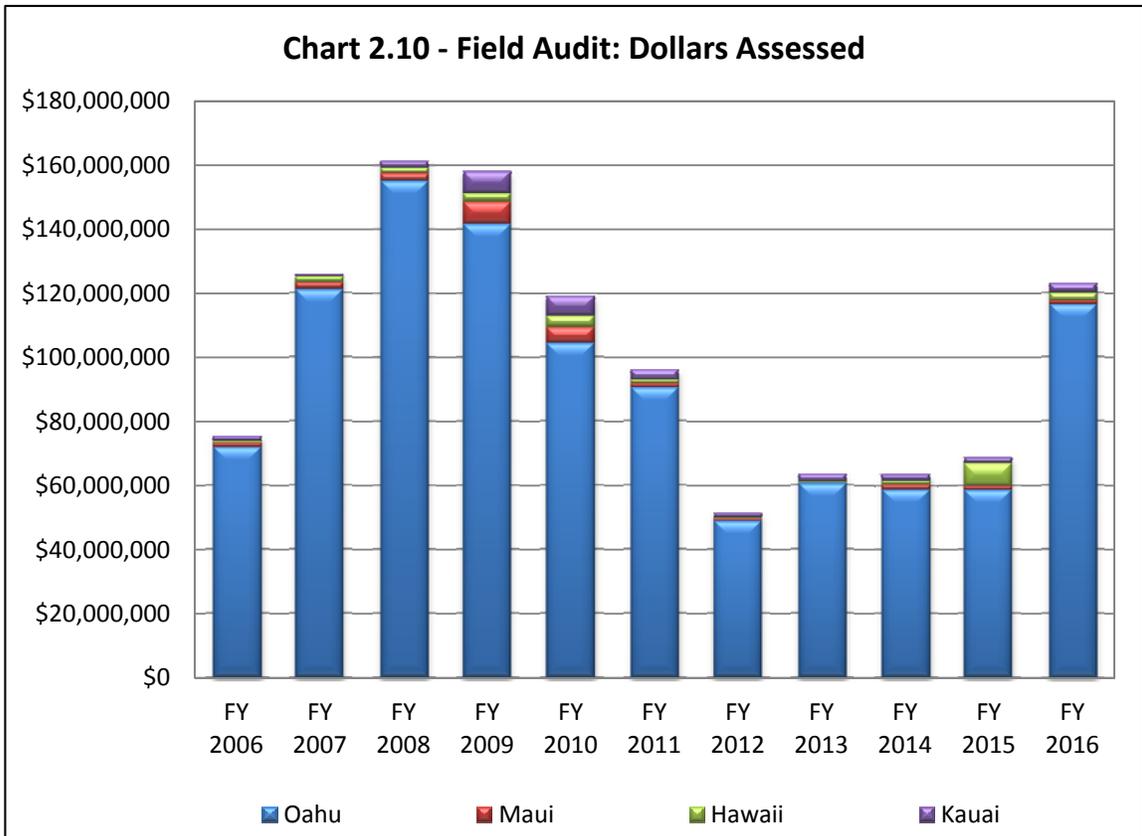
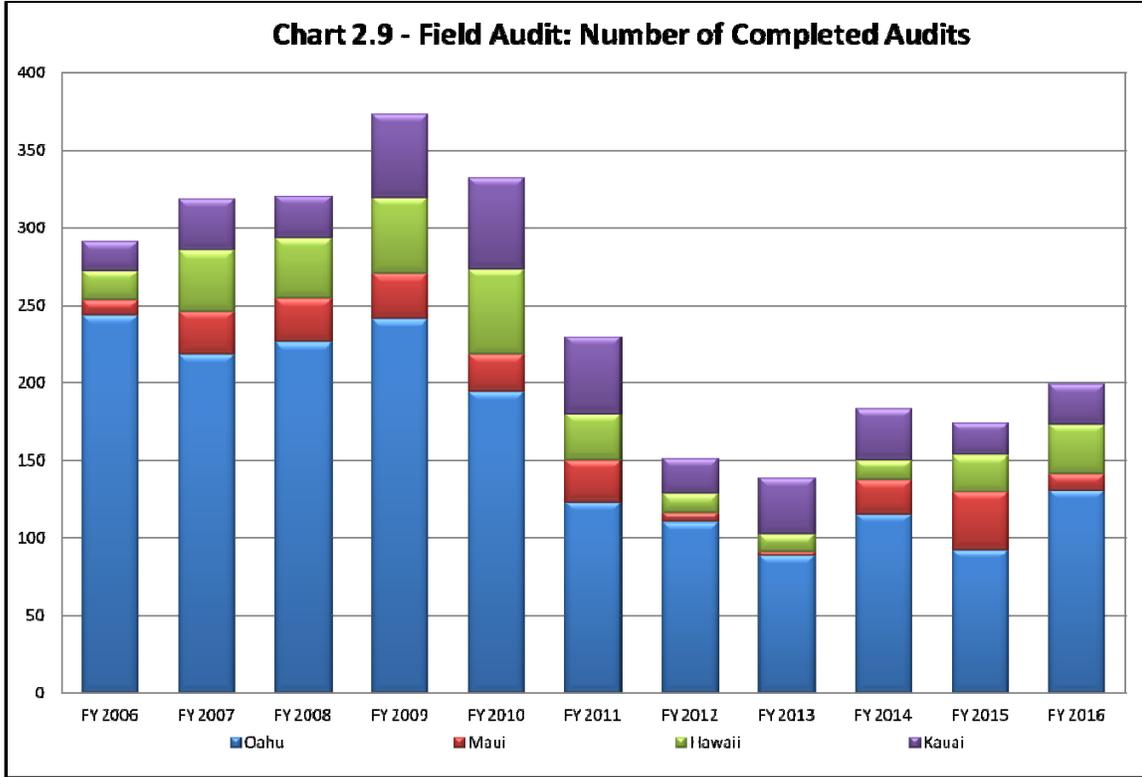
Similar to the Office Audit Branch, the Field Audit Branch performed examinations and audits to enhance voluntary compliance. The Field Audit Branch handled audits involving intricate auditing procedures. In FY 2016, the Field Audit Branch completed 199 cases, an increase of 14.4% (25 cases) compared to FY 2015, and the total dollars assessed was \$122.9 million. Charts 2.9 and 2.10 show the number of audits completed and the dollars assessed by Field Audit for FY 2006 through FY 2016.

**Chart 2.7 - Office Audit: Number of Completed Audits**



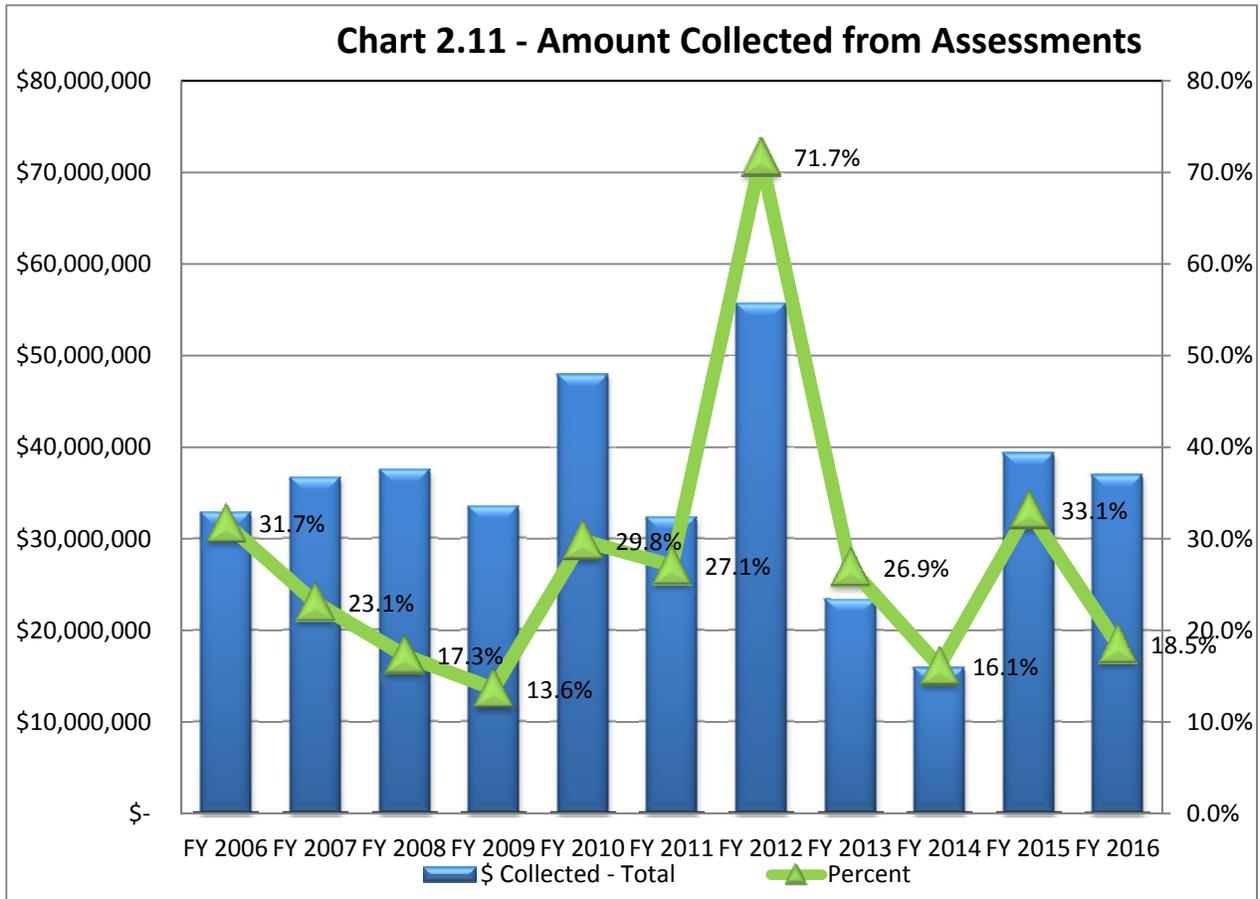
**Chart 2.8 - Office Audit: Dollars Assessed**





### 2.3.4 Revenue – Office and Field Audit Assessments

The amount collected at the time the audits were closed and prior to the mailing of any billing notices decreased from \$39.3 million in FY 2015 to \$37.0 million in FY 2016.<sup>3</sup> The figure for FY 2016 represents a collection rate of 18.5%. Chart 2.11 summarizes the amounts collected from assessments made by the Office and Field Audit Branches for FY 2006 through FY 2016. Table 2.1 shows the amounts assessed for FY 2016.



<sup>3</sup> The amounts assessed are the assessments generated during FY 2016. The amounts collected during FY 2016 may include assessments and settlements from prior fiscal years.

TABLE 2.1 - AMOUNTS ASSESSED FOR FY 2016

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits	Dollar Assessed	Number of Audits	Dollar Assessed
Oahu	14,390	\$66,459,410	130	\$116,266,709
Maui	951	\$ 4,968,855	11	\$ 1,160,214
Hawaii	962	\$ 5,249,421	32	\$ 2,458,091
Kauai	563	\$ 1,018,804	26	\$ 2,995,656
Total FY 2016	16,866	\$77,696,490	199	\$122,880,670
Total FY 2015	17,362	\$50,219,290	174	\$ 68,743,016
Difference	(496)	\$27,477,200	25	\$ 54,137,654

**2.3.5 Special Projects**

Oahu Office Audit Branch conducted the following special projects during the fiscal year:

- Renewable Energy Tax Credit: The reviews of the tax credits claimed resulted in \$406,360 in assessments and adjustments.
- 1099-MISC: The examination of tax returns resulted in \$1.0 million in assessments and adjustments.
- Non-Filers: The examination of tax returns resulted in \$13.6 million in assessments and adjustments.
- Itemized Deductions: The examination of tax returns resulted in \$6.8 million in assessments and adjustments.

Oahu Field Audit Branch conducted the following special projects during the fiscal year:

- Federal Contractors Project: This project, which targets unlicensed contractors working on federal installations, was started in 1983 and is an ongoing activity. Six audits were completed and resulted in \$480,356 in assessments.
- Referral Cases from the Criminal Investigation Unit: Five cases that were either originally considered for possible criminal prosecution or that arose pursuant to a criminal investigation were completed, resulting in \$3,723,731 in assessments.
- Renewable Energy Tax Credit: The review of the credits claimed resulted in \$6,181,699 in assessments from 11 audits.
- Multistate Tax Commission: During this fiscal year, 12 audit cases were completed that resulted in \$60,940,475 in assessments.

- Online Travel Companies: The Field Audit Branch assisted the Attorney General's Office and issued assessments to nine online travel companies. The assessments totaled \$15,149,234.

The Maui Office Audit Section conducted the following special projects during the fiscal year:

- Miscellaneous Deduction Project: Maui Office Audit assessed 186 taxpayers a total of \$615,393 in tax, \$1,095 in late filing penalties, \$9,323 in negligence penalties, \$34,626 in understatement of tax or overstatement of refund penalties and \$63,338 in interest.
- Renewable Energy Technologies Income Tax Credits: Maui Office Audit examined renewable energy income tax credits claimed in the amount of \$1,120,000, which resulted in the disallowance of credits in the amount of \$160,751.

The Maui Field Audit Section conducted the following special project during the fiscal year:

- Renewable Energy Technologies Income Tax Credits: Maui Field Audit reviewed renewable energy income tax credits claimed in the amount of \$963,707 which resulted in the disallowance of credits in the amount of \$39,131.

The Hawaii District Office Audit Section conducted the following special projects during the fiscal year:

- Renewable Energy Tax Credits: The review of renewable energy tax credits claimed resulted in \$55,058 in assessments and adjustments.
- Itemized Deductions: The examination of tax returns resulted in \$677,187 in assessments and adjustments.
- 1099-MISC: The examination of tax returns resulted in \$780,202 in assessments and adjustments.

Hawaii District Field Audit Section conducted the following special project during the fiscal year:

- Capital Goods Excise Tax Credit: The review of the credits claimed resulted in \$46,735 in assessments and adjustments.

### ***2.3.6 Taxpayer Assistance Provided***

During FY 2016, the personnel in neighbor island district tax offices helped taxpayers properly file numerous tax returns and other documents over the telephone, at the service counter, and via correspondence. The Oahu Office Audit, Field Audit, and Collection units also provided support services to the neighbor island district tax offices and to the Oahu Taxpayer Services Branch when requested. Table 2.2 summarizes the number of times that taxpayer assistance was provided by the Maui, Hawaii, and Kauai District Tax Offices.

TABLE 2.2 - TAXPAYER ASSISTANCE PROVIDED BY  
MAUI, HAWAII AND KAUAI DISTRICT OFFICES

	FY 2016	FY 2015	<u>Difference</u>	
			Number	Percentage
Counter	73,568	72,998	570	0.8
Phone Services	51,694	56,213	(4,519)	(8.0)
Tax Clearances	5,542	7,462	(1,920)	(25.7)
Correspondence	19,872	18,856	1,016	5.4

The taxpayer services sections in the districts provide telephone and counter services, supplementing the centralized customer services provided by the Oahu TSP Division. The districts continue to receive a steady flow of telephone inquiries, and can use the statewide tax data system to assist with any tax inquiry.

Providing assistance to taxpayers is part of the Compliance Division’s continuing emphasis on taxpayer education and problem resolution. The Compliance Division believes that it is important to maintain taxpayers’ willingness to accurately and voluntarily comply with the State’s tax laws, so it will continue to emphasize its “taxpayer enabling and empowering activity.”

**2.3.7 Collection Branch**

The Compliance Division’s Tax Collections program consists of the Oahu collection branch and the collection sections in the Maui, Hawaii, and Kauai District Tax Offices. Collections of delinquent taxes totaled \$217.6 million for FY 2016, compared to \$235.9 million in FY 2015, a decrease of \$18.3 million or 7.8%. The Oahu collection branch accounted for 82% of the statewide delinquent tax collections in FY 2016. The Oahu collection branch experienced a 16% reduction in delinquent collectors in FY 2016 owing to special project assignments and attrition. New delinquency referrals were down \$15.1 million or 5.3%. Chart 2.12 shows delinquent collections for FY 2006 through FY 2016. Table 2.3 shows major performance measures for FY 2016 and FY 2015.

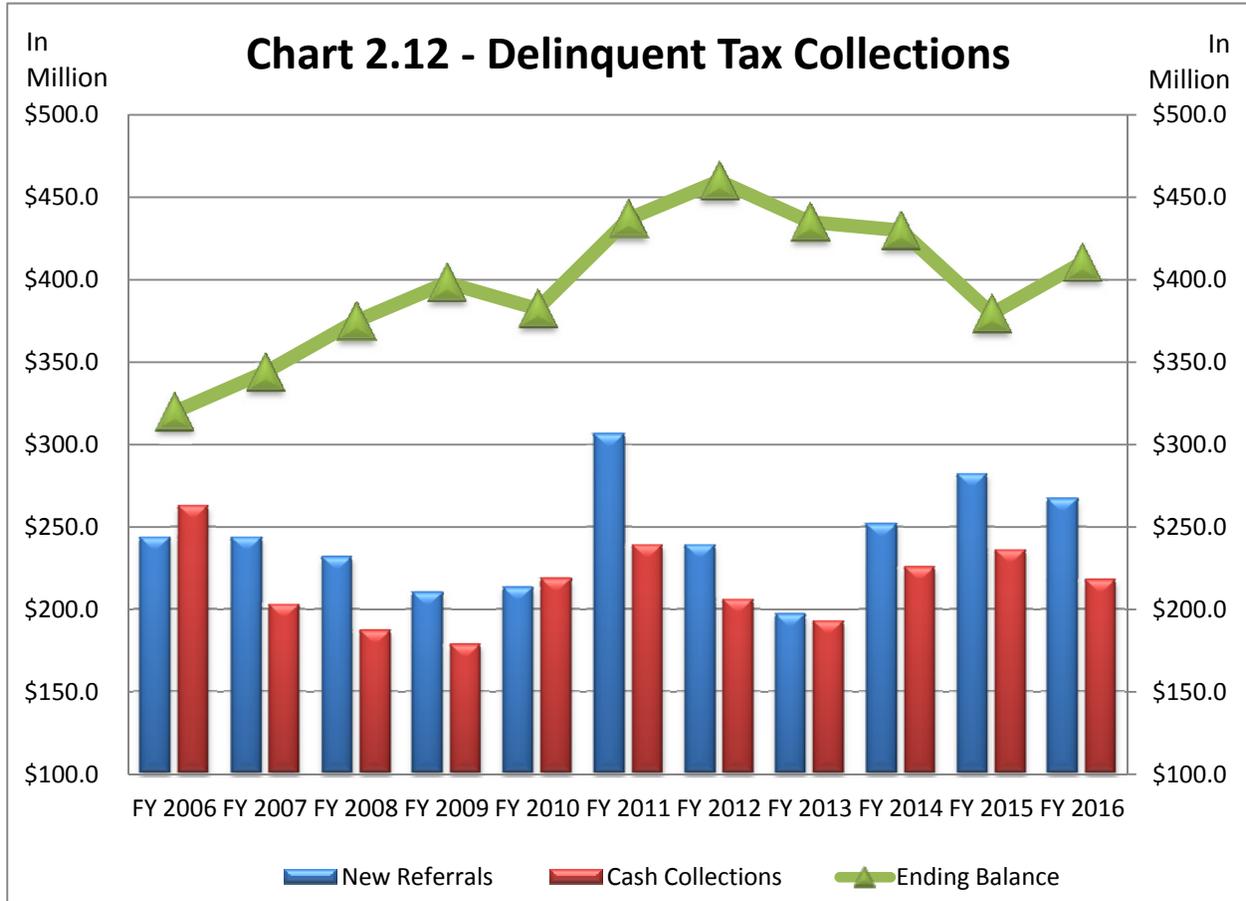


TABLE 2.3 - MAJOR PERFORMANCE MEASURES FOR FY 2016 AND FY 2015

Measure	FY 2016	FY 2015	Difference	
			Amount	Percentage
Total Delinquent Tax Balance (\$ Millions)	\$ 410.5	\$ 384.2	\$ 26.3	6.8
Total New Delinquent Referrals (\$ Millions)	\$ 267.2	\$ 282.3	\$ (15.1)	(5.3)
Total Cash Collected (\$ Millions)	\$ 217.6	\$ 235.9	\$ (18.3)	(7.8)
Uncollectible Tax Write-Offs (\$ Millions)	\$ 23.3	\$ 92.1	\$ (68.8)	(74.7)
Payment Plans Initiated	33,237	33,055	182	0.6
Tax Liens Filed	2,886	3,130	(244)	(7.8)
Levies Served	21,001	21,599	(598)	(2.8)

### ***2.3.8 Criminal Investigation Section***

During FY 2016, the Criminal Investigation Section (CIS) made significant strides in refocusing its investigative priorities and has achieved substantial outcomes. CIS conducted 35 investigations, including those on entities with legitimate sources of income and those on individuals and groups involved in illegal activities, such as narcotics trafficking, gambling, prostitution, and financial frauds. In addition, CIS conducted three investigations relating to threats made against Department employees and two internal investigations.

Three joint investigations were referred to the U.S. Attorney's Office for review and federal prosecution. The cases are described as follows:

- (1) A fraudulent refund scheme with a State of Hawaii loss in excess of \$275,000.
- (2) An investigation involving multiple defendant tax preparers and over 400 tax returns.
- (3) An investigation relating to a false and fraudulent tax return filed by an individual with a high public profile.

In an ongoing investigation of multiple businesses, the overall entity made unsolicited admissions after the fact and filed their returns, with payments, for one of the businesses.

In one significant investigation, a mainland corporation, upon learning that they were under criminal investigation by CIS, made unsolicited admissions after the fact and filed their returns with payments. The investigation has been referred to the Hawaii AG's office for prosecution. The investigation was initiated based on an anonymous letter. Investigative techniques in the case included using a confidential informant and executing state search warrants.

Another significant investigation was of a multiple refund fraud scheme perpetuated by a criminal group based in another state. The investigation was initiated by CIS and was subsequently conducted jointly with the state police and the department of revenue of the other state. The investigation revealed that the criminal group targeted 40 states. The other state suffered little or no losses due to their own internal controls. However, the State of Hawaii suffered over \$500,000 in losses through the issuance of fraudulent refunds. The investigation has been referred to an out-of-state jurisdiction for prosecution. It is anticipated that over 25 suspects will be arrested at the culmination of the investigation. The out-of-state prosecuting authority agreed to seek restitution for the State of Hawaii losses. Investigative techniques in the case included using computer forensics and executing out-of-state search warrants.

CIS is currently investigating other mainland companies doing business in the State of Hawaii with similar magnitudes of criminal and civil liabilities at stake.

During FY 2016, CIS completed investigations that were not referred for criminal prosecution. These investigations were referred to either Oahu Office Audit or to Oahu Field Audit for civil assessments that totaled an estimated \$2,191,888. Additionally, over \$400,000.00 was paid by taxpayers under investigation for outstanding tax liabilities.

CIS will continue to be innovative in its investigative approach and will strive to improve its processes for the Department.

**2.3.9 Special Enforcement Section**

Act 134, SLH 2009, provided resources for the creation of the Special Enforcement Section (SES). SES is an initiative to increase compliance by businesses that conduct a significant number of difficult-to-trace cash transactions in what has been called the "cash economy." SES began conducting investigations in FY 2010.

In FY 2016 the unit was given a new assignment, namely to bring into compliance short term rentals or transient accommodations (TA), specifically TAs rented through websites. This area has a high percentage of non-compliance and it is difficult to identify the taxpayers. SES divided its resources between efforts to bring the short term rentals into compliance and efforts to continue work on the cash economy.

Act 204 went into effect in FY 2016. The Act allowed SES to fine certain individuals and brokers (entities running websites) for failing to display the proper information. To ensure proper information was reaching the public, SES sent out over 70 letters to brokers in FY 2016.

The unit has increased its effectiveness and efficiency by working more closely with other parts of the Department to streamline the compliance process for the taxpayers, from filing to payment. Revenue collected as a result of SES efforts more than doubled from FY 2015 to FY 2016. The tabulation below provides statistics on SES operations from FY 2014 to FY 2016.

	FY 2016	FY 2015	FY 2014
Complaints filed by anonymous persons	364	391	195
Vendors educated on how to comply with tax laws	1,470	1,554	1,005
Sites visited throughout the State of Hawaii	28	60	18
Number of investigations completed	31	34	31
Number of referrals sent for assessment	30	7	22
Total liability on secured returns - SES Project	\$ 2,944,583	\$ 2,332,782	\$ 996,211
Total liability on secured returns - TA Project	\$ 1,638,607	N/A	N/A
Revenue collected	\$ 3,505,618	\$ 1,619,235	\$ 805,776

**2.4 STAFF OFFICES**

**2.4.1 Administrative Services Office**

**2.4.1.1 Fiscal Office**

The Administrative Services Office submitted the Department's supplemental budget for FY 2017 to the 2016 Legislature. The Legislature appropriated \$28.8 million for the Department's FY 2017 operating expenses.

For fiscal year 2016, \$29.7 million was appropriated for the Department, but in discharging its duties and responsibilities, the Department incurred operating expenses of only \$24 million for the year. The Department collected \$6.89 billion in net tax revenues in fiscal year 2016, so the cost to collect \$100.00 of taxes was about 35 cents.

**2.4.1.2 Personnel Management**

In FY 2016 the Personnel Office emphasized the enforcement of personnel regulations to ensure fair and equitable treatment of employees. However, the continued high vacancy rate hindered the Department in fully achieving its program objectives.

During that fiscal year, the Department's vacancy rate for permanent positions declined from 20% to 14%. Vacancies in the Compliance Division fell by 45% while those in Tax Services & Processing and in Staff Offices both decreased by 14%.

In FY 2017 the Personnel Office will emphasize filling the Department's vacancies as quickly and efficiently as possible. It will also concentrate on helping the Department achieve its objectives by efficiently organizing, placing, and retaining its employees.

To provide sufficient and quality staff in the Department's major program areas, the Personnel Office aims to significantly reduce the Department's vacancies in the new fiscal year. Adjustments to the recruitment process have been made that will expedite recruitment and help program officers select the best qualified candidates available.

The Department had 384 authorized permanent positions for FY 2016, which was the same as in FY 2015. Employees were geographically distributed as follows: Oahu, 315; Hawaii, 28; Maui/Molokai, 24; and Kauai, 17. For FY 2017, the Legislature approved 5 new positions and abolished 1 position, for a net gain of 4 positions (1 per island). The geographic distribution of the positions is as follows: Oahu, 316; Hawaii, 29; Maui/Molokai, 25; and Kauai, 18.

The following tabulation shows the Department's staffing pattern from FY 2013 to FY 2017:

**STAFFING PATTERN**  
(Number of Authorized Permanent Positions)

By Organization/Operating Program	Fiscal Year				
	2017	2016	2015	2014	2013
Headquarters Administration	74	75	75	75	72
Tax Services and Processing Division	118	118	118	118	122
Compliance Division	196	191	191	189	189
<b>TOTAL</b>	<b>388</b>	<b>384</b>	<b>384</b>	<b>382</b>	<b>383</b>

## ***2.4.2 Rules Office***

The Rules Office is comprised of the Rules staff and the Technical Section. The function of the Rules Office is to serve as a resource for complex policy recommendations and complex internal support. The Rules Office also assists in the Department's implementation of new legislation and in creating and maintaining the Department's tax forms, form instructions, and publications.

### ***2.4.2.1 Rules Staff***

The Rules staff serves as the Department's internal advisory arm to the Director of Taxation on tax policy and advises the Director's Office and the Department on legislative and tax policy issues. Litigation and other external legal matters are handled exclusively by the Tax Division of the Department of the Attorney General.

In addition, the Rules staff assists, counsels, and represents the Department's compliance personnel with tax disputes and other administrative tax controversies. For example, the Rules staff provided assistance to the Department's compliance function in interpreting issues under audit, settlement negotiations and closings, and appeared on behalf of the Department before the Boards of Review. The Rules staff also assisted the Tax Division of the Department of the Attorney General with the judicial tax appeals and provided support to the Department's Tax System Modernization project.

The Rules staff also testified at legislative hearings on behalf of the Director, provided training for Department personnel, and spoke at several workshops for tax practitioners. For the 2016 legislative session, the Rules staff drafted and submitted nine bills sponsored by the administration, which were submitted to both the House of Representatives and the Senate. 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 the bills introduced to the 2016 Legislature, the Director's Office and the Rules staff determined there were approximately 250 measures proposing tax law changes and analyzed them in depth. The measures were tracked throughout the legislative session and written testimonies were prepared each time a tax measure was heard by the Legislature. In addition, the Rules staff drafted letters to legislative committee chairs to respond to specific questions raised during hearings or to address specific concerns of committee members.

During the fiscal year, the Rules staff prepared Tax Announcements, Tax Information Releases, letter rulings, Administrative Directives, and other publications. During FY 2016, seven Tax Announcements were issued. Since 2009, when it became the Department's policy to publicly release taxpayer letter rulings in redacted form, 60 redacted letter rulings have been released.

In FY 2016, the Department promulgated administrative rules relating to the Cash Economy Enforcement administered by the Special Enforcement Section, Reconsideration of Assessment, Alternative Methods of Apportionment, Car Sharing Vehicle Surcharge Tax, Act 204, Session Laws of Hawaii 2015, Disclosure of Tax Return Information, and Revocation of General Excise Tax Licenses because of Abandonment. The Rules staff also reviewed and certified 119 requests for the credit for research activities pursuant to HRS § 235-110.91.

### ***2.4.2.2 Technical Section***

The Technical Section is tasked with varying responsibilities to carry out the Department's projects, goals and initiatives, and to support the Department's operational needs. Specifically, the Technical Section assists and advises all divisions within the Department, as well as outside parties such as individual and corporate taxpayers and tax professionals, on complex areas of the state tax laws. For FY 2016, the Technical Section responded to 1,411 email inquiries and 4,481 telephone inquiries. Technical Section also responded to formal requests which includes requests for letter rulings or information letters, determinations of tax status (such as for eligibility for the general excise tax exemptions for air-pollution control facilities), multi-level marketing agreements, and tax surveys and questionnaires from other government agencies, educational institutions, and major tax service product providers.

The Technical Section also reviews, researches, analyzes, and provides comments and recommendations on the technical and procedural aspects of legislative bills, administrative rules, and Tax Information Releases. The staff is responsible for revising or creating the State's tax forms and instructions, incorporating all applicable federal and state tax law changes. For FY 2016, the Technical Section reviewed 292 tax forms and 55 tax form instructions. This past fiscal year saw neither additions nor obsolescence of forms or instructions. As part of the forms process, the Department has a Forms Reproduction Policy under which companies who reproduce state tax forms, such as tax preparation software companies, must submit their facsimiles for review and testing through the Department's tax return scanning machines. For FY 2016, 439 tax forms were submitted to the Technical Section for review, testing, and approval.

Other duties of the Technical Section include analyzing and reviewing certain applications for tax exemptions. In FY 2016, 206 applications for an exemption from the general excise tax were received, 182 applications were reviewed and approved, 67 applications are pending further action and 12 applications were cancelled due to lack of response to a request for additional information or the organization did not qualify as exempt under §237-23(b), HRS. In addition, 2,718 applications for conveyance tax exemptions were reviewed and processed.

### ***2.4.3 Tax Research and Planning Office***

The following are the main functions of the Tax Research and Planning (TRP) Office: (1) prepare reports on data collected by the Department, including reports on collections of the State's various taxes, on the income patterns of individual and business taxpayers, and on tax credits claimed by taxpayers; (2) provide administrative and technical support to the Council on Revenues to assist it in preparing its forecasts of General Fund tax revenues and total personal income; (3) provide economic and statistical analyses to help the Department execute its policies and programs; (4) prepare reports on the revenue consequences of proposed tax legislation for the Legislature, the Governor, and other agencies in the Administration; and (5) provide administrative and technical support to the Tax Review Commission when it is in session.

The TRP Office prepares the following reports on a monthly, fiscal year, and calendar year basis: (1) State Tax Collections and Distributions; (2) General Excise and Use Tax Collections; (3) Liquid Fuel Tax Base and Collections; (4) Liquid Fuel Tax Allocations by Fund; (5) Liquor Tax Collections and Permits; (6) Tobacco Tax Collections and Licenses, and (7) Preliminary Comparative Statement of General Fund Tax Revenues.

In fiscal year 2016, the TRP Office worked on the Department of Taxation's Annual Report: 2014–2015, which was completed and submitted in November of 2015. The Office also published reports on tax credits claimed by Hawaii taxpayers in tax year 2013 and on statistics on Hawaii's individual income tax in tax year 2013. Owing to staff shortages, the reports on tax credits and on the individual income tax had been discontinued since 2007 when the report for tax year 2005 was issued. Statistics from the report are used to estimate the revenue consequences of legislative proposals and to inform policy officials about the revenue costs of the tax credits.

For the 2016 Legislative session, TRP staff reviewed and tracked tax-related legislative bills and resolutions, and prepared more than 300 revenue estimates for various drafts of the bills. Revenue estimates were also prepared for various proposals in response to requests from the Administration, legislators, and others.

An important function of the TRP Office is to provide administrative and technical support to help the Council on Revenues produce its forecasts of tax revenues. The seven members of the Council are responsible for forecasting State General Fund revenues and the State's total personal income. The Council provides forecasts of State revenue for the current and six subsequent fiscal years. The forecasts are due on September 10, January 10, March 15, and June 1 of each year. The forecasts are used by the Governor and by the Legislature to develop and administer the State's budget. The Council also forecasts total personal income (TPI) for the current and immediately following calendar years. The TPI forecasts are due on August 5 and November 5 of each year. The growth in Hawaii total personal income is used to set the ceiling for expenditures from the State's General Fund, as required by the State's Constitution.

TRP staff applied advanced econometric modeling techniques to data on State tax collections and to data on other economic variables to help the Council produce its forecasts. The Council's last General Fund forecast for fiscal year 2016 was produced on May 24, 2016. The forecast called for tax collections dedicated to the Fund to grow by 6.1% compared with fiscal year 2015. Tax collections actually grew by 8.0%, as General Fund collections grew from \$5.74 billion in fiscal year 2015 to \$6.19 billion in fiscal year 2016. The Council's last forecast for total personal income for calendar year 2015 was produced on November 5, 2015 and called for growth of 4.0% over calendar year 2014. The actual growth was 4.75%, from \$65.99 billion in calendar year 2014 to \$69.13 billion in calendar year 2015.

The TRP Office updated its econometric models that were developed to predict General Fund tax collections based on the Council's forecasts for economic variables, including its original model, the model that was developed under a contract with UCLA Anderson Forecast, and the single-equation model that the Office developed at the request of the Council on Revenues.

#### ***2.4.4 Information Technology Services Office***

The Information Technology Services (ITS) team is responsible for providing technical support for the Department's computerized tax systems and applications, for local area networks, and for network-related components and infrastructures. The System Administration team provides business analysis and functional support for the Department's operation. It also provides statistical data and facilitates discussion in process improvement.

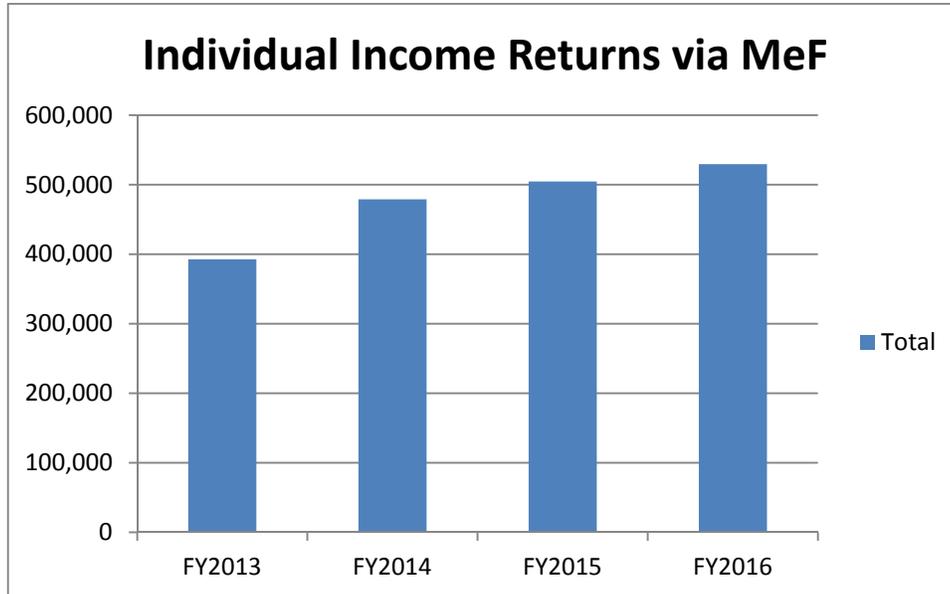
During FY 2016, the ITS Office's ITS team and the System Administration team continued to focus on managing, administering, and maintaining the Integrated Tax Information Management System (ITIMS). The teams also supported network-related components and infrastructures and provided business analysis and operational support for the Department. In addition, the ITS Office began work on the multi-year Tax System Modernization (TSM) Program, which will eventually replace all of the Department's current information technology systems and applications.

As specified in its charter, the TSM Program is overseen by an executive steering committee consisting of senior Department officials, including the Director of Taxation, which acts as the program executive sponsor. The TSM Program Manager directs the TSM Program Management Office (PMO) and reports to the TSM Executive Steering Committee. The TSM PMO is tasked with providing project management, information technology and system analysis expertise to facilitate the implementation of new technology and business process improvements.

The management of the TSM Program complies with recommendations made by the State Auditor in 2010 and uses experienced professionals and best practice methods to ensure the success of the Department's modernization initiative. Managing information technology projects under a program structure allows for coordination to obtain benefits and control not available from managing projects individually.

Key information technology, system analysis, and operational support initiatives that were continued or accomplished during FY 2016 include the following:

- Completing the State's banking conversion from First Hawaiian to Wells Fargo bank with respect to the transmission of ACH files for direct deposit refunds.
- Implementing the "Lockbox" to expedite General Excise Tax payments processing.
- Providing technical and functional support for the Department's operation.
- Upgrading the Department's networking infrastructure to support the Department's operations and the TSM program.
- The System Administration team addressed 985 help tickets to change user security, to answer general system/tax law questions, or to provide statistical data or quality assurance updates.
- A \$30 million contract was successfully executed for the implementation and support of hardware, software, and services in partnership with FAST Enterprises, LLC. Full funding of the awarded proposal will require \$60 million to cover the implementation and maintenance of new systems through FY 2025.
  - The first of five planned rollouts successfully went into operation within budget and before the scheduled deadline of December 28, 2015. Aging information technology that was replaced as part of the rollout includes scanning and mail opening equipment, interactive voice response and telephony equipment, and a Modernized Electronic Filing (MeF) system for processing electronic returns received through an interface with the IRS. There were 529,662 individual income tax returns accepted via MeF in fiscal year 2016, an increase of 5% from fiscal year 2015.



- The second rollout of the TSM Program involves the deployment of a new tax information system for General Excise; Use; Seller’s Collection; County Surcharge; and Rental Motor Vehicle, Tour Vehicle, and Car-Sharing Vehicle Surcharge tax types. The preparation, definition, and base configuration phases of the second planned rollout were completed. Development, conversion, testing, and training phases were initiated in anticipation of an August 15, 2016 cutover target.
- A request for proposals for independent verification and validation services was issued and awarded. A contract worth about \$1.4 million over eight years was executed with Advantech, LLC. Under the contract, consultants conducted a site visit in April 2016 and drafted an initial assessment in May 2016.
- An invitation for bids was issued and an award was made for data center space. Production hardware for the TSM Program was migrated to a secure data center managed by DR Fortress.

Items that will likely continue into the next reporting period include the following: 1) TSM Program rollouts; 2) annual Tax Law Changes; 3) further measures to detect and stop fraudulent refunds.

While the complete replacement of existing legacy systems under the TSM Program is scheduled for completion by mid-2019, priority is being given to replace systems that are impairing the Department's performance in order to provide the State with the greatest benefits at the earliest opportunity.

### *2.4.5 Administrative Appeals Office*

On February 1, 2016, the Department launched the Administrative Appeals and Dispute Resolution program (AADR). This is an informal appeals process authorized by section 231-7.5, HRS, and administered by the Administrative Appeals Office (AAO). The AAO's objective is to resolve tax disputes fairly, quickly, and without litigation. The AAO considers cases that involve proposed, final, and return preparer assessments that were issued as a result of a Department audit. Taxpayers or return preparers who disagree with the Department's assessments may apply to the AADR program. The AAO is separate and independent of the Department offices that conduct audits and issue assessments.

The AAO operated for 5 months in FY 2016. Caseload data for FY 2016 are provided below:

- 29 appeals were filed with the AAO, of which 16 cases were closed and 13 cases are pending.
- The appealed cases consisted of 21 income tax cases, 7 general excise tax cases, and 1 transient accommodations tax case.
- Of the appealed cases, 25 were from the Oahu district, 2 were from the Hawaii district, and 2 were from the Maui district. There were no cases from the Kauai district.

The AAO's short term goal is to make tax practitioners aware of the AADR program and educate them about what the program has to offer. To accomplish this goal, we have presented the AADR program to the National Association of Tax Professionals-Hawaii Chapter, to the Hawaii State Bar Association-Tax Division, and to the tax professionals at the Department's annual summer workshops held on Hawaii, Kauai, Maui, and Oahu. We are planning additional outreach activities in the coming fiscal year. Based on the feedback we received, we have done the following:

- (1) Eliminated the requirement that taxpayers must withdraw their appeals from the Board of Review (BOR) in order to participate in the AADR program. After careful consideration, this requirement was eliminated to make the program more accessible to taxpayers.*
- (2) Set a long-term goal to expand the scope of cases eligible to participate in the AADR program. We received requests to expand the program's scope from taxpayers and tax professionals alike. The AAO's current challenges are staffing and office space. The AAO is staffed with one full-time employee and temporarily housed in office space borrowed from another office in the Department. Legislation was proposed to allow the Director to provide more staffing, but it did not pass.*

Overall, the AADR program has been well received and the number of appeals into the program continues to increase. In the next fiscal year, we will continue to develop and refine the program and use various outreach activities to make people aware of the program and to educate them about what it offers. For more information about the program, please visit our website at [tax.hawaii.gov/appeals](http://tax.hawaii.gov/appeals).

### 2.4.6 Taxpayer Advocate

The Taxpayer Advocacy Program assists taxpayers who do not have a resolution to their tax related issue after going through normal channels. The program was reinstated on October 1, 2015 and helped 882 taxpayers resolve tax related issues during FY 2016.

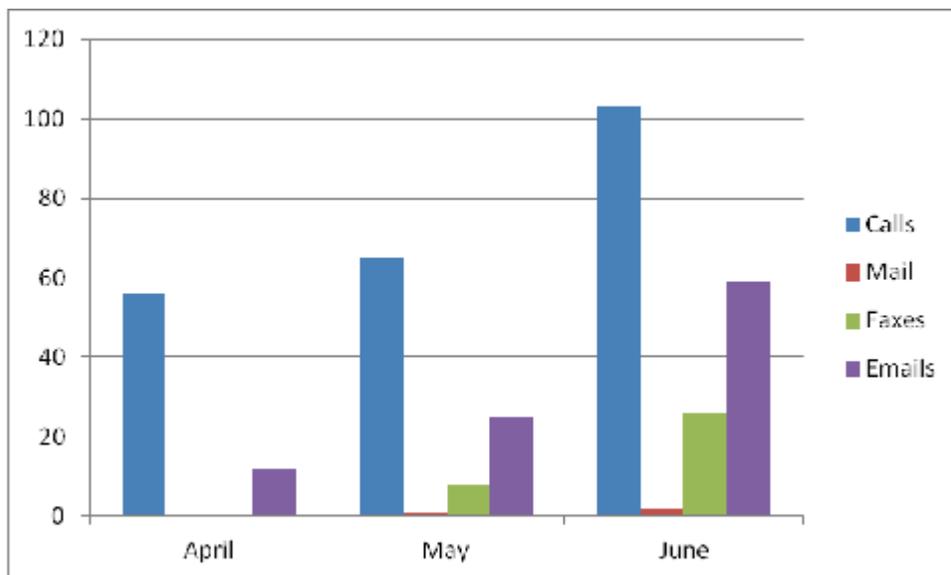
Indirectly, the Taxpayer Advocate worked to resolve problems within the Department that affect taxpayers. Examples of the problems that were found include those in processing of returns, checks and refunds, and in inter-departmental handling of taxpayer issues. Other accomplishments of the office include educating and assisting taxpayers in workshops and through community outreaches.

### 2.4.7 Tax Practitioner Priority Office

The Tax Practitioner Priority program started on April 1, 2016. The Practitioner Priority Specialist works directly with registered tax practitioners to resolve issues related to taxpayer accounts. The goal of the office is to provide quality service to registered tax practitioners in a timely manner.

The Practitioner Priority Specialist helps tax practitioners by locating and applying payments; explaining Department notices and letters; providing information on the taxpayer's accounts; providing general procedural guidance and time frames; and directing inquiries to the appropriate offices within the Department.

Registered tax practitioners may send inquiries by email, fax, phone, or regular mail. The chart below shows the volume of inquiries received for the months from April through June of 2016.



## 2.5 MANAGEMENT PERSONNEL

As of June 30, 2016

### OFFICE OF THE DIRECTOR

Director of Taxation.....Maria E. Zielinski  
Deputy Director of Taxation.....Joseph K. Kim

### STAFF OFFICES

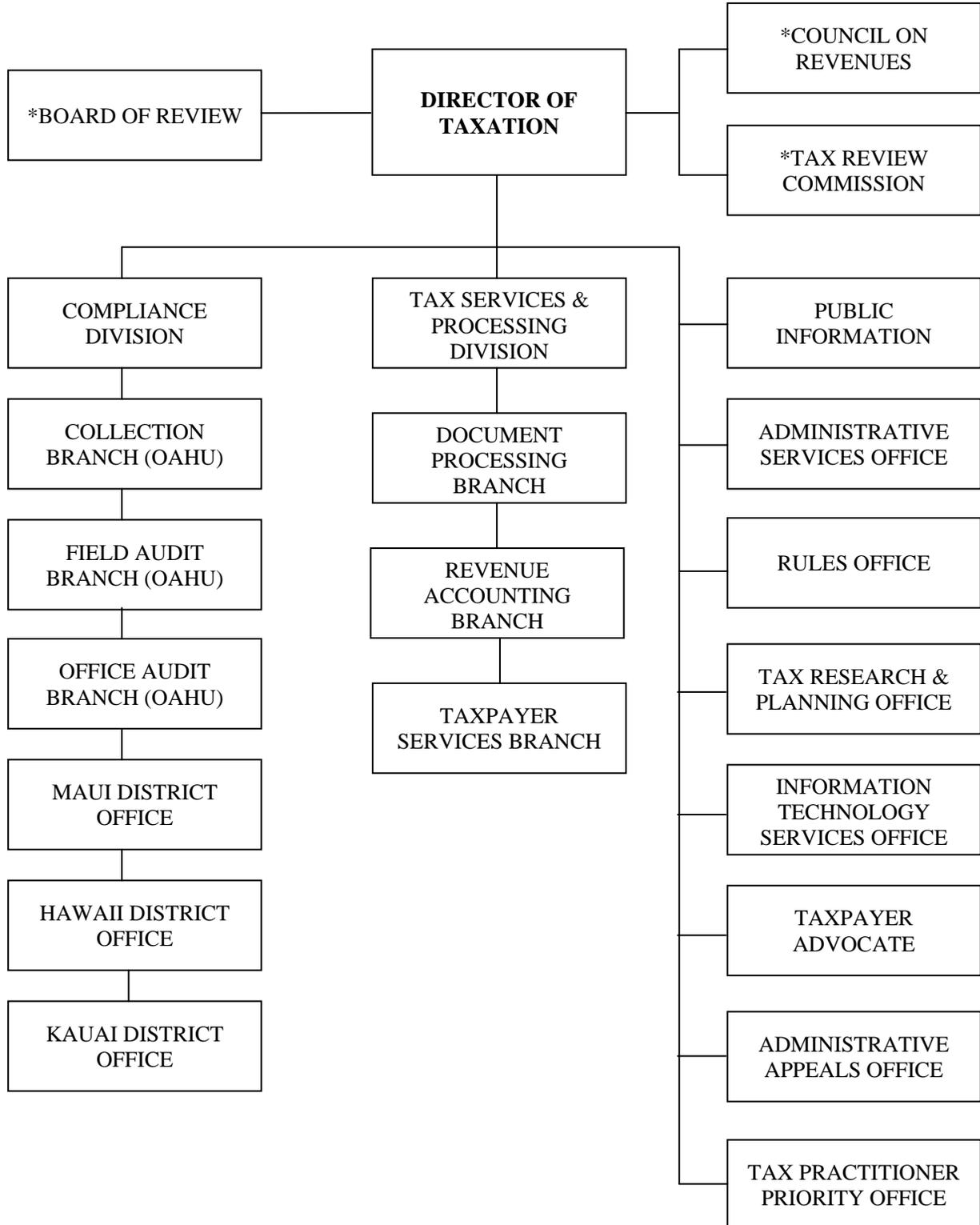
Public Information Officer.....Mallory Fujitani  
Rules Officer ..... Ted Shiraishi  
    Technical Section Supervisor ..... Denise Inouye  
Acting Tax Research & Planning Officer.....Donald Rousslang  
    Senior Economist..... Yvonne Chow  
Information Technology Services Officer ..... Robert Su  
Administrative Services Officer ..... Dexter Suzuki  
Acting Personnel Officer ..... Gene J. Dumaran  
Taxpayer Advocate ..... Jaysen Y. Morikami  
Administrative Appeals Officer.....Adriane Aaronson  
Tax Practitioner Priority Specialist..... Jenny Xu

### OPERATIONS STAFF

Taxation Compliance Administrator ..... Kevin Wakayama  
    Tax Compliance Coordinator ..... Damien A. Elefante  
    Oahu Field Audit Branch Chief..... Madelaina Lai  
    Oahu Office Audit Branch Chief..... Donald Kuriki  
    Oahu Collection Branch Chief ..... William Deeley  
    Maui District Tax Manager ..... Kathleen Uehara  
    Hawaii District Tax Manager ..... Duquesne Hulihee  
    Kauai District Tax Manager ..... Erin Tsuda  
  
Acting Taxation Services Administrator ..... Janyne Kaai  
    Document Processing Operations Manager ..... Todd Kuromoto  
    Revenue Accounting Branch Chief..... Jennifer Oshiro  
    Taxpayer Services Branch Chief..... John Pacheco

## 2.6 ORGANIZATION CHART

Department of Taxation  
State of Hawaii



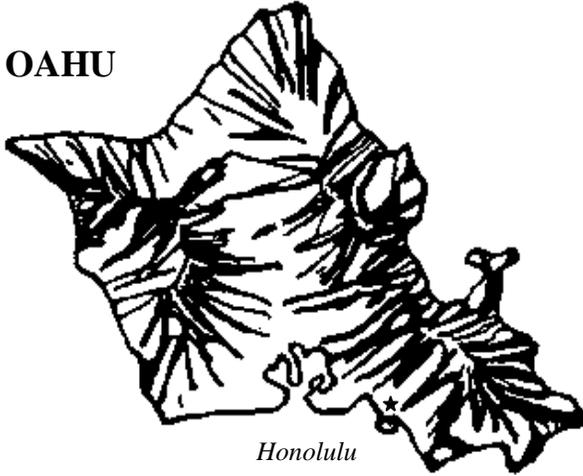
\*For Administrative Purposes.

**2.7 DISTRICT OFFICES**

**FIRST TAXATION DISTRICT**

City & County of Honolulu

**OAHU**



*Honolulu*

Oahu Office  
830 Punchbowl Street  
Honolulu, Hawaii 96813

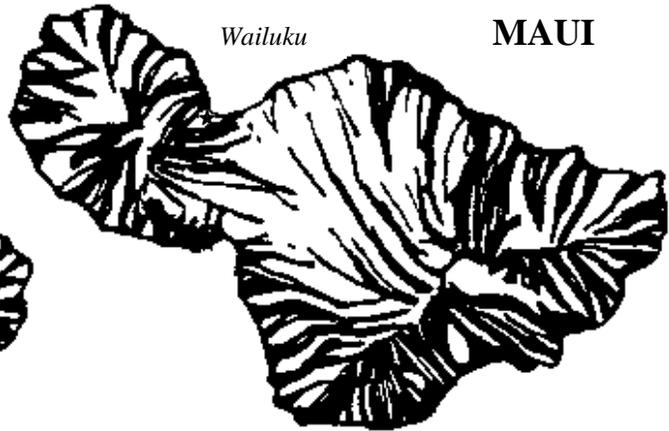
**SECOND TAXATION DISTRICT**

Counties of Maui and Kalawao



*Kaunakakai*

**MOLOKAI**



*Wailuku*

**MAUI**

**LANAI**



**KAHOOLAWE**

Maui Office  
54 South High Street  
Wailuku, Hawaii 96793

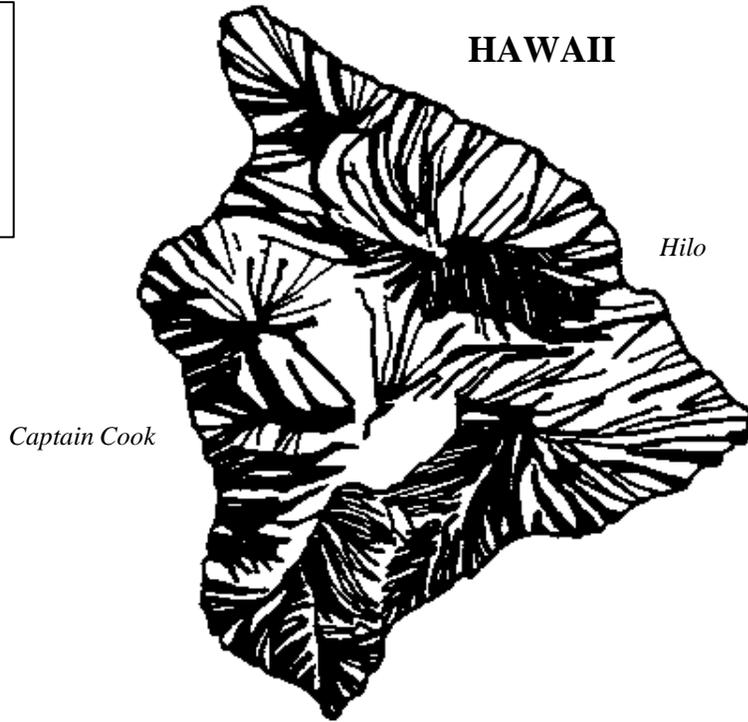
Molokai Office  
35 Ala Malama Street #101  
Kaunakakai, Hawaii 96748

# THIRD TAXATION DISTRICT

County of Hawaii

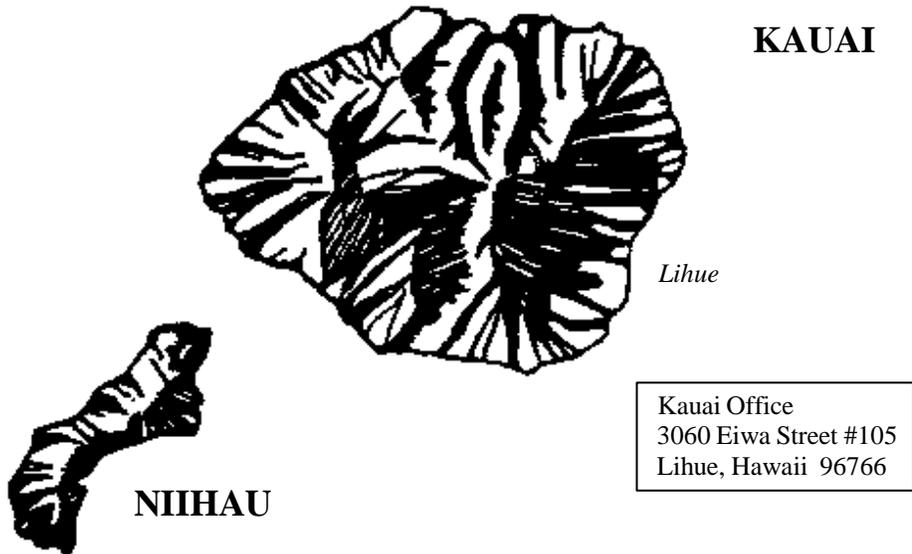
Hilo Office  
75 Aupuni Street  
Hilo, Hawaii 96720

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



# FOURTH TAXATION DISTRICT

County of Kauai



Kauai Office  
3060 Eiwa Street #105  
Lihue, Hawaii 96766

### 3.0 TAX APPEALS AND LITIGATION

#### 3.1 BOARDS OF TAXATION REVIEW

Each taxation district has an administrative (i.e., non-judicial) Board of Taxation Review consisting of five members. Tax disputes that are not resolved at the district tax office level may be appealed to a Board of Taxation Review unless the dispute involves the Constitution or laws of the United States. Statewide, the boards began the fiscal year with 174 pending tax appeals. During FY 2016, 61 new appeals were filed, 14 appeals withdrawn, and 15 appeals settled; a total of 206 appeals to the Boards of Taxation Review were pending at the end of the fiscal year.

The following table details appeals to the Boards of Taxation Review by taxation district:

Taxation District	First		Second	Third	Fourth	Totals
	Field	Office				
Appeals Pending (Beginning)	76	19	45	26	8	174
New Appeals	30	17	4	7	3	61
Appeals Withdrawn	6	1	0	5	2	14
Appeals Settled	4	2	0	9	0	15
Appeals Pending (Ending)	96	33	49	19	9	206

#### 3.2 CIVIL DECISIONS, SETTLEMENTS AND OTHER LEGAL MATTERS

##### Matters Closed

During the last fiscal year, the Tax & Charities Division (“Division”) closed 854 Tax Department-related legal matters (excluding legislative matters in our case management system that the Department’s Legislative Division has not closed). This report also does not include the myriad of charitable oversight, charity registration, and charitable solicitation or charitable trust-related matters the Division routinely handles.

Appeals	-	54
Bankruptcies	-	548
Contracts	-	27
Foreclosures	-	163
Legislation (None closed yet)		
Miscellaneous	-	18
Opinions	-	9
Quiet Title	-	7
Subpoenas	-	28

## Amounts Collected

Last fiscal year, the Division collected the following amounts<sup>4</sup>:

Tax Appeals	\$ 53,788,009.59 <sup>5</sup>
Foreclosures	\$ 10,904.36
Bankruptcies	\$ 1,330,759.32
Trusts	\$ 749.84
Miscellaneous	<u>\$ 56,030.32</u>
TOTAL:	<u>\$ 55,186,453.43</u>

### **3.2.1 Settled Cases**

#### ***Tax Appeal Court***

In the Matter of the Tax Appeal of One Napili Way Interval Owners Association, Case No. 09-0069, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for amounts it received for condominium maintenance fees collected on behalf of its members and paid to the One Napili Way AOA. Taxpayer asserted the fees it collected were not income for purposes of chapter 237, HRS, and, alternatively, that the amounts were exempt reimbursements under § 237-20, HRS. The parties have reached a settlement in this case.

In the Matter of the Tax Appeal of JTSI, Inc., Case No. 12-1-0276, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and county surcharge taxes on sales of services to government instrumentalities. Taxpayer argues that it primarily sold tangible personal property to the federal government that is exempt from general excise taxes. This case was settled.

In the Matter of Tax Appeal of James & Associates CPAs, Inc., Case No. 1 T.X. 10-1-001806, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's reclassification and recalculation of its tax liability that was based on Taxpayer's IRC § 338(g) election of a sale of a business. The basis of Taxpayer's claim was that it made an election error on the Form 8023 and the parties to the sale intended a § 338(h)(10) election instead of the § 338(g) election. The case was settled.

In the Matter of Tax Appeal of James Professional Services, Inc., Case No. 1 T.X. 10-1-001807, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's reclassification and recalculation of its tax liability that was based on Taxpayer's IRC § 338(g) election of a sale of a business. The basis of Taxpayer's claim was that it made an election error on the Form 8023 and the parties to the sale intended a

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<sup>4</sup> The Division also secured the dismissal of several tax appeals that would have potentially resulted in refunds to taxpayers from the General Fund and won cases on appeal that will have fiscal impact on similarly situated taxpayers and result in future tax collections that are impossible to forecast.

<sup>5</sup> This figure includes amounts recovered from the Litigated Claims Fund as a result of the Hawaii Supreme Court's March 2015 Travelocity.com decision.

§ 338(h)(10) election instead of the § 338(g) election. Taxpayer also challenged the use tax assessments on property it purchased. The case was settled.

In the Matter of the Taxpayer Appeal of Stephan A. Cipres, Case Nos. 11-1-0084, 12-1-0436, 12-1-0437, Tax Appeal Court, State of Hawaii.

Taxpayer challenged the Department's general excise tax assessments on the basis that the Department incorrectly increased his commissions for certain years and misinterpreted and misapplied the penalty provisions in the HRS. This case was settled.

In the Matter of the Tax Appeal of Safeway Inc., Case No. 12-1-0385, Tax Appeal Court, State of Hawaii.

Taxpayer's claim for refund of use taxes was denied. Taxpayer argued that it should not have paid use taxes on amounts paid to a licensed shipper. The Department asserted use tax was calculated on the landed value of the imported items, including shipping. This case was settled.

In the Matter of the Tax Appeal of Cubic Applications, Inc., Case No. 1 T.X. 14-1-0268, Tax Appeal Court, State of Hawaii.

Taxpayer amended its general excise tax returns claiming refunds under the exported services exemption under § 237-29.53, HRS. The Department of Taxation denied the refund claims. Taxpayer appealed the denial of the refund claims for lack of sufficient substantiation. This case was settled and dismissed by stipulation.

Maria E. Zielinski v. Robert O. Lillie, Jr. and Shari N. Lillie, Case No. 1 T.X. 15-1-0222

Maria E. Zielinski v. Kenneth T. Matsuda and Cynthia H. Matsuda, Case No. 1 T.X. 15-1-0223

Maria E. Zielinski v. Chester M. and Prudence S. Kanehira, Case No. 1 T.X. 15-1-0227

Maria E. Zielinski v. Fred M. and Shirfeir S. Sunada, Case No. 1 T.X. 15-1-0226

Maria E. Zielinski v. Wayne K. and Sheri L. Wills, 1 T.X. 15-1-0228

Maria E. Zielinski v. Paul R. and Claudia S. Johnstone, 1 TX 15-1-0230

Maria E. Zielinski v. Dale and Alison Ohama, Case No. 1 T.X. 15-1-0231

Maria E. Zielinski v. Morris S. and Jeanne A. Creel, Case No. 1 T.X. 15-1-0232

In these cases, the Director of Taxation appealed decisions of the Board of Review. The Department denied Taxpayers fully refundable Renewable Energy Technologies tax credits under § 235-12.5, HRS because Taxpayers' adjusted gross incomes exceeded the statutory threshold entitling them to a fully refundable credit. The Board of Review ruled that Taxpayers could revoke their elections to receive refundable tax credits. These cases were settled.

In the Matter of the Tax Appeal of Andrew Bernstein and Jacqueline S. Showback, Case No. 1 T.X. 15-1-0249, Tax Appeal Court, State of Hawaii.

Taxpayers appealed from a final assessment reducing their renewable energy tax credit under § 235-12.5, HRS. This case was dismissed by stipulation.

### **3.2.2 Closed Cases**

#### ***Tax Appeal Court***

In the Matter of the Travelocity.Com, LLC, Case No. 11-1-0020, Tax Appeal Court, State of Hawaii (Consolidated Cases).

Travelocity.com LP, Site 59.com LLC, Expedia, Inc., Hotwire, Inc., Hotels.com, L.P., Orbitz, LLC, Internetnetwork Publishing Corp. (d/b/a Lodging.com), Trip Network, Inc. (d/b/a CheapTickets.com), priceline.com Inc., and Travelweb LLC filed separate Notices of Appeal to the Tax Appeal Court of the State of Hawaii, timely appealing final notices of assessments of general excise tax and transient accommodations tax for the period 1999 through 2011, inclusive. By orders filed on February 8, 2012 the Tax Appeal Court granted the Department's motions for summary judgment on the general excise tax assessments and denied the Department's assessments of transient accommodations taxes. On August 15, 2013, the Tax Appeal Court entered a final judgment in favor of the State on the general excise tax assessments and against the State on the transient accommodations tax assessments. The amount of general excise tax, penalties and interest owed as of the date of the final judgment was \$246.8 million. The Hawaii Supreme Court granted the parties' petition to transfer the appeal directly to the Hawaii Supreme Court. In an opinion issued on March 17, 2015, the Hawaii Supreme Court ruled that the online travel companies are "travel agents" and therefore entitled to the benefit of the income splitting provision of § 237-18(g), HRS, such that Taxpayers are subject to general excise taxes on the amounts that they retain after remitting payments to hotel operators for the hotel rooms they sell online. The Hawaii Supreme Court upheld the imposition of penalties and interest on Taxpayers and upheld the Tax Appeal Court's ruling that Taxpayers are not subject to transient accommodations taxes because they are travel agents. On remand, the parties stipulated to a judgment in favor of the State of Hawaii in the amount of \$53.2 million.

In the Matter of the Tax Appeal of Zephyr Insurance Company, Inc., Case Nos. 1 T.X. 13-1-0223, 1 T.X. 13-1-0227, 1 T.X. 13-0229, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing the Insurance Commissioner's tax assessment that disallowed its claim to the Qualified High Technology Business ("QHTB") tax credit pursuant to § 235-110.9, HRS. The disallowance was based on the Department determination letter to the Insurance Commissioner that ruled that Taxpayer was not entitled to claim the QHTB. The claims were dismissed.

Fredrick D. Pablo, Director of Taxation, State of Hawaii vs. BGCH Solar Fund, LLC., Case No. 1 T.X. 14-1-0253, Tax Appeal Court, State of Hawaii.

The Director appealed the Board of Review's decision allowing developer's fee, developer's reimbursement, and bank loan fees as creditable costs under § 235-12.5, HRS. The Tax Appeal court entered judgment in favor of Taxpayer. This case was dismissed.

Fredrick D. Pablo, Director of Taxation, State of Hawaii vs. First Risk Mgmt., Inc., Case No. 1 T.X. 14-1-0254, Tax Appeal Court, State of Hawaii.

The Director appealed the Board of Review's decision allowing developer's fee, developer's reimbursement, and bank loan fees as creditable costs under § 235-12.5, HRS. This case was dismissed.

Fredrick D. Pablo, Director of Taxation, State of Hawaii vs. KEC Solar Fund, LLC, Case No. 1 T.X. 14-1-0255, Tax Appeal Court, State of Hawaii.

The Director appealed the Board of Review's decision allowing developer's fee, developer's reimbursement, and bank loan fees as creditable costs under § 235-12.5, HRS. This case was dismissed.

Maria E. Zielinski vs. Patrick and Grace Duarte, Case No. 1 T.X. 1-15-0233, Tax Appeal Court, State of Hawaii.

The Director of Taxation appealed from a Board of Review Decision in favor of Taxpayers finding that the Taxpayers "irrevocable" election of a fully refundable renewable energy technologies tax credit under section 235-12.5, HRS, could be revoked. The Tax Appeal Court entered judgment in favor of the Department of Taxation after granting the Department's motion for summary judgment.

In re Tax Appeal of Thomas E. Gebhard and Julie M. Gebhard, Case No. 1 T.X. 15-1-0247, Tax Appeal Court, State of Hawaii.

The Director appealed the Board of Review's decision allowing developer's fee, developer's reimbursement, and bank loan fees as creditable costs under § 235-12.5, HRS. The Tax Appeal Court entered judgment in favor of Taxpayers. This case was dismissed.

In the Matter of the Tax Appeal of KEC HM Maui Solar Fund LLC, Case No. 1 T.X. 15-1-0248, Tax Appeal Court, State of Hawaii.

Taxpayer appealed an income tax assessment reducing the total renewable energies technologies income tax credit under § 235-12.5, HRS. Taxpayer claimed that all of the costs it claimed qualified for the tax credit and that the reduction of the credit was erroneous. This case was dismissed by stipulation.

### ***3.2.3 Pending Appeals***

#### ***Hawaii Supreme Court***

None.

#### ***Intermediate Court of Appeals***

In the Matter of the Tax Appeal of CompUSA Inc., Case Nos. 12-1-0264, 12-1-0265, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from the disallowance of a use tax refund request for tax years 2006, 2007, and 2008. Taxpayer argued that under the commerce and equal protection clauses of the United States Constitution the imposition of Hawaii's use tax is unconstitutional. The Tax Appeal Court determined that the use tax is constitutional under the commerce and equal protection clauses of the United States Constitution.

Tax Foundation of the State of Hawaii, Inc. v. State of Hawaii, Case No. 15-1-2020-10, Circuit Court of the First Circuit, State of Hawaii.

In this case, the Tax Foundation of the State of Hawaii brought an action for injunctive and mandamus relief. At issue was the county surcharge on state tax, § 248-2.6, HRS, that requires the Department of Budget and Finance to transfer ten percent of the amount collected to the

general fund to reimburse the Department of Taxation's costs of assessment and collection of the surcharge. Plaintiff argued that amounts transferred to the general fund exceed the Department of Taxation's actual costs and expenses. Under these facts, Plaintiff alleged that the statute violated the due process and equal protection clauses of the United States Constitution. The complaint sought refunds on Plaintiff's behalf and on behalf of the City and County of Honolulu. The State moved to dismiss the complaint for lack of subject matter jurisdiction and the court granted the motion.

### ***Tax Appeal Court***

In the Matter of the Tax Appeals of TMI Management, Inc., Case Nos. 09-0071 and 09-0072, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on amounts received for performing work for the federal government. Taxpayer argued, among other things, that the disputed income was exempt because Taxpayer was an employee leasing company and the disputed income was for salaries and expenses of leased employees. This case has been taken off the calendar to give the parties time to work on settlement.

In the Matter of the Tax Appeals of Bernard & Ellen Fuller and South Pacific Builders, Ltd., Case Nos. 09-0087, 09-0088, and 09-0089, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional general excise and net income taxes on amounts received for performing work within the state. Taxpayers argued, among other things, that the disputed income was exempt because Taxpayers paid certain amounts to other contractors. Trial is set for July 10, 2017.

In the Matter of the Tax Appeal of CBIP, Inc., Case No. 09-0203, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise tax assessments. The parties filed a stipulation for partial dismissal of the case. In the appeal that remains, Taxpayer argued that: (1) the assessment erroneously included general excise tax on amounts that were not gross income but, rather, were rebates of expenses; and (2) penalties were erroneous because non-filing and/or underpayment was not due to negligence or intentional disregard of rules. Trial is set for January 9, 2017.

In the Matter of Tax Appeal of James J. Richard & Rachael D. Richard, Case No. 10-1-1805, Tax Appeal Court, State of Hawaii.

Taxpayers were assessed additional income and general excise taxes. Taxpayers challenged the Department's reclassification and recalculation of its liability that was based on Taxpayers' IRC § 338(g) election on a sale of a business. The basis of Taxpayers' claim was that they made an election error on the Form 8023 and the parties to the sale intended a § 338(h)(10) election instead of the § 338(g) election. Taxpayers also challenged the Department's reclassification of income that changed the amount received as personal loans and/or advances from their business to wages.

In the Matter of the Tax Appeal of JN Group, Inc., Case No. 10-1808, Tax Appeal Court, State of Hawaii.

Taxpayer appealed general excise assessments for tax years ending March 31, 1998 through March 31, 2006, inclusive. Taxpayer claimed that the amounts assessed constituted

reimbursements that were exempt under § 237-20, HRS; the assessments of penalties were erroneous because any non-filing or underpayment was not due to negligence or intentional disregard of rules; the assessments violated the due process, commerce, and/or equal protection clauses of the United States Constitution and the Constitution of the State of Hawaii. Trial is set September 18, 2017.

In the Matter of the Tax Appeal of Patrick O'Brien, Case No. 11-1-0013, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income taxes for unreported schedule C income from a single member LLC the Taxpayer owned. Taxpayer denied the income is taxable to him. Taxpayer's counsel has withdrawn from this case and Taxpayer is seeking new counsel. Trial is set for May 8, 2017.

In the Matter of the Tax Appeal of Security Resources, LLC, Case No. 11-1-0014; Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes for underreporting the amount of gross receipts it received. Taxpayer claims the assessments are overstated and that it is entitled to be taxed at the wholesale rate of .5 percent. Taxpayer also claims some of its sales are exempt because they were sales of tangible personal property to the federal government. Taxpayer's counsel has withdrawn from this case and Taxpayer is seeking new counsel. Trial is set for May 8, 2017.

In the Matter of the Tax Appeal of Ronald Au, Case No. 11-1-0144, Tax Appeal Court, State of Hawaii.

Taxpayer filed a petition to compel the Board of Review to prepare findings of fact and conclusions of law. The court denied the petition but granted leave to the Taxpayer to file a notice of appeal from general excise tax assessments for the period 2002 through 2005, inclusive, totaling \$175,000.00. The Tax Appeal Court granted the Department of Taxation's motion to dismiss the appeal for lack of subject matter jurisdiction by order filed February 29, 2012; however, the Court granted Taxpayer's motion for reconsideration of the dismissal. The Court took a motion for summary judgment under advisement.

In the Matter of the Tax Appeal of Kamaaina's Food Service, Inc., Case Nos. 12-1-0237 and 12-1-0244, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise tax and county surcharge when applicable, for unreported service income for tax years 1987 through 1992, 1994, 1995, 1997, 1998, and 2000 through 2009, inclusive, and/or imposed a 25 percent penalty for failure to file and a 25 percent penalty due to negligence or intentional disregard of rules. Taxpayer was assessed for general excise tax for unreported service income for tax years 1993, 1996, and 1999; the Department imposed a 25 percent penalty for failure to file and a 25 percent penalty due to negligence or intentional disregard of rules. Taxpayer disputed the assessments, arguing that the imposition of both penalties is not authorized by statute. Trial is set for March 27, 2017.

In the Matter of the Tax Appeal of Barbara Gilliss, Case No. 12-1-0303, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and county surcharge taxes, when applicable, for rental income in tax years 2002 through 2011, inclusive. Taxpayer argued that the penalties and interest should be waived. The Department filed a motion for summary judgment that was

heard and granted on April 18, 2016. The order granting the motion for summary judgment was entered on August 11, 2016.

In the Matter of the Tax Appeal of Julie A. Dunham, Case No. 12-1-0390, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise and income taxes on non-filed returns for 1999 through 2010, inclusive. Taxpayer argued that the Department's income figures are incorrect. Trial is set for September 11, 2017.

In the Matter of the Tax Appeal of Ronald Au, Case No. 1 T.X. 12-1-0393, Tax Appeal Court, State of Hawaii.

Taxpayer is appealing the Department's income tax assessments on unreported income received for tax years 2008 and 2009. Trial is set for February 20, 2017.

In the Matter of the Tax Appeal of William A. Bartenstein, Case No. 13-1-0228, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise and/or use taxes, penalties and interest on goods imported for resale. Taxpayer argued that the Department's income figures were incorrect and the stacking of the negligence and underpayment penalties was erroneous. Trial is set for March 13, 2017.

In the Matter of Priceline.com, 1 T.X. 13-1-0269, Tax Appeal Court, State of Hawaii. (and consolidated cases).

These consolidated tax appeals are by online travel companies Priceline.com, Travelocity.com, Orbitz.com, Hotels.com ("OTCs") from assessments of general excise tax, penalties and interest for the OTCs' rental motor vehicle transactions in the State for tax years 2000 through 2013, inclusive. The Department assessed the OTCs for their "stand alone" car rentals as well as car rentals included as part of travel or tour packages. The Tax Appeal Court partially granted the Department's motion for partial summary judgment on August 5, 2016. The Tax Appeal Court ruled that the OTCs are taxable on their gross receipts from "stand alone" car rental transactions and that under § 237-18, HRS, the OTCs are taxable on their net receipts from car rentals that are part of tour packages. The Tax Appeal Court has not determined the amount of taxes the OTCs owe.

In the Matter of Charles A. Shipman, Jr., Case No. 13-1-0301, Tax Appeal Court, State of Hawaii.

Taxpayer appealed his tax assessment for general excise and transient accommodation taxes stating the assessed amounts were speculative/inflated and included improper stacking of failure to file penalties with negligence penalties. The parties have agreed to dismiss this case.

In the Matter of the Tax Appeal of Ronald Au, T.A. No. 1 T.X. 14-1-0216, Tax Appeal Court, State of Hawaii.

Taxpayer appealed to the Tax Appeal Court, State of Hawaii from assessments of general excise taxes for 2009 and 2010 in the amount of \$13,114.62. The Department moved to dismiss the tax appeal because it was not timely filed and because Taxpayer failed to pay the assessment in his appeal from the Board of Review. The motion was heard on March 17, 2014 and taken under advisement.

In the Matter of the Tax Appeal of Skydiving School, Inc., Case Nos. 1 T.X. 14-1-0217 and 1 T.X. 14-1-0218, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from the denial of a refund claim and assessments of general excise taxes related to its skydiving business. Taxpayer's major issue is that its gross receipts from skydiving activities is not subject to the general excise tax because of federal preemption under the Anti-Head Tax Act, P.L. 103-272, 108 Stat. 1111, as amended, and as codified in 49 U.S.C. § 40116. Trial is set for January 30, 2017.

In the Matter of the Tax Appeal of Edward A. Alquero, M.D., Inc., Case No. 1 T.X. 14-1-0219, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income and general excise taxes, penalties, and interest for underreported income related to his medical practice. Taxpayer claims he is entitled to deductions for certain expenses that were disallowed by the Department. Trial is set for January 16, 2017.

In the Matter of the Tax Appeal of Avery B. Chumbley, Case No. 1 T.X. 14-1-0226, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes and interest for underreported gross receipts of a non-profit organization's fund raising activities. Taxpayer was assessed personally as the president of the organization at the time. Taxpayer claimed he was entitled to deductions for certain expenses that were disallowed by the Department. Trial is set for February 27, 2017.

In the Matter of the Tax Appeal of Darren Truitt, Case No. 1 T.X. 14-1-0228, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional income taxes, penalties, and interest for income attributed to his wholly-owned LLC. Trial is set for July 17, 2017.

In the Matter of the Tax Appeal of Construction Servs. & Management LLC, Case No. 1 T.X. 14-1-0229, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed general excise taxes, penalties, and interest for underreported gross receipts. Trial is set for July 17, 2017.

In the Matter of the Tax Appeal of Hawaiian Telcom Services Company, Inc., Case No. 1 T.X. 14-1-0231, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Telcom Services Company, Inc., Case No. 1 T.X. 15-1-0245, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claimed that §§ 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution; the statutes discriminate against interstate commerce and are not fairly apportioned; and that Taxpayer erroneously paid use taxes with respect to services and/or contracting performed within the state by a licensed seller. Trial is not set.

In the Matter of the Tax Appeal of Hawaiian Telcom, Inc., Case No. 1 T.X. 14-1-0232, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Telcom, Inc., Case No. 1 T.X. 15-1-0244, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claims that sections 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution; the statutes discriminate against interstate commerce and are not fairly apportioned; and that Taxpayer erroneously paid use taxes with respect to services and/or contracting performed within the state by a licensed seller. Trial is not set.

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 14-1-0233, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 15-1-0296, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaiian Electric Company, Inc., Case No. 1 T.X. 16-1-0316, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claimed that §§ 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and were not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of BAE Systems Holdings, Inc. & Subs., Case No. 1 T.X. 14-1-0234, Tax Appeal Court, State of Hawaii.

Taxpayer's claims for the High Tech Credit provided under § 235-110, HRS, were denied because Taxpayer did not make an investment as defined by statute. Taxpayer prevailed at the Board of Review and the Department filed this appeal. Trial is set for December 5, 2016.

In the Matter of the Tax Appeal of Hawaiian Airlines, Inc., Case No. 1 T.X. 14-1-0258, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claimed that §§ 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 14-1-0259, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 15-1-0297, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Hawaii Electric Light Company, Inc., Case No. 1 T.X. 16-1-0317, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claimed that §§ 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 14-1-260, Tax Appeal Court, State of Hawaii;

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 15-1-0298, Tax Appeal Court, State of Hawaii; and

In the Matter of the Tax Appeal of Maui Electric Company, Inc., Case No. 1 T.X. 16-1-0315, Tax Appeal Court, State of Hawaii.

Taxpayer appealed the denial of use tax refund claims. Taxpayer claimed that §§ 238-2 and 238-2.3, HRS, impermissibly imposes use tax in violation of the commerce clause and the equal protection Clause of the United States Constitution and that the statutes discriminate against interstate commerce and are not fairly apportioned. Trial is not set.

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 14-1-0240, Tax Appeal Court, State of Hawaii;

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 15-1-0237, Tax Appeal Court, State of Hawaii; and

In re Tax Appeal of Longs Drug Stores Ca., LLC, Case No. 1 T.X. 16-1-0314, Tax Appeal Court, State of Hawaii.

These cases are on hold pending the outcome of In the Matter of the Tax Appeal of CompUSA Inc., Case Nos. 12-1-0264, 12-1-0265, Tax Appeal Court, State of Hawaii. No trial date will be set until the Tax Appeal Court is notified of a decision in the CompUSA matter.

In the Matter of the Tax Appeal of Home Depot U.S.A., Inc., Case No. 1 T.X. 15-1-0218, Tax Appeal Court, State of Hawaii.

Taxpayer was disallowed the wholesale rate on general excise taxes due on sales to customers at its retail stores. Taxpayer was also denied the subcontractor deduction related to work performed for customers. Trial is set for December 5, 2016.

In the Matter of the Tax Appeal of Dan S. Tetsutani, Case No. 1 T.X. 15-1-0219, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from a final assessment of additional general excise tax and/or use taxes stating the assessments were improper or in the alternative that Taxpayer should pay the wholesale rate of .5 percent. Trial is set for December 4, 2017.

Maria E. Zielinski v. Blake and Bianca Goodman, Case No. 1 T.X. 15-1-0221; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Mark W. Baker and Lisa A. Hendrickson, 1 T.X. 15-1-0225; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Richard J. Peterson and Lynne D. Peterson, Case No. 1 T.X. 15-1-0224; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Timothy M. and Iwalani O. Dayton, 1 T.X. 15-1-0229; Tax Appeal Court, State of Hawaii;

Maria E. Zielinski v. Predrag & Doris Miocinovic, Case No. 1 T.X. 15-1-0234; Tax Appeal Court, State of Hawaii; and

Maria E. Zielinski v. Neal S. and Linda Takase, Case No. 1 T.X. 15-1-0235; Tax Appeal Court, State of Hawaii.

In these cases, the Director of Taxation appealed decisions of the Board of Review. The Department denied Taxpayers fully refundable Renewable Energy Technologies tax credits under section 235-12.5, HRS because Taxpayers' adjusted gross incomes exceeded the

statutory threshold entitling them to a fully refundable credit. The Board of Review ruled that Taxpayers could revoke their elections to receive refundable tax credits. On June 22, 2015, the Tax Appeal Court granted the Director's motion for summary judgment in one of the appeals, concluding that Taxpayers could not revoke their election to receive a refundable tax credit and upheld the Department's adjustment of Taxpayers' returns. Trials are scheduled for various dates.

In the Matter of the Tax Appeal of Steve F. Klein and Krista S. Bridges, Case No. 1 T.X. 15-1-0322, Tax Appeal Court, State of Hawaii.

Taxpayers appealed the disallowance of the Renewable Technologies Income Tax Credit under section 235-12.5, HRS, for failing to timely claim the credit. Trial is not set.

In the Matter of the Tax Appeal of New Cingular Wireless, Case No. 1 T.X. 15-1-0241, Tax Appeal Court, State of Hawaii.

Taxpayer filed refund claims for the PSC tax it paid to the State. Taxpayer claimed it paid the tax on amounts not subject to the PSC. The Director denied the refund claims as they were barred by the statute of limitations. Trial is set for November 21, 2016.

In the Matter of Red Time Realty, LLC, Case No. 1 TX 15-1-0261, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from a final assessment of general excise tax on gross income under §§ 237-38 and 237-39, HRS. Trial is set for March 6, 2017.

In re Tax Appeal of Edward K. Fuller, Case No. 1 T.X. 15-1-0270, Tax Appeal Court, State of Hawaii;

In re Tax Appeal of Edward K. Fuller, Case No. 1 T.X. 15-1-310, Tax Appeal Court, State of Hawaii; and

In re Tax Appeal of Fuller Anesthesia, LLC, Case No. 1 T.X. 15-1-0309, Tax Appeal Court, State of Hawaii.

These three cases involve the same Taxpayer and his LLC, appealing general excise and income taxes for fiscal years 2006 through 2013, inclusive. The Department assessed Taxpayers after it disallowed Taxpayers' claims of the wholesale rate and certain deductions. Trial is scheduled for October 2, 2017.

In re Tax Appeal of Escal Institute of Advanced Technologies, Inc., Case No. 1 T.X. 15-1-0276, Tax Appeal Court, State of Hawaii.

Taxpayer, for itself and its shareholders, appealed assessments on tax years 2008 and 2010 for income tax refunds denied; 2011 through 2013, inclusive, for income taxes assessed; and 2008, 2009, 2011 through 2013, inclusive, for general excise taxes assessed, alleging that refunds to shareholders were wrongly denied. Additionally, Taxpayer alleged that income taxes and general excise taxes were assessed on income from services performed outside Hawaii. Trial is scheduled for November 13, 2017.

In the Matter of Charles Mixon, Case No. 1 T.X. 15-1-0281, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from a final assessment of general excise tax for underreported income under § 237-13(6)(A), HRS. Trial is not set.

In re Tax Appeal of David J. Scroggin and Genya G. Scroggin, Case No. 1 T.X. 15-1-0286, Tax Appeal Court, State of Hawaii.

Director prevailed on a motion to dismiss for failure to properly serve this appeal. Subsequently, after the Order granting the motion and Judgment were filed, Taxpayers filed a motion to set aside the dismissal claiming that they did not receive notice of the hearing on the Motion to Dismiss. Director filed an opposition. To date, no ruling has been issued.

In re Tax Appeal of Pacific Isles Equipment Rental Inc., Case No. 1 T.X. 15-1-0315, Tax Appeal Court, State of Hawaii.

Taxpayer's President, a non-attorney, initially filed a Notice of Appeal of general excise taxes for tax years 2010, 2011, and 2012 and made payment "under protest." Taxpayer hired an attorney who filed a Complaint for Refund of Taxes in the tax appeal case. A motion to dismiss was granted in part and denied in part; the appeal survived. Taxpayer claimed that pursuant to § 237-13, HRS, the 0.5 percent wholesale rate applies rather than the 4.5 percent contracting rate. Trial is not set.

In re Tax Appeal of Jeffrey Scott Lindner, Case No. 1 T.X. 16-1-0300, Tax Appeal Court, State of Hawaii.

Taxpayer appealed income taxes for tax years 2012 through 2014, inclusive. Taxpayer claimed that he properly filed returns to qualify for HTBITC credits per § 235-110.9, HRS; however, the Department claims that it did not receive the returns. Trial is not set.

In re Tax Appeal of WC Maui Coast, LLC, Case No. 1 T.X. 16-1-0271, Tax Appeal Court, State of Hawaii.

Taxpayer appealed application of transient accommodations tax assessments for tax years 2012 and 2013 per § 237D-2, HRS. Taxpayer claimed that amounts received from long term contracts with airlines are exempt from Transient accommodations taxes based on AG Opinion 90-6. Trial is scheduled for July 31, 2017.

In the Matter of the Tax Appeal of Polynesian Cultural Center, Case No. 1 T.X. 16-1-0290, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes based on the disallowance of the income splitting provisions allowed under § 237-18(f), HRS. Trial is set for December 5, 2016.

In re Tax Appeal of Thomas Aki, Case No. 1 T.X. 16-1-0291, Tax Appeal Court, State of Hawaii.

Taxpayer appealed income tax assessments for tax years 2012, 2013, and 2014 in which the Department disallowed business expenses and deductions under chapter 235, HRS, disallowed the personal exemption deduction, and disallowed the application of losses from prior years. Trial is not set.

In re Tax Appeal of Editha C. Doctolero, Case No. 1 T.X. 16-1-0292, Tax Appeal Court, State of Hawaii.

Taxpayer has a wholesale flower-selling business and failed to fully pay general excise taxes on tax years 2001, 2003, and 2005 through 2013, inclusive. Taxpayer argued that the twelve-month limitation under § 237-9.3, HRS, does not apply because the wholesale rate is not a tax benefit subject to denial under § 237-9.3, HRS, but rather the regular rate of tax on wholesale sales. Trial is not set.

In the Matter of the Tax Appeal of Howard T. Chang and Jenifer M. Chang, Case No. 1 T.X. 16-1-0318, Tax Appeal Court, State of Hawaii.

Taxpayers appealed final assessments of income taxes based on gambling winnings without offset of gambling losses. Trial is not set.

### ***3.2.4 Criminal Investigations/Enforcement Actions***

During FYE 2016, three cases were adjudicated with guilty pleas with expected payments for restitution and criminal fines. Prison sentences ranged from 10 days to 90 days with up to four years probation. The three cases included an individual who filed false tax returns to obtain fraudulent refunds, an individual who defrauded three businesses of approximately \$500,000 and failed to file a tax return, and an individual who filed false tax returns and fled the state to avoid prosecution. There are four cases pending trial and three cases pending action by the Hawaii Department of the Attorney General or by the local prosecutor's office.

One pending case relates to a tax preparer who failed to pay over \$100,000 of withholding taxes. After being contacted by CIS, the tax preparer began to file current returns with payments.

Another case relates to a mainland corporation for the willful failure to file tax returns. The corporation made unsolicited admissions after the fact and filed general excise tax returns with payments.

During FYE 2016, Hawaii's criminal courts awarded a total of \$2,000 in judicial fines and \$89,033.81 in restitution. In addition, CIS collected \$1,617,932.82 in unpaid taxes, including awarded restitution, civil assessments, penalties, and interest.

**ADMINISTRATIVELY ATTACHED ENTITIES**

As of June 30, 2016

**COUNCIL ON REVENUES**

Kurt Kawafuchi, Chair  
Marilyn M. Niwao, Vice-Chair  
Carl S. Bonham  
Christopher Grandy  
Elizabeth P. Cambra  
Jack P. Suyderhoud  
Kristi L. Maynard

**BOARDS OF TAXATION REVIEW**

**FIRST TAXATION DISTRICT**

(OAHU)

Eric Ching  
Curtis Saiki  
Vacant  
Vacant  
Vacant

**SECOND TAXATION DISTRICT**

(MAUI)

Alan Bernaldo  
Vacant  
Vacant  
Vacant  
Vacant

**THIRD TAXATION DISTRICT**

(HAWAII)

Marilyn Gagen  
Valerie Peralto  
Richard Rovelstad  
Peter M. Tadaki  
Vacant

**FOURTH TAXATION DISTRICT**

(KAUAI)

Eric N. Yama  
Vacant  
Vacant  
Vacant  
Vacant

