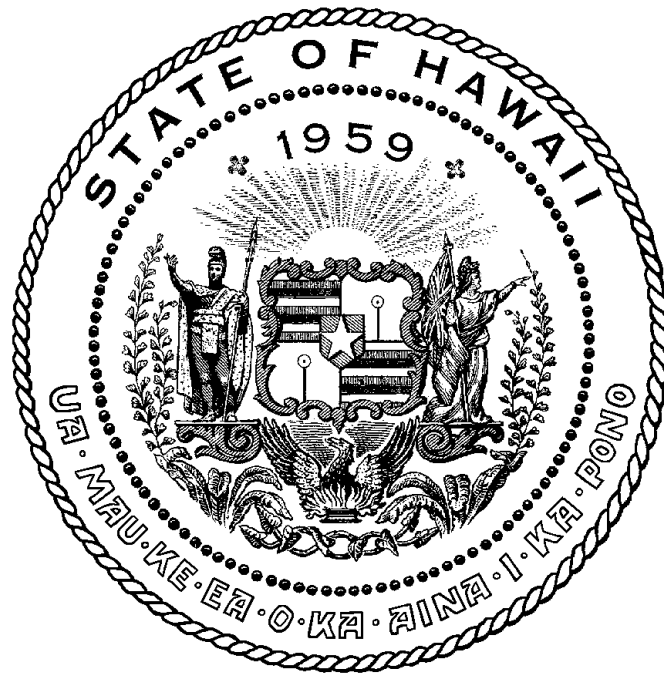


DEPARTMENT OF TAXATION STATE OF HAWAII



ANNUAL REPORT 1996-1997

January 15, 1998

The Honorable Benjamin J. Cayetano
Governor
State of Hawaii

Dear Governor Cayetano:

During this fiscal year, the department completed its reorganization, designed to consolidate functions and eliminate supervisory layers. Key to the reorganization is the consolidation under one manager of all compliance functions, our Tax Compliance Administrator. The establishment of this position was designed to foster coordination between our audit and delinquent collection functions; and places under one supervisor each of the different functions of the neighbor island district offices. Our technical and policy offices have been realigned to better serve the taxpayers.

Under our compliance initiatives, audit assessments were up by 34% compared to the previous year, and delinquent collections maintained a high level of productivity. Our criminal tax program, still in its infancy, continues to produce tangible results by way of convictions, sanctions, and criminal fines.

Forms processing was improved by the requirement of rounding of tax return entries for all personal and business forms. Filings of the single-page Form N-11 were made even easier in the 1997 filing season by dispensing with the need to attach the federal form. More simplification is being planned for the next filing season in 1998.

Our electronic funds transfer program resulted in over \$1.2 billion in general excise, transient accommodations, and withholding taxes being deposited into the general fund instantaneously through bank-to-bank transfers. Personal income taxes will be phased in under this program when our new integrated computer system is in place.

Our taxpayer services and policy offices are offering more electronic and other services to practitioners and taxpayers through the internet, forms by fax, telephone recordings, quarterly newsletters, workshops, and practitioner forums. The department introduced its 1996 Tax Information CD-ROM, containing all of the department's publications, rulings, and notices, and recent tax return forms, all in searchable format. We plan to issue updated CD-ROM versions every year.

The performance-based procurement for our systems replacement project progressed to the point of bidding. It is becoming increasingly clear that a new system is critical to the department in terms of enforcement, taxpayer services, economic analysis, and flexibility to accommodate executive and legislative initiatives.

Respectfully Submitted,



RAY K. KAMIKAWA
Director of Taxation

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THE YEAR IN REVIEW

TAX SERVICES AND PROCESSING DIVISION

The department's reorganization during the fiscal year expanded the scope of activities and functions of the Tax Services and Processing Division to meet its objectives and to improve services to the public.

The major objective of the Documents Processing Branch is to efficiently process all tax returns and documents. Act 133, enacted during the 1996 legislative session, helped to speed tax returns processing time by requiring taxpayers to use rounded figures on all individual and business income tax forms. The department received and processed 95,700 pounds of incoming mail. Incoming mail poundage dropped approximately 6%, primarily due to the reduced number of required pages to attach to the net income tax return and the elimination of the requirement to attach a copy of the front page of the federal return. Approximately 1.4 million payment transactions were processed during the year.

The electronic funds transfer (EFT) program for general excise and use, employer's withholding, transient accommodations, and rental motor vehicle and tour vehicle surcharge taxes collected over \$1.2 billion in its first full year of operation.

Transfer of the Data Control Section of the former Systems and Procedures Office to the Data Entry Section, Documents Processing Branch is in progress. This transfer will enhance interaction with the operating branches of the department and reduce blurring of technical and programming staff functions.

The Revenue Accounting Branch achieved its objective of maintaining accurate accounting records through controlling and accounting for all tax collections and refunds and preparing timely accounting reports. This year certain federal and state agencies coordinated with Department of Accounting and General Services to intercept approximately \$3.4 million in net income refunds.

A Technical and Education Section was added to the Taxpayer Services Branch to improve delivery of information and services to the public. This has allowed the branch to greatly expand its education and information program. Addition of staff from the former Technical Review Office has increased the capability of the branch to address complex taxpayer questions. The reorganization was implemented on January 10, 1997.

The department has made its information and forms more readily available through various media.

- A website has been established and has been accessed by the public worldwide for tax forms, information brochures, releases, announcements, legislative digests, reports, etc.
- A CD-ROM was released in December 1996 and contains tax statutes, administrative rules and formal opinions by the Attorney General's Office, in addition to the tax forms and instructions on the website.
- Commonly requested forms are available through a forms-by-fax program in conjunction with the traditional forms-by-mail telephone request system implemented in March 1997.

A tax bulletin board was established on the Department of Commerce and Consumer Affairs' Consumer Dial telephone information system. Current information on the department's upcoming seminars, refund processing status and new tax publication releases is available on the bulletin board.

The department also has continued its publication of *Tax Facts*, which provides timely and relevant information to the general public. Topics covered during the year were Act 314, SLH 1996, dealing with contractors and the general excise and use taxes, and income tax issues for nonresident members of the U. S. Armed Services.

Recorded tax filing and information tips were again offered to radio stations. 'Olelo Community Television assisted in videotaping and airing three ten-minute tax information segments during April 1997.

The department conducted seminars and workshops, published a quarterly newsletter, *Hawaii Tax News*, for tax practitioners and other interested parties, and conducted a quarterly forum for tax practitioners to meet with the Director of Taxation and key staff.

COMPLIANCE DIVISION

The primary objective of the Compliance Division is to maximize taxpayer compliance with the Hawaii tax laws. The Division is comprised of the Auditing Branches and the Collection Branches. The programs established to meet our objective in our voluntary-compliance, self-assessment environment are: (1) returns processing, exception handling; (2) auditing; (3) collection; and (4) taxpayer services and information dissemination.

Exception Handling/Error Correction

The Audit Branches perform exception handling of returns and other documents processed by the department. During the fiscal year, the department processed 931,700 net income tax related documents, of which 12.3 percent contained errors. The Audit Branches were able to process and correct errors on-line in a timely manner.

The Audit Branches performed exception handling for General Excise, Use, Transient Accommodations and other miscellaneous taxes. These types of returns represent the largest volume of returns processed by the department and include periodic (monthly, quarterly, and semi-annual) and annual returns.

Auditing

To support self-assessment and voluntary compliance, the Audit Branches performed both office and field audits throughout the year. Office Audit operations closed 5,673 cases with assessments totaling \$6,874,604, while Field Audit operations closed 431 cases with assessments totaling \$70,962,619. The increasing complexity and size of the issues audited along with the increasing experience and sophistication of the audit staff are reflected in the Field Audit operational statistics. Field audits resulted in adjustments in ninety percent of the cases, with seventy-four percent of the cases yielding adjustments of \$10,000 or more.

Assessment per work hour increased to approximately \$2,660 from \$1,490 for the previous fiscal year. This is seen to be a result of the larger type of cases handled and the increasing efficiency of the audit staff.

During fiscal year 1997, the Criminal Tax Section received five complaints against three individuals and two corporations. Of the five complaints, four were indicted and charged with criminal fines of \$107,000; taxes, penalties and interest of \$219,342; and community service of 250 hours. The largest criminal tax fine of \$100,000 was ordered on a physician's medical corporation for failure to file its 1995 general excise annual return and to supply information on employees' withheld taxes.

Delinquent Tax Collections

The statewide total outstanding delinquent tax balance amounted to \$183.3 million at the end of the fiscal year, representing a 16.0% increase over FY 1996. A total of \$91.0 million in delinquent taxes was collected in FY 1997, dropping 4.0% over FY 1996. As a result of field collectors on the neighbor islands intensifying their collection efforts, the number of levies served jumped from 6,016 to 8,158. The amount of delinquent taxes declared uncollectible and written-off rose from \$6.4 million to \$12.3 million.

Taxpayer Assistance Provided

The reorganization of the Audit and Collection Divisions into the Compliance Division created a new operating situation on the neighbor islands. Extensive cross-training was conducted during the year in order to allow for more flexibility and better resource utilization to meet the changing levels of taxpayer services demanded. The staff of the neighbor island district offices helped taxpayers properly file their tax returns through telephone support and over-the-counter assistance, which included tax return preparation and correspondence.

This service provided to taxpayers is part of the continued emphasis on taxpayer education and problem resolution, which is important to maintain taxpayer willingness to accurately and voluntarily comply with tax laws. Taxpayer assistance by neighbor island offices included 70,971 telephone calls, 48,333 over-the-counter assistance, 11,832 tax correspondences, and 8,327 clearances.

The neighbor island district offices continue to provide speakers for tax preparation and other workshops, such as the Tax Counseling for the Elderly, University Extension Service, Small Business Administration and other outreach programs.

Special Projects

Various special projects assigned to each district allowed the department to assess additional revenues to date of over \$20 million. The following is a list of special projects assigned to each of the district offices:

Oahu District

- Office Audit Branch Project N-11
- Field Audit Branch Mainland Audit Trips
- Field Audit Branch Combined Reporting Project
- Field Audit Branch Federal Contractors Project
- Field Audit Branch Miscellaneous Tax Project
- Use Tax Project Direct Marketers
- Use Tax Project Aircraft Parts
- Collection Branch Real Estate Relicensing
- Collection Branch Private Collection Agency

Maui District

- Helicopter Project
- Real Estate Licensee Project

Hawaii District

- Condominium Rentals
- Real Estate Licensee Project

Kauai District

- Non-filers Use Tax
- Non-filers Time Share
- Real Estate Licensees

STAFF OFFICES

Administrative Services Office

Fiscal Office

The Administrative Services Office submitted the fiscal biennium budget for fiscal years 1998 and 1999 to the 1997 Legislature. For fiscal years 1998 and 1999, the department was appropriated \$16.6 million and \$16.5 million, respectively.

In carrying out its duties, the Department of Taxation incurred operating expenditures of \$16.5 million for fiscal year 1997. As total taxes collected and administered by the department rose by \$11 million and expenditures fell from \$16.9 to \$16.5 million, the cost to collect \$100 of taxes decreased from 48 cents in fiscal year 1996 to 47 cents in fiscal year 1997.

Personnel Management

The department was authorized 344 positions for the fiscal year. This represents a drop in staff from 349 in 1996, and 408 in 1995. Employees were geographically distributed as follows: Oahu, 275; Hawaii, 30; Maui/Molokai, 25; and Kauai, 14.

Personnel actions within the department included 2 new civil service hires, 5 retirements, 114 temporary hires, and 8 resignations. Other personnel actions included the resignation or termination of 98 temporary employees hired for the tax season.

STAFFING PATTERN (Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
Headquarters Administration	49	50	63	63
Tax Services and Processing Division	90	90	106	107
Compliance Division	205	209	239	238
TOTAL	344	349	408	408

Employees participated in various training programs to expand their professional skills, thus increasing their efficiency and effectiveness in performing their duties. Computer software use and leadership training programs were some of a series of programs attended by department employees.

Rules Office

The Administrative Rules Office is the central authority for tax policy. In addition to drafting and commenting on tax proposals, the Rules Office develops tax policy in rules, tax information releases, announcements, directives, and other publications.

For the 1997 legislative session, the Rules Office drafted 22 administration-sponsored tax proposals; prepared 374 testimonies on 256 bills and 10 resolutions; drafted 56 memorandums regarding legislative proposals; and submitted comments to the Governor's Office on 19 acts passed by the legislature. Members of the Rules Office also testified at legislative committee hearings on behalf of the Director of Taxation.

The Rules Office prepared 33 Governor's letters; 57 Director's correspondences; two administrative directives; seven announcements; one rule; and four tax information releases. Work-in-progress includes 17 rules and 12 tax information releases. The office also reviewed legislative proposals and rules of other agencies, and provided speakers at several tax forums.

Information Technology Services Office

On October 28, 1996, the department released a request for proposal for a business partner to provide an integrated tax information management system. The department needs to replace its current systems that are old, prone to failure and are no longer capable of keeping pace with changing departmental, legislative and taxpayer requirements.

The department is embarking on a new "alternative procurement process" to replace the existing Comprehensive Net Income Tax (CNIT) and General Excise, Withholding and Transient Accommodation Tax (GEW/TAT) systems with a new integrated tax information management system. Due to the current tight fiscal conditions of the State of Hawaii, one critical element of the new alternative procurement process is the provision for performance-based funding arrangements, per Act 273 (1996). Another important element is the selection of qualified business partners who possess the expertise and creativity to provide business solutions that can effectively achieve the department's program objectives.

The alternative procurement process will allow the department to identify and form business partnerships with selected contractors who possess the expertise to assist in developing the new system. A competitive screening process will be used to establish partner relationships with qualified contractors. Potential partners should demonstrate success in areas including design of environment and awareness of new technology products and trends. As a private business partner, the selected contractor supplies the expertise and the money needed to develop and implement the new system. As components of the system are implemented, the resulting benefits will pay for the design and implementation efforts. The department is currently reviewing and evaluating proposal responses and expects to award a contract in the near future.

The department has moved aggressively in building one of its critical systems replacement project components, the information technology infrastructure. The Systems Networking staff completed the installation and implementation of the local area network (LAN) for the Oahu and Maui District Offices. Installation for the Kauai and Hawaii District office's LANs and the department wide area network, which will connect all district offices is in progress.

In-house training for department personnel on basic personal computer fundamentals, Windows, LAN orientation, Groupwise, and research using the Internet was developed and conducted by the Systems Networking staff.

The GEW/TAT System continues to explore ways to streamline costs, improve efficiency, and increase revenue. A cooperative effort which began at the beginning of the fiscal year between the Department of Taxation and the Department of Commerce and Consumer Affairs was completed, yielding millions of dollars in tax delinquencies not previously identified in the contracting and real estate industries. Another project was completed that fixed problems in the housecleaning areas of the system, thereby improving system efficiency and online response time. Currently, efforts are underway to reduce the cost of printing tax booklets by spreading the printing of booklets over a larger portion of the year.

Liaison tasks continued to be provided for the CNIT System. Tasks that were implemented for the 1996 tax law changes included the modification of individual tax returns to round amounts to the nearest dollar, the elimination of the general income tax credit, and the elimination of approximately six error codes which increased efficiency in processing refunds.

Tax Research & Planning Office

The Tax Research & Planning Office (TR&P) reviews and analyzes the effect of legislative tax proposals, publishes statistics on income tax and tax credits, and provides administrative and technical support to the Council on Revenues.

TR&P reviewed over 300 tax proposals introduced by the 1997 Legislature. Eighteen of these proposals were enacted into law. Some of the more significant proposals include: 1) the provision of motion picture income tax credits; 2) the exemption of aircraft service and maintenance and construction of airline maintenance facilities from general excise and use tax; 3) the establishment of a refundable income tax credit for hotel renovations; and 4) the increase in cigarette tax. See "Legislation" section for details and more proposals.

The Council on Revenues consists of seven community members who provide the state with projection of state general fund revenues and state total personal income. This information determines the state's expenditure ceiling. The Council estimated a 1.2% growth in general fund tax revenues for FY 1997. Actual general fund revenues of \$2.8 billion represent a 0.5% growth over FY 1996. For CY 1996, the Council's estimated total personal income growth rate was 2.7%, while the actual growth was 2.05%.

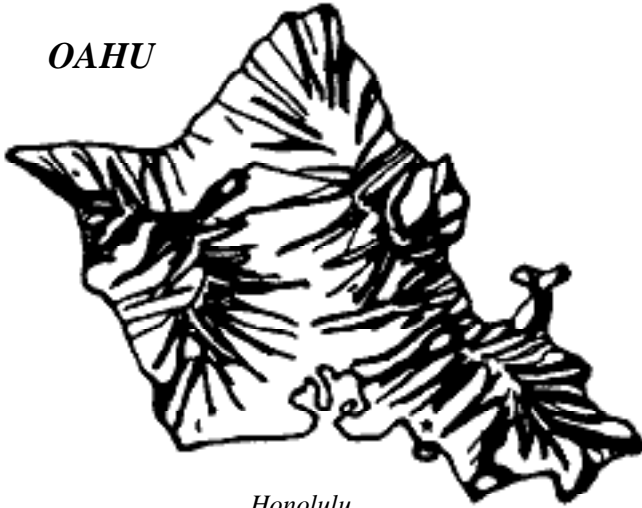
Two annual publications were completed for returns filed for tax year 1994: "Hawaii Income Patterns--Individuals" and "Tax Credits Claimed by Hawaii Residents". In the 1994 tax year, total income reported was \$16.0 billion, of which \$12.0 billion was taxable income. Nearly 90% of all residents filing a return claimed \$114.3 million in tax credits.

FIRST TAXATION DISTRICT

Island of Oahu

Office: 830 Punchbowl Street
P.O. Box 259
Honolulu, Hawaii 96809

OAHU



Honolulu

<i>Compliance Division Chief</i> Vacant
<i>Field Audit Branch</i> Vacant
<i>Office Audit Branch</i> Ronald Randall
<i>Collection Branch</i> Gary Fukumura
<i>Tax Services & Processing Branch Chief</i> Marie Okamura
<i>Taxpayer Services Branch</i> June Yamamoto
<i>Document Processing Branch</i> Jerry Ebesu
<i>Revenue Accounting Branch</i> Deanne Obatake

SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



MOLOKAI

Kaunakakai



Wailuku

MAUI



LANAI

Office: 54 South High Street
P.O. Box 1169
Wailuku, Maui 96793

<i>Maui District Office</i> Stanley Ching
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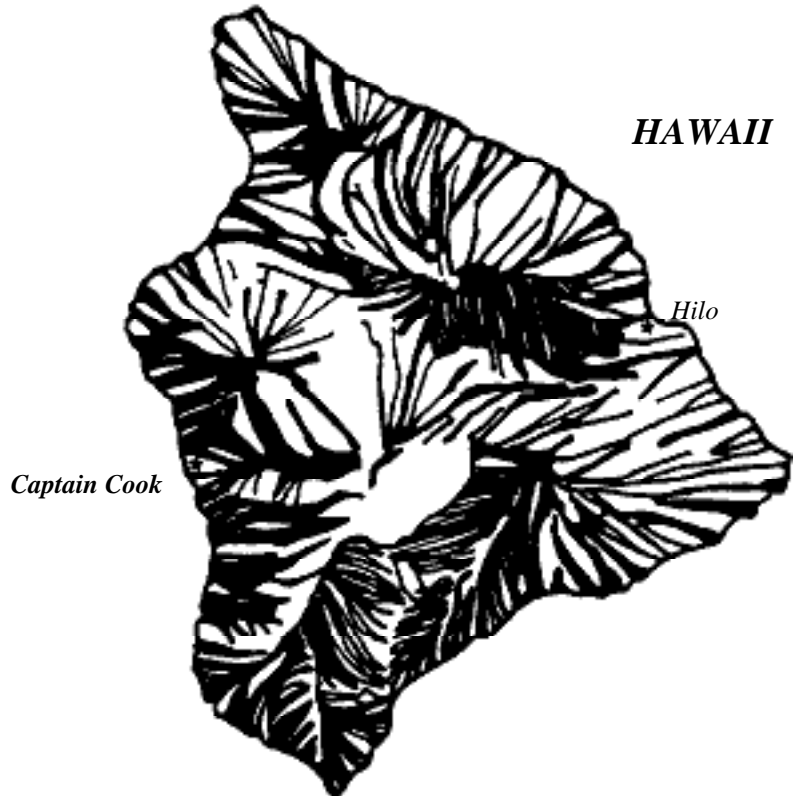
KAHOOLAWE

THIRD TAXATION DISTRICT

Island of Hawaii

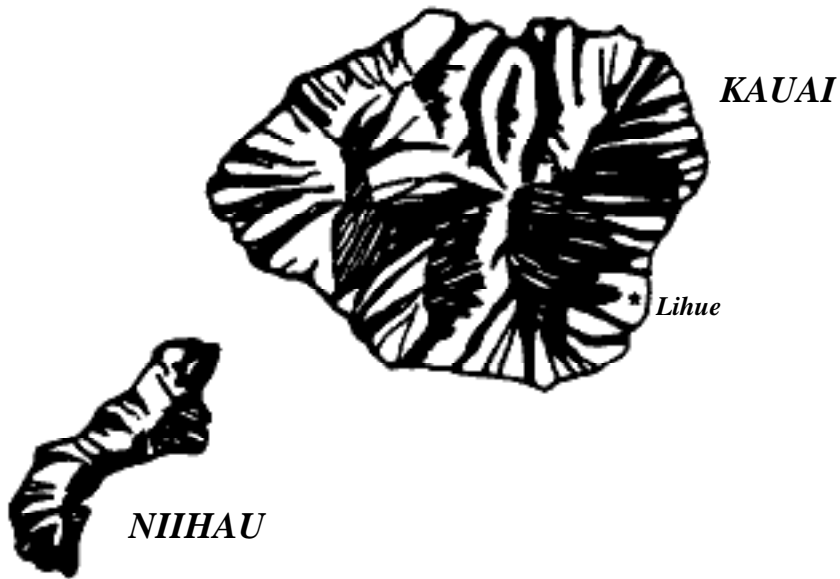
Office: 75 Aupuni Street
P.O. Box 1377
Hilo, Hawaii 96721

Hawaii District Office
Ronald Yabe



FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau



Office: 3060 Eiwa Street
P.O. Box 1689
Lihue, Kauai 96766

Kauai District Office
Ernest Balderas

MANAGEMENT PERSONNEL

OFFICE OF THE DIRECTOR

Director of Taxation Ray K. Kamikawa
Deputy Director of Taxation Susan K. Inouye

STAFF OFFICES

Rules Officer Grant Tanimoto
Tax Research & Planning Officer Francis Okano
Information Technology Services Officer Vacant
Administrative Services Officer Warren Higashi
Personnel Officer Stanley Onaga

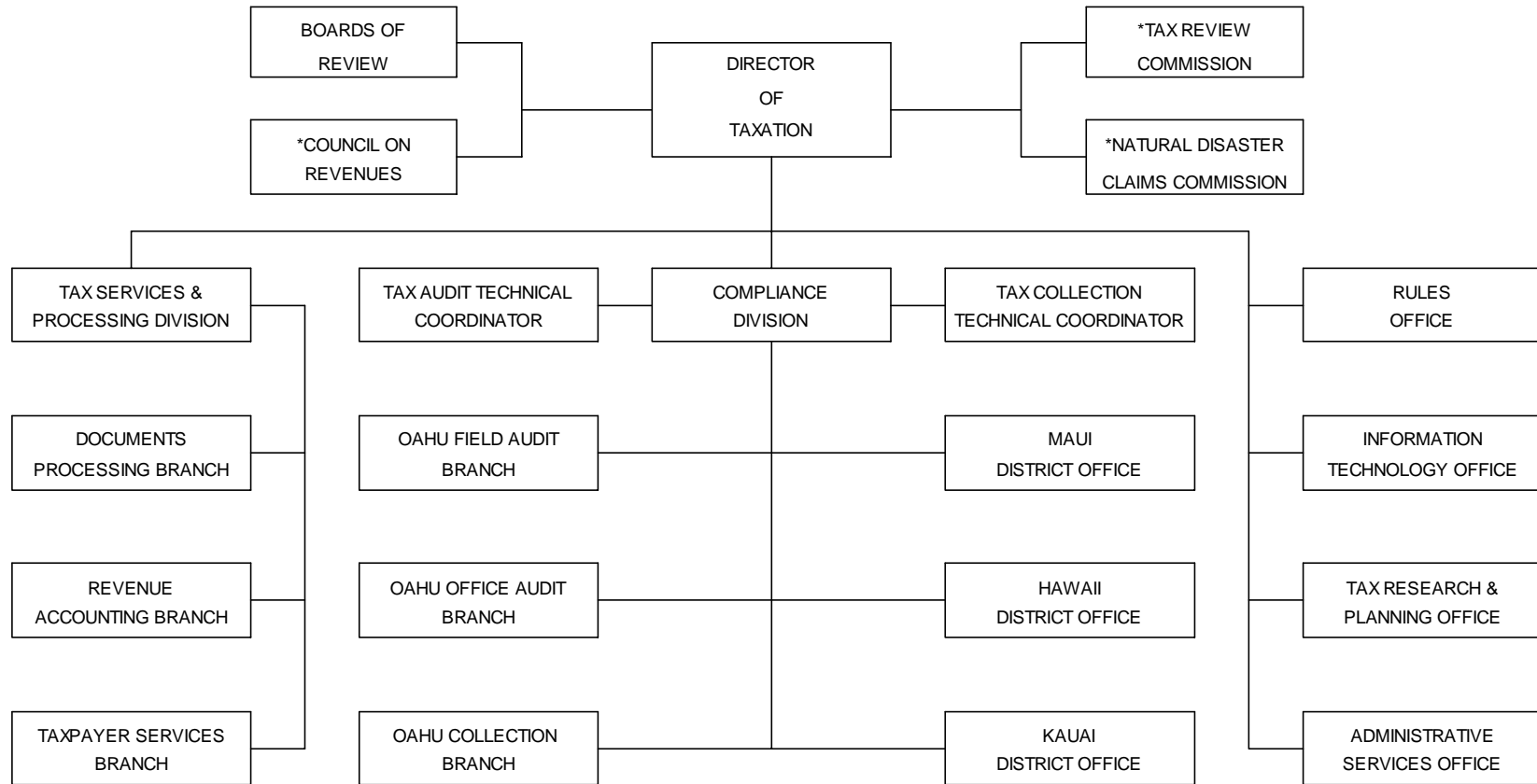
OPERATIONS STAFF

Compliance Division Chief Vacant
Oahu Field Audit Branch Vacant
Oahu Office Audit Branch Ronald Randall
Oahu Collection Branch Gary Fukumura
Maui District Office Stanley Ching
Hawaii District Office Ronald Yabe
Kauai District Office Ernest Balderas

Tax Services and Processing Division Chief Marie Okamura
Taxpayer Services Branch June Yamamoto
Document Processing Branch Jerry Ebesu
Revenue Accounting Branch Deanne Obatake

ORGANIZATION CHART

Department of Taxation
State of Hawaii



*For administrative purposes.

TAX APPEALS AND LITIGATION

BOARDS OF REVIEW

A Board of review, consisting of five members, is established in each taxation district. Tax disputes that are not resolved at the district tax office level are presented to the Board of Review. Statewide, the boards began the fiscal year with 62 pending tax appeals. Although 13 appeals were settled, 22 new appeals were filed, resulting in a total of 71 pending at the year end. A summary of the number of appeals before the boards by tax district follows:

	<u>Oahu</u>	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals Pending - Beginning	57	2	1	2	62
New Appeals Filed	16	2	4	0	22
Appeals Settled	11	0	0	2	13
Appeals Pending - Ending	62	4	5	0	71

Of the 13 cases settled, 11 were settled in favor of the state involving tax liabilities of \$921 thousand, none were in favor of the taxpayer and two were split decisions.

COURT DECISIONS

In re Tax Appeal of the American Express Travel Related Services Company, Inc. v. State of Hawaii, Case No. 19035, Supreme Court of the State of Hawaii

The Supreme Court summarily affirmed the decision of the Tax Appeal Court that the Hawaii use tax was properly imposed on the Taxpayer's importation of merchandise catalogs and promotional materials to Hawaii residents from out-of-state offices. The Taxpayer argued that its importation of promotional materials and merchandise catalogs from unlicensed sellers for distribution by direct delivery to customers and potential customers in Hawaii did not fall within the meaning of the use tax statute because it did not exercise control over the items within the state. The Department argued that the use tax applied because it was intended to seal a loophole that would exist if taxpayers went out-of-state to purchase items that were brought into the state for use, avoiding the local excise tax and discriminating unfairly against local businesses subject to that tax. In addition, an overriding concern was the broad-based economic utilization of advertising materials, in which the Taxpayer garners additional customers and business from the distribution of promotional materials.

Henry K. McKeague v. State of Hawaii, et al., Civil No. 96-0190-01, Circuit Court of the First Circuit, State of Hawaii

The Taxpayer requested that the Department refund all withholdings deducted from his wages based on his recent discovery that the State was not entitled to the money on the grounds that the State did not have the power to tax him because he was a nonresident and a sovereign entity. The Taxpayer also asserted a claim against the Department and the State for the improper collection of taxes. The Tax Appeal Court disagreed and granted the Department's motion to dismiss, recognizing that the State has the inherent power to tax its residents and that the State has not waived its sovereign immunity with respect to claims arising from the assessment or collection of any tax.

In re Tax Appeal of Mark Miyashiro, T.A. No. 96-5371, Tax Appeal Court of the State of Hawaii

In this tax protestor case, the Department had assessed the Taxpayer for additional income tax. The Taxpayer asserted the defenses that he was a nonresident and a sovereign entity not subject to the State's taxing authority and that he was not subject to the jurisdiction of the Department because he was a citizen of the Hawaiian Kingdom. The Department filed a motion to dismiss, which the Tax Appeal Court granted, based on similar grounds to the motion filed in the McKeague case. The motion to dismiss also brought to the Court's attention Hawaii supreme court cases that determined that the Hawaiian Kingdom was not a recognized sovereign entity and therefore, the Taxpayer's argument that he was a resident of the Hawaiian Kingdom was not a valid defense to the State's power to tax its residents.

Balboa v. Takayama, T.A. No. 3062, Tax Appeal Court of the State of Hawaii

On August 23, 1996, the State defeated the Taxpayers' Joint Motion for Return of Funds to the Litigated Claims Fund, for Interest, and for Sanctions. The Taxpayers argued that the Insurance Commissioner improperly transferred approximately \$36 million in undisputed

funds from the insurance premium tax credit litigated claims fund to the State's general fund. The Tax Appeal Court disagreed and ruled that the Insurance Commissioner is authorized pursuant to Haw. Rev. Stat. §40-35(a) to transfer any undisputed amounts from the litigated claims fund to the State's general fund. As a result, approximately \$10 million in undisputed funds is transferred to the State's general fund at the end of each fiscal year.

Cases Settled

In re Tax Appeal of Toys R Us, Inc., T.A. No. 97-5539 Tax Appeal Court of the State of Hawaii

The Taxpayer agreed to a judgment in favor of the Department on general excise tax deductions incorrectly claimed for sales to nonprofit organizations and for collection fees on uncollectible debts.

Other Matters Closed

Tax Appeals	12
Bankruptcies	289
Foreclosures	152
Subpoenas	43
Opinions	26
Contracts/Bids	14
Legislation	56
Miscellaneous	40

Amounts Collected

Tax Appeals	\$ 45,833,777
Foreclosures	\$ 124,678
Bankruptcies	\$ 1,608,979
Miscellaneous	\$ 749,836
TOTAL	\$ 48,317,269

NOTE: Due to rounding, detail may not add to total.

LEGISLATION

During its regular session, the 1997 legislature passed 23 tax related bills, four of which were vetoed by the governor, and one that was returned to the legislature for further action. The eighteen (18) tax related bills passed and signed into law are summarized below:

Act Brief Description

20	Exempts the sale of liquor shipped out of state from the liquor tax. Eff. 7/1/97.
86	Amends the licensure requirements for public accountancy practice. Eff. 4/29/97.
97	Requests an emergency appropriation of \$1.4 million for funds not carried over to FY 96-97 due to a technical error. Eff. 5/2/97.
106	Ensures funding for the Dept. of Land and Natural Resource's Trail and Access Program (Na Ala Hele) from a proportional share of fuel tax revenue, user fees, and private funding to be deposited in the Special Land and Development Fund. Funding through the fuel tax is limited to \$250,000 per fiscal year. Eff. 7/1/97.
107	Provides for motion picture income tax credits of up to 4% of general excise tax paid and of up to 6% of transient accommodations tax paid. Eff. 7/1/97. Exempts from the general excise and use taxes aircraft service and maintenance and construction of airline maintenance facilities. Eff. 7/1/97. Repeals the sunset date for stock exchange general excise tax exemption. Eff. 6/5/97.

- 108 Establishes a refundable income tax credit for hotel renovations equal to 4% of renovation costs incurred during the taxable year for each qualified hotel facility located in Hawaii. The credit is not to exceed 10% of the transient accommodations tax paid by the taxpayer in the preceding taxable year. Available for taxable years 1997-1998. Eff. 6/5/97, and shall be repealed 12/31/99.
- 140 Allows auto rental companies to include an assessment in rental agreements for prorated license and registration fees. Requires lessors to disclose, as part of any quotation of price, all payments a lessee must make to rent a vehicle, including charges assessed for general excise taxes and fees allowed under chapter 437D, HRS. Eff. 6/16/97.
- 176 Authorizes the Department of Taxation to allow taxpayers to file tax returns, applications, reports, or other tax documents through electronic, telephonic, or optical means. Eff. 6/16/97.
- 177 Establishes a \$15 service charge of electronic funds transfer payments that are dishonored. A penalty of 2% of the amount of tax due is imposed on those who fail to pay taxes using an electronic funds transfer method approved by the Department of Taxation, unless it is shown that the failure is due to reasonable cause and not neglect. Requires report to legislature. Eff. 6/16/97.
- 178 Amends certain chapters under title 14 administered by the Department of Taxation to reflect the passage of Act 92, SLH 1996, the Uniform Limited Liability Company Act. Makes necessary technical amendments to the tax provisions to adequately allow for reference to this new entity and its members in various contexts. Eff. 6/16/97.
- 179 Allows the Department of Taxation to accept remittances by credit or debit cards. Allows the department to charge a service fee in accepting remittances using credit cards, but not debit cards. Eff. 7/1/97.
- 253 Expands the type of delinquent taxpayer that may be pursued out of state and authorizes the use of contingent and other fee arrangements (except that contingent fee arrangements are not allowed for accountants and auditors). Provides for retention of private auditing firms to examine and investigate taxpayers for the determination of their tax liabilities arising from Hawaii source income. Eff. 6/20/97.
- 262 Amends the state enterprise zone law. Makes Waialua district on Oahu an enterprise zone from 7/1/97 to 6/30/2002. Exempts qualified businesses from the use tax in addition to the existing general excise tax exemption. Exempts contractors from the general excise tax on gross receipts of construction in an enterprise zone for a qualified business. Exempts agricultural producers located in counties with a population less than 100,000 from certain requirements. Eff. retroactive to 12/31/96.
- 281 Requires nonresidents and part-year residents to determine their Hawaii net income liability by calculating taxes as if they are Hawaii residents, then multiplying that amount by the ratio of Hawaii adjusted gross income to total adjusted gross income from all sources. Eff. 6/21/97, applies to taxable years beginning after 12/31/96.
- 297 Conforms to the Internal Revenue Code through 12/31/96, including section 584 (relating to common trust funds); section 220 (as it applies to medical savings accounts); timely mailed is treated as timely filed and paid (private delivery); filing of a joint return after the individual has filed a separate return without full payment of the amount shown as tax on the joint return; expands spousal IRA contributions from \$250 to \$2,000; increases allowable deduction for health insurance for self-employed. Makes inoperative certain parts of section 213 as it applies to long-term care insurance premiums, long-term care services, and long-term care premiums. Eff. 6/21/97, applies to taxable years beginning after 12/31/96.
- 331 Increases the cigarette tax from 3 to 4 cents per cigarette after 8/31/97; and 5 cents per cigarette after 6/30/98. Eff. 9/1/97.
- 352 Amends chapter 103D (Public Procurement Code) and section 103-53 (prerequisite of final settlement of public contracts) to allow Director of Taxation to waive the IRS tax clearance requirement in certain cases to expedite the procurement process. Eff. 7/1/97.
- 353 Alleviates the pyramiding of the general excise tax on lease transaction by providing a deduction from rental income for subleasing of real property with a seven year phase-in. When fully phased-in, the deduction will amount to the equivalent of 1/2% general excise tax on sublease income to the extent it pyramids. The Department of Taxation will implement by rules. Eff. 10/1/98.

INCOME ASSESSMENT AND AUDIT

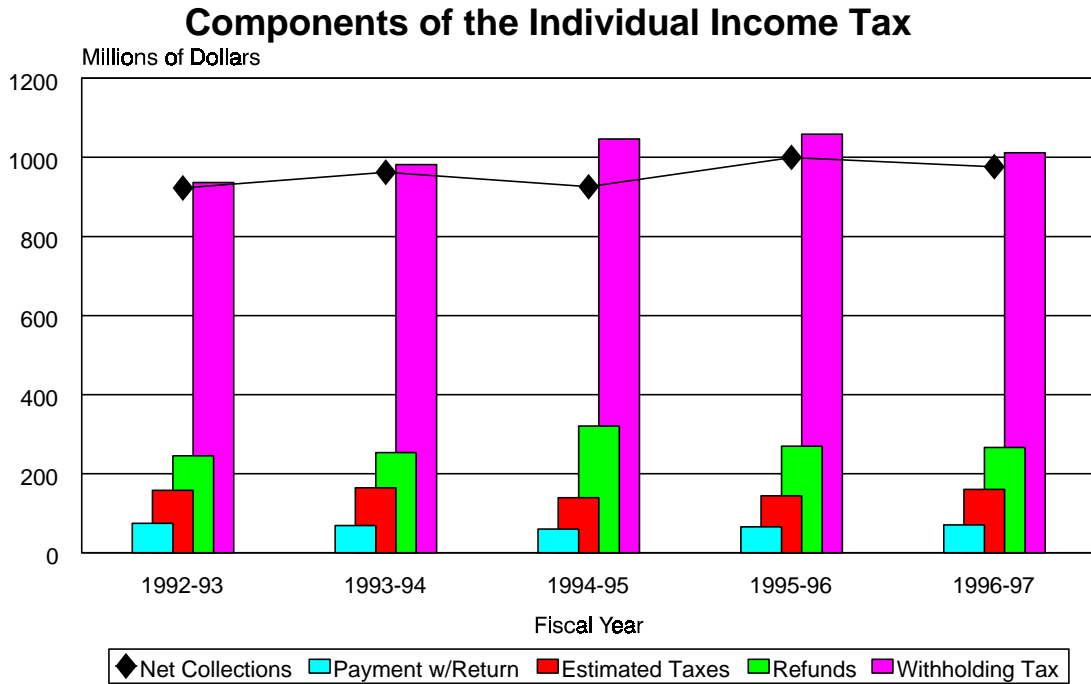
INDIVIDUAL INCOME TAX

Taxes paid by individuals under the individual income tax law slipped 2.4% in fiscal year 1997. Estimated taxes accelerated 11.0% to \$160.5 million and payments made at the time of filing advanced 6.3% from \$66.1 million to \$70.3 million. However, the 4.4% drop in withholding tax on wages mitigated by a 1.1% decline in refunds resulted in the slide in individual net income taxes to the year-end total of \$976.3 million. The dip in withholding tax on wages was a first since Hawaii became a state in 1959.

TAXES PAID BY INDIVIDUALS (In Thousands of Dollars)

	FY 1997	FY 1996	Av. Annual Change (Percent)	
			1996-97	1993-97
Declaration of Estimated Taxes	\$ 160,481	\$ 144,624	11.0	-1.4
Payment with Return	70,281	66,105	6.3	-3.1
Withholding Tax on Wages	<u>1,011,876</u>	<u>1,058,548</u>	<u>-4.4</u>	<u>2.5</u>
Subtotal	\$ 1,242,638	\$ 1,269,277	-2.1	1.5
Refunds	<u>266,327</u>	<u>269,349</u>	<u>-1.1</u>	<u>2.2</u>
NET	<u>\$ 976,311</u>	<u>\$ 999,928</u>	<u>-1.4</u>	<u>1.6</u>

Legislative actions contributed to the decline in withholding tax revenue. Act 73, SLH 1993, increased the maximum rate from 8% to 10%, for two and one-half years from January 1, 1994. Act 187, SLH 1996, restored the 8% tax cap in calendar year 1996, and the measure was implemented in October, 1996.



A total of 451,495 refund claims totaling \$228.6 million was processed from January through June, 1997, for an average refund of \$506.21. Preceding year data show 442,601 refund claims totaling \$230.0 million, or an average refund of \$519.64.

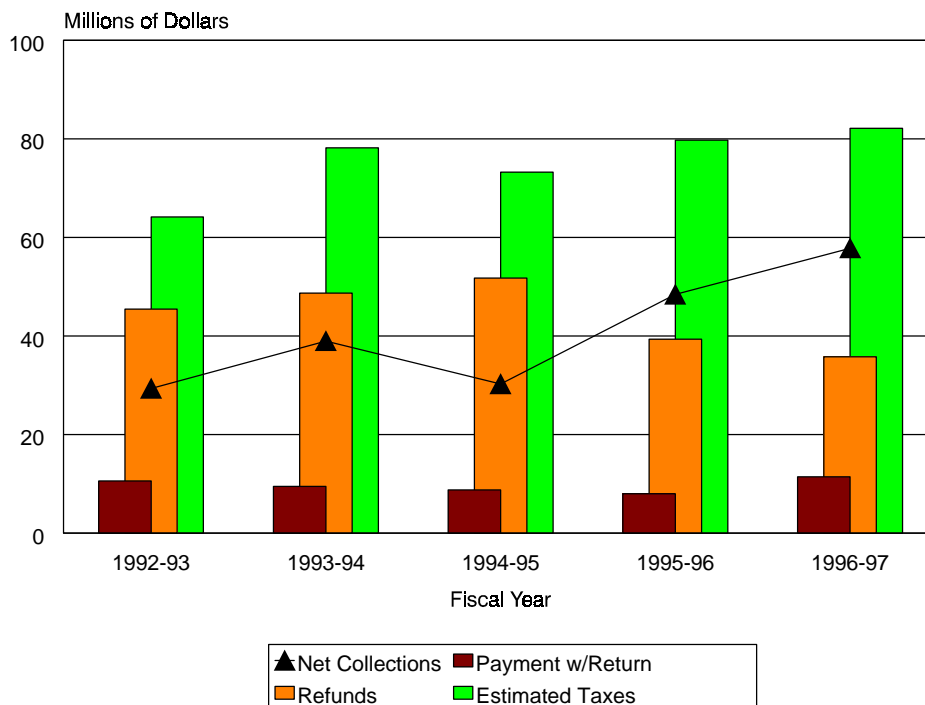
CORPORATE INCOME TAX

For the second consecutive year, net income tax revenue from corporations continued its upward trend, rising 19.4% from \$48.4 million to \$57.8 million in fiscal year 1997. As presented in the table below as well as in the graph, higher than expected year-end profits resulted in a 42.8% rise in payments made at the time of filing from \$8.0 million to \$11.5 million. The amount of refunds disbursed dipped 24.0% from \$51.8 million to \$39.4 million, and together with higher estimated taxes and payments made at the time of filing resulted in the 19.4% growth in net corporate income taxes to \$57.8 million.

TAXES PAID BY CORPORATIONS (In Thousands of Dollars)

	FY 1997	FY 1996	Av. Annual Change (Percent)	
			1996-97	1993-97
Declaration of Estimated Taxes	\$ 82,165	\$ 79,770	3.0	1.8
Payment with Return	<u>11,452</u>	<u>8,020</u>	<u>42.8</u>	<u>- 1.8</u>
Subtotal	\$ 93,618	\$ 87,790	6.6	0.9
Refunds	<u>35,778</u>	<u>39,352</u>	<u>- 9.1</u>	<u>- 5.5</u>
NET	<u>\$ 57,839</u>	<u>\$ 48,438</u>	<u>19.4</u>	<u>11.4</u>

CORPORATE INCOME TAX COMPONENTS



GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 1997 & 1996
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	1997	1996	% Change
TAX BASE				
Retailing		\$ 16,002,192	\$ 15,575,638	2.7
Services		5,549,429	5,474,079	1.4
Contracting		3,069,784	3,235,301	-5.1
Hotel Rentals		2,090,774	1,887,206	10.8
All Other Rentals		3,816,477	3,772,361	1.2
All Others (4%)		<u>2,826,996</u>	<u>2,672,772</u>	<u>5.8</u>
Subtotal		\$ 33,355,652	\$ 32,617,357	2.3
Sugar Processing		\$ 10,110	\$ 30,777	- 67.2
Pineapple Canning		4,889	6,522	-25.0
Producing		476,572	476,787	0.0
Manufacturing		593,012	629,554	-5.8
Wholesaling		8,055,644	7,823,225	3.0
Use (½%)		4,610,057	4,157,804	10.9
Intermediary Services		290,153	285,458	1.6
Insurance Commissions		<u>547,329</u>	<u>762,528</u>	<u>-28.2</u>
Subtotal		\$ 14,587,766	\$ 14,172,655	2.9
TOTAL-ALL ACTIVITIES		<u>\$ 47,943,418</u>	<u>\$ 46,790,012</u>	<u>2.5</u>
TAX				
Retailing	4%	\$ 640,088	\$ 623,026	2.7
Services	4%	221,977	218,963	1.4
Contracting	4%	122,791	129,412	-5.1
Hotel Rentals	4%	83,631	75,488	10.8
All Other Rentals	4%	152,659	150,894	1.2
All Others	4%	<u>113,080</u>	<u>106,911</u>	<u>5.8</u>
Subtotal		\$ 1,334,226	\$ 1,304,694	2.3
Sugar Processing	.50%	\$ 51	\$ 154	-66.9
Pineapple Canning	.50%	24	33	-27.3
Producing	.50%	2,383	2,384	0.0
Manufacturing	.50%	2,965	3,148	-5.8
Wholesaling	.50%	40,278	39,116	3.0
Use (½%)	.50%	23,050	20,789	10.9
Intermediary Services	.50%	1,451	1,427	1.7
Insurance Commissions	.15%	<u>821</u>	<u>1,144</u>	<u>-28.2</u>
Subtotal		\$ 71,023	\$ 68,195	4.1
Unallocated*		<u>52,025</u>	<u>58,913</u>	<u>-11.7</u>
TOTAL-ALL ACTIVITIES		<u>\$ 1,457,274</u>	<u>\$ 1,431,802</u>	<u>1.8</u>

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

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

GENERAL EXCISE AND USE TAXES

More than half of general fund tax revenues, or 52.6%, was derived from the general excise tax. Tax collections from the general excise and use taxes posted a change of 1.8% to \$1,457.3 million. Revenues from business activities subject to the 4% tax rate registered a modest gain of 2.3% from \$1,304.7 million to \$1,334.2 million. The bright spots included the 10.8% increase in hotel rental tax collections and the 2.7% growth in retail sales.

TRANSIENT ACCOMMODATIONS TAX

Consistent with rising average room rates, transient accommodations tax revenue posted an 8.4% increase from \$115.7 million to \$125.5 million in fiscal year 1997. As provided by law, one-sixth of the collections, or \$20.9 million was transferred to the convention center capital and operations special fund and a total of \$5.2 million was allocated to the state general fund to cover administrative costs. The remaining amount was distributed among the four counties according to the following distribution factors: Oahu, 44.1%; Maui, 22.8%; Hawaii, 18.6%; and Kauai, 14.5%.

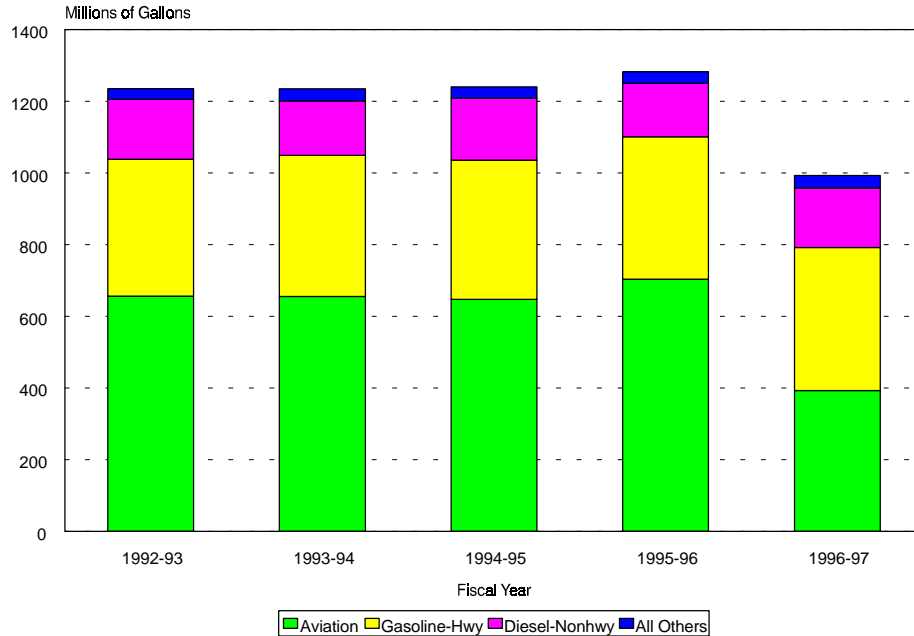
TRANSIENT ACCOMMODATIONS TAX (In Thousands of Dollars)

	<u>FY 1997</u>	<u>FY 1996</u>	<u>Difference</u>
Transient Accommodations Tax	\$ 125,455	\$ 115,741	\$ 9,714
Transient Accommodations Fees	<u>6</u>	<u>6</u>	<u>0</u>
SUB-TOTAL	\$ 125,461	\$ 115,747	\$ 9,714
Counties' Share	99,319	91,628	7,691
Convention Center Fund	<u>20,909</u>	<u>19,290</u>	<u>1,619</u>
Net Addition to General Fund	<u>\$ 5,233</u>	<u>\$ 4,829</u>	<u>\$ 404</u>

FUEL TAXES

Effective July 1, 1996, the state 1¢ per gallon aviation fuel tax is no longer imposed on the sale of bonded aviation/jet fuel to air carriers departing for or arriving from foreign ports before continuing on to their final destinations. In the past, consumption of aviation fuel accounted for more than half of the fuel subject to the state fuel tax. With bonded aviation/jet fuel no longer subject to the tax, statewide fuel consumption tax base slipped nearly 23%, or 289.2 million gallons, to 993.2 million gallons. As can be seen from the following table, highway diesel fuel oil consumption posted a change of 3.0 million gallons and statewide gasoline fuel consumption edged upward a minuscule 0.6% from 397.1 million gallons to 399.3 million gallons.

Trends in Fuel Consumption ~~Ta~~Base



GALLONS OF FUEL CONSUMED (In Thousands of Gallons)

	FY 1997	FY 1996	Av. Annual Change (Percent)	
			1996-97	1993-97
Gasoline	399,327	397,078	0.6	1.1
Diesel Oil - Non-highway	165,862	149,568	10.9	0.8
Diesel Oil - Highway	31,279	28,315	10.5	4.3
Liq. Pet. Gas - Off Highway	3,462	3,218	7.6	- 0.5
Liq. Pet. Gas - Highway	365	447	-18.3	- 7.9
Small Boats - Gasoline	45	51	-11.8	-1.4
Small Boats - Diesel Oil	183	356	-48.6	- 8.6
Aviation Fuel	<u>392,652</u>	<u>703,326</u>	<u>-44.2</u>	<u>- 9.6</u>
TOTAL-GALLONS	<u><u>993,175</u></u>	<u><u>1,282,359</u></u>	<u><u>-22.6</u></u>	<u><u>- 4.9</u></u>
Environmental Tax (Barrel)	35,624	33,387	6.7	NA

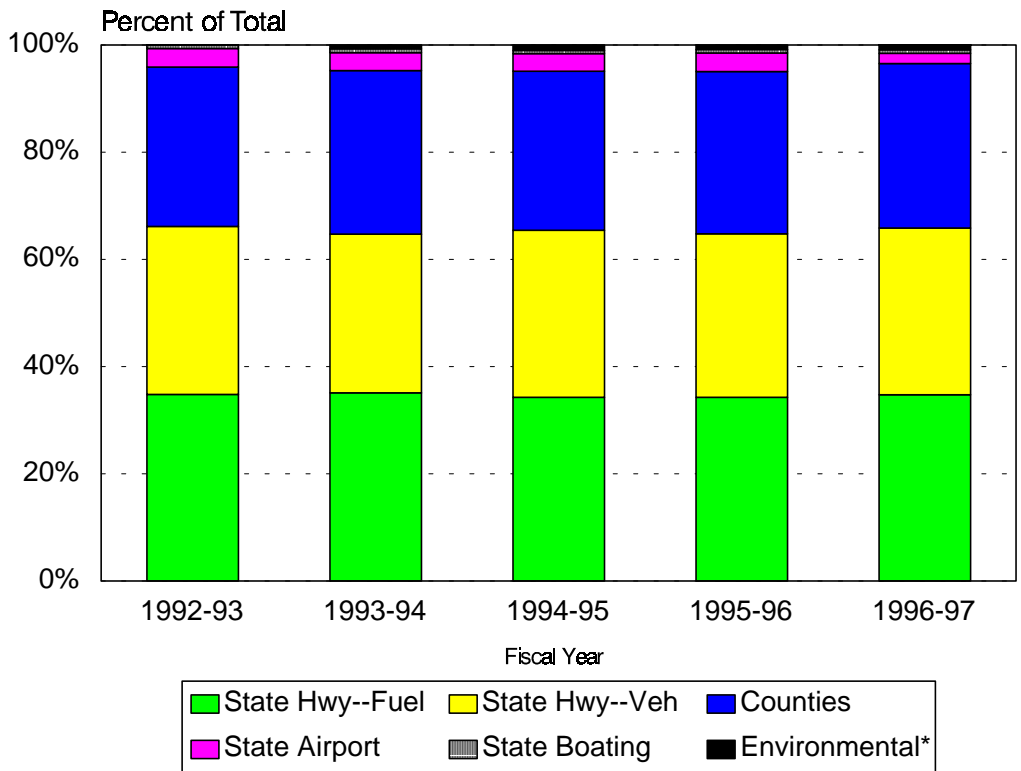
NOTE: Due to rounding, detail may not add to totals.

Revenues generated by state fuel taxes and allocated to the state highway fund rose 1.3% to \$69.9 million. Collections from both the state motor vehicle weight tax and registration fees and the rental vehicle surcharge tax added another \$62.6 million, bringing the total state highway fund to \$132.5 million, up 1.5% from \$130.5 million the preceding year.

Because bonded fuel sold to air carriers flying foreign routes is no longer subject to the aviation fuel tax, revenue to the state airport fund tumbled from \$7.0 million to \$3.9 million. An environmental response tax of 5¢ is levied on each barrel of petroleum products sold by a distributor to any retail dealer or end user, other than a refiner of petroleum products. The tax, which totaled \$1.8 million in fiscal year 1997, is deposited into a special fund administered by the Department of Health for its oil spill prevention and remediation programs. Excluding the aviation fuel tax, 3/4 of 1% of all state and county fuel taxes collected are deposited into the boating special fund. Transfers to the fund remained nearly unchanged at \$1.3 million.

The department collects the fuel taxes for both the state and counties. Accruals to the county highway funds increased in varying degrees for all counties except the county of Kauai. Transfers to the counties amounted to \$61.7 million compared to the preceding year's \$60.9 million.

Distribution of Fuel Tax Collections by Type of Fund



*Effective July 1, 1993

ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

	<u>FY 1997</u>	<u>FY 1996</u>	<u>Difference</u>
STATE HIGHWAY FUND:			
Gasoline	\$ 63,208	\$ 62,961	\$ 247
Diesel Oil - Non-highway	1,644	1,484	160
Diesel Oil - Highway	4,954	4,484	470
Liq. Pet. Gas - Off Highway	34	32	2
Liq. Pet. Gas - Highway	<u>40</u>	<u>49</u>	<u>(9)</u>
Subtotal	\$ 69,881	\$ 69,010	\$ 870
Motor Vehicle Weight Tax/Reg. Fees	40,021	39,543	478
Rental Vehicle Surcharge Tax/Fees	<u>22,601</u>	<u>21,951</u>	<u>650</u>
TOTAL	<u>\$ 132,502</u>	<u>\$ 130,504</u>	<u>\$ 1,998</u>
COUNTY HIGHWAY FUNDS:			
City & County of Honolulu	\$ 46,227	\$ 45,989	\$ 237
County of Maui	7,215	6,792	423
County of Hawaii	5,855	5,706	149
County of Kauai	<u>2,404</u>	<u>2,423</u>	<u>(20)</u>
TOTAL	<u>\$ 61,700</u>	<u>\$ 60,911</u>	<u>\$ 789</u>
BOATING SPECIAL FUND	<u>\$ 1,329</u>	<u>\$ 1,312</u>	<u>\$ 17</u>
STATE AIRPORT FUND:			
Aviation Fuel	<u>\$ 3,927</u>	<u>\$ 7,033</u>	<u>\$(3,107)</u>
ENVIRONMENTAL TAX FUND	<u>\$ 1,781</u>	<u>\$ 1,669</u>	<u>\$ 112</u>

State fuel tax rates are set by the state legislature while the county councils set the county rates. The effective rates for fiscal year 1997 are summarized below:

FUEL TAX RATES PER GALLON ¹			
	<u>State</u>	<u>County</u>	<u>Total</u>
GASOLINE AND DIESEL OIL (HWY. USE): ²			
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui ³	16.0¢	13.0¢	29.0¢
County of Hawaii	16.0¢	8.8¢	24.8¢
County of Kauai	16.0¢	10.0¢	26.0¢
LIQUID PETROLEUM GAS (HWY. USE):			
City & County of Honolulu	11.0¢	11.0¢	22.0¢
County of Maui ³	11.0¢	9.0¢	20.0¢
County of Hawaii	11.0¢	6.0¢	17.0¢
County of Kauai	11.0¢	7.0¢	18.0¢
ENVIRONMENTAL RESPONSE TAX (per barrel) ⁴			
All Counties	5.0¢	-	5.0¢

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

²Includes 1¢ state license tax on diesel oil.

³Maui County tax rates effective August 1, 1995.

⁴Effective July 1, 1993.

PUBLIC SERVICE COMPANY TAXES

Public service company taxes paid by public utilities and motor carriers-contract carriers increased 9.8% to \$113.9 million. Collections from public utilities rose \$9.6 million from \$88.7 million to \$98.3 million and revenues from motor carriers-contract carriers advanced 3.0% to \$15.5 million.

PUBLIC SERVICE COMPANY TAXES (In Thousands of Dollars)

	<u>FY 1997</u>	<u>FY 1996</u>	<u>Av. Annual Change (Percent)</u>	
			<u>1996-97</u>	<u>1993-97</u>
Public Service Company Taxes	\$113,871	\$103,777	9.7	6.8
Penalty & Interest	<u>493</u>	<u>353</u>	<u>39.6</u>	<u>36.7</u>
TOTAL	<u>\$114,364</u>	<u>\$104,131</u>	<u>9.8</u>	<u>6.8</u>

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

INHERITANCE AND ESTATE TAXES

The number of estates settled in fiscal year 1997 dropped 6.2% to 1,996 and the number of taxable estates fell 30.4% from 431 to 300 estates. However, reflecting the large values of some estates, the amount of taxes collected rose 19.5% to \$19.9 million. In addition, penalty and interest incurred by some large estates contributed to the \$1.3 million increase to \$2.2 million.

Estates of persons who passed away before June 30, 1983, are subject to the inheritance tax. After June 30, 1983, a Hawaii estate tax is imposed only if the estate is subject to the federal estate tax.

INHERITANCE AND ESTATE TAXES (In Thousands of Dollars)

	<u>FY 1997</u>	<u>FY 1996</u>	<u>Av. Annual Change (Percent)</u>	
			<u>1996-97</u>	<u>1993-97</u>
Estate Tax	\$ 19,930	\$ 16,681	19.5	16.9
Penalty & Interest	<u>2,239</u>	<u>859</u>	<u>160.6</u>	<u>290.8</u>
TOTAL	<u>\$ 22,169</u>	<u>\$ 17,540</u>	<u>26.4</u>	<u>20.4</u>

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

OTHER TAXES

As presented in the tabulation below, combined revenues from various miscellaneous sources dropped 7.8% to \$314.0 million. Refund of prior years' taxes resulting from net operating losses contributed to the drop in collections from banks and other financial corporations. Employment security contributions, which are realizations to the unemployment trust fund administered by the Department of Labor and Industrial Relations and collected by the Department of Taxation, slipped 7.4% from \$183.5 million to \$170.0 million.

A positive note is the 5.9% increase in conveyance tax revenues collected by the Department of Land and Natural Resources. This tax is levied on documents transferring ownership or interest in real property and the moderate revenue increase suggests a slight increase in real estate activity.

MISCELLANEOUS TAXES (In Thousands of Dollars)

	<u>FY 1997</u>	<u>FY 1996</u>	<u>Av. Annual Change (Percent)</u>	
			<u>1996-97</u>	<u>1993-97</u>
Banks & Other Financial Corp.	\$ 9,731	\$ 17,109	-43.1	- 0.3
Conveyance*	3,003	2,835	5.9	-12.3
Empl. Security Contributions	169,984	183,526	-7.4	24.6
Insurance Premiums	55,847	59,164	- 5.6	6.5
Liquor & Permits	38,347	37,811	1.4	- 1.5
Tobacco & Licenses	36,427	39,572	-7.9	8.7
General Excise Licenses & Fees	633	685	- 7.6	- 3.2
TOTAL	<u>\$ 313,972</u>	<u>\$ 340,701</u>	<u>-7.8</u>	<u>9.4</u>

*Includes allocation to "Rental Housing Fund" and "Natural Area Reserves Fund"
NOTE: Due to rounding, detail may not add to totals.

COLLECTION AND ACCOUNTING OF TAXES

TAX COLLECTIONS

Net tax collections by the department, excluding taxes collected by other state and county agencies, totaled \$3,169.5 million, a scant 0.4% more than the \$3,158.0 million in fiscal year 1996. Taxes collected by other agencies include \$3.0 million in conveyance tax, \$55.8 million in insurance premium tax, and \$40.0 million in state vehicle weight tax and registration fees. The conveyance tax is collected by the Department of Land and Natural Resources and the state vehicle weight and registration fees are collected by the counties and turned over to the State Director of Finance for deposit into the state highway fund.

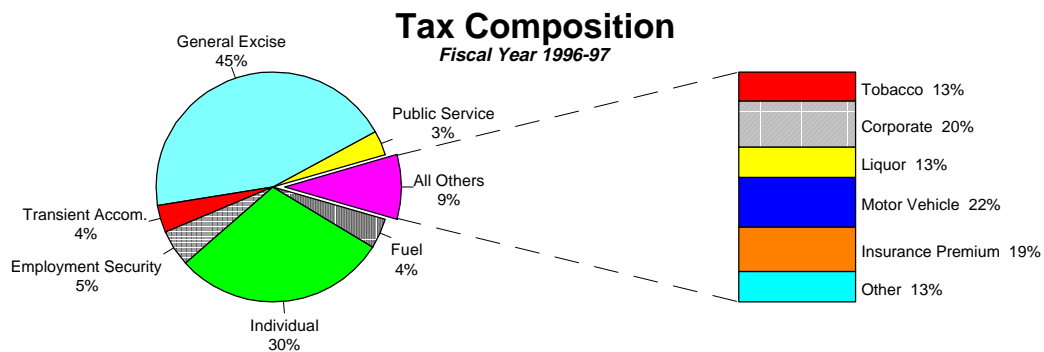
TAX COLLECTIONS

SOURCE OF REVENUE	FY 1997		FY 1996	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 9,730,590	0.30%	\$ 17,108,600	0.52%
Conveyance	6,006,707	0.18%	5,669,074	0.17%
Employment Security Contributions	169,983,877	5.20%	183,526,023	5.63%
Fuel	138,617,851	4.24%	139,936,366	4.29%
General Excise & Use	1,457,274,037	44.54%	1,431,801,812	43.89%
Income - Corporations	57,839,460	1.77%	48,438,414	1.48%
Income - Individuals	976,311,103	29.84%	999,928,324	30.65%
Inheritance and Estate	22,169,104	0.68%	17,540,096	0.54%
Insurance Premiums	55,846,717	1.71%	59,164,180	1.81%
Liquor & Permits	38,347,177	1.17%	37,810,985	1.16%
Motor Vehicle Tax*	62,621,240	1.91%	61,494,048	1.88%
Public Service Companies	114,364,015	3.50%	104,130,810	3.19%
Tobacco & Licenses	36,427,347	1.11%	39,571,941	1.21%
Trans. Accom. Fees	5,594	0.00%	6,215	0.00%
Trans. Accom. Tax	125,455,218	3.83%	115,740,954	3.55%
All Others	641,211	0.02%	686,446	0.02%
TOTAL	\$ 3,271,641,248	100.00%	\$ 3,262,554,288	100.00%

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

The state general fund's share of the taxes collected by the state and county agencies amounted to \$2,771.9 million, or 84.7% of the total; the counties received \$161.0 million, or 4.9%. The remaining 10.4% accrued to the state special funds; among the major ones, the highway, airport, and unemployment trust funds.

Shown below is a comparative summary of the distribution of tax collections to the various state funds and the transfers to the counties.



DISTRIBUTION OF COLLECTIONS

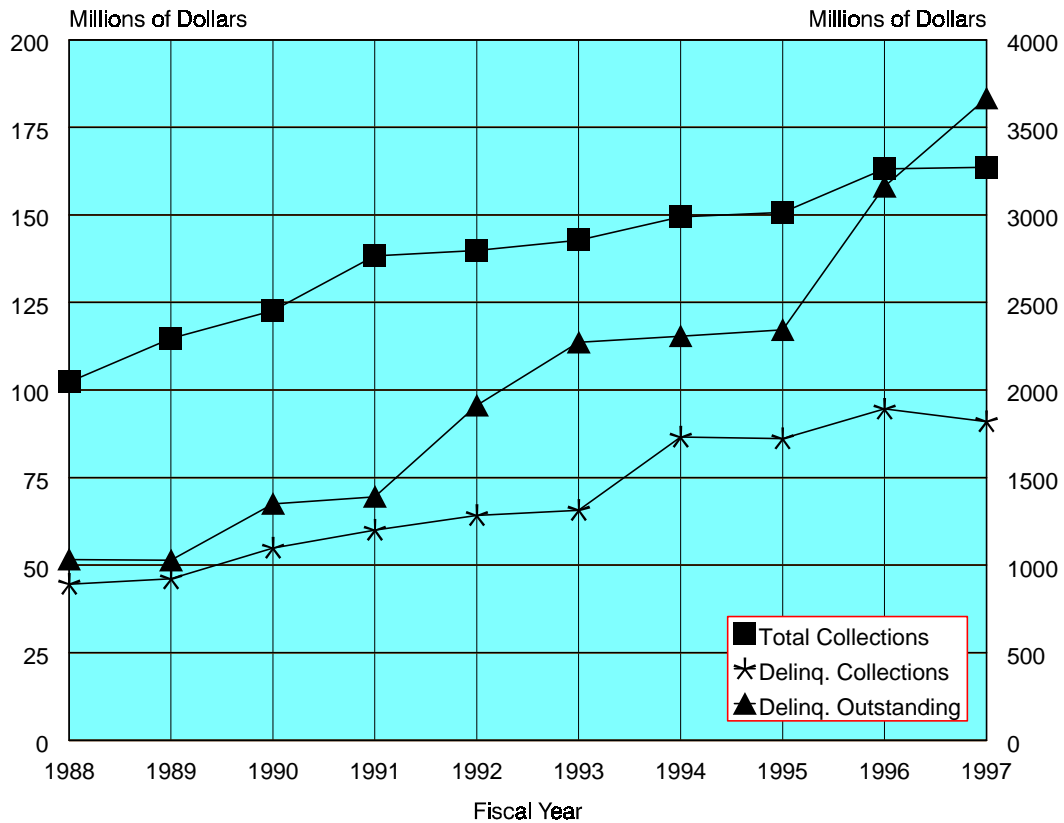
	FY 1997		FY 1996	
	Amount Distributed	% of Total	Amount Distributed	% of Total
STATE FUNDS:				
State General	\$ 2,771,881,205	84.72%	\$ 2,758,541,260	84.55%
State Highway	132,501,879	4.05%	130,504,377	4.00%
State Airport	3,926,523	0.12%	7,033,261	0.22%
Boating Special Fund	1,329,101	0.04%	1,312,338	0.04%
Environmental Fund	1,781,222	0.05%	1,669,354	0.05%
Bond Reserve Fund	5,000,000	0.15%	5,000,000	0.15%
Unemployment Trust	169,983,877	5.20%	183,526,023	5.63%
Election Campaign Fund	305,804	0.01%	303,640	0.01%
Rental Housing Fund	1,501,677	0.05%	1,417,269	0.04%
Natural Area Reserve Fund	1,501,677	0.05%	1,417,269	0.04%
Convention Center Fund	<u>20,909,203</u>	<u>0.64%</u>	<u>19,290,159</u>	<u>0.59%</u>
Subtotal - State	\$ 3,110,622,168	95.08%	\$ 3,110,014,950	95.32%
COUNTY REVENUES:				
Fuel	61,700,365	1.89%	60,911,085	1.87%
Trans. Accom. Tax	<u>99,318,714</u>	<u>3.04%</u>	<u>91,628,256</u>	<u>2.81%</u>
Subtotal - Counties	\$ 161,019,079	4.92%	\$ 152,539,341	4.68%
TOTAL	<u>\$ 3,271,641,247</u>	<u>100.00%</u>	<u>\$ 3,262,554,291</u>	<u>100.00%</u>

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

DELINQUENT TAXES

Efforts to abate the rising number of delinquent accounts were stalled by new referrals which outpaced the accounts closed. Although 54,620 accounts were closed, new referrals numbered 61,531 so that the number of outstanding accounts at the end of the year was 6,911 more than the 40,811 which was carried over from the preceding year. The amount of delinquencies outstanding at the end of the year increased 15.9%, closing the year at \$183.3 million compared to \$158.1 million in fiscal year 1996.

Delinquent Taxes Collected and Outstanding



*Use right scale for total collections

Despite the growing number of delinquent accounts, the average outstanding delinquent amount slipped slightly from \$3,873 in fiscal 1996 to \$3,841. Department collectors aggressively pursued larger accounts which resulted in average collections improving by 30.2% from \$1,452 to \$1,891 in fiscal year 1997.

BRIEF SUMMARY OF HAWAII'S TAX SYSTEM

Two notable characteristics of Hawaii's tax structure are the high degree of centralization at the state level and the comprehensive utilization of revenue sources. The general excise tax continues to be the major source of the state's general fund tax revenue, followed by the individual income tax.

Qualified residents may claim the food, renter's, dependent care, energy, capital goods excise, child passenger restraint and nursing facility tax credits. The food tax credit is equal to \$27 per qualifying exemption. Taxpayers with AGI under \$30,000 and rental expenses of \$1,000 or more may claim a \$50 credit per exemption (plus an extra exemption for elderly taxpayers). Taxpayers may also claim a credit for dependent care, energy device purchase and installation, child passenger restraint (car seat), and nursing facility expenses. The mandated general income tax credit was not available this year because general fund year-end balances did not exceed 5% of general fund revenues for two successive fiscal years.

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

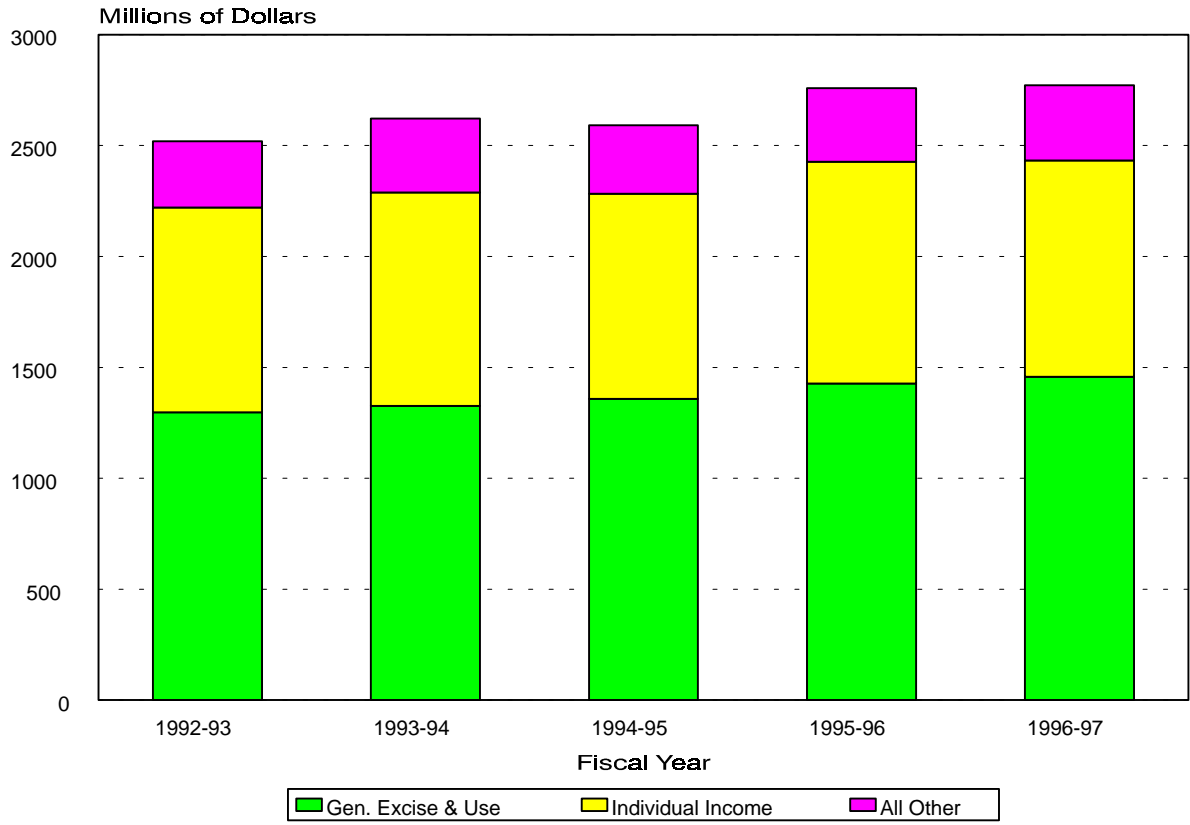
Revenues from eleven of the state-administered taxes go into the state's general fund and are used to provide government services, including the educational system which is a state function in Hawaii. Although the fuel tax is administered by the state, it is a source of revenue for both the state and county highway funds. The employment security tax is a dedicated tax, used exclusively to provide benefits to covered unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the state highway fund. Revenue from the nursing facility tax is deposited into the health care revolving fund.

STATE GENERAL FUND

SOURCE OF REVENUE	FY 1997		FY 1996	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks - Financial Corps.	\$ 9,730,590	0.35%	\$ 17,108,600	0.62%
Conveyance	3,003,353	0.11%	2,834,536	0.10%
General Excise & Use	1,452,274,037	52.39%	1,426,801,812	51.72%
Income - Corporations	57,839,460	2.09%	48,438,414	1.76%
Income - Individuals	976,005,299	35.21%	999,624,684	36.24%
Inheritance & Estate	22,169,104	0.80%	17,540,096	0.64%
Insurance Premiums	55,846,717	2.01%	59,164,180	2.14%
Liquor & Licenses	38,347,177	1.38%	37,810,985	1.37%
Public Service Companies	114,364,015	4.13%	104,130,810	3.77%
Tobacco & Licenses	36,427,347	1.31%	39,571,941	1.43%
Trans. Accom. Fees	5,594	0.00%	6,215	0.00%
Trans. Accom. Tax	5,227,301	0.19%	4,822,539	0.17%
All Others	641,211	0.02%	686,446	0.02%
TOTAL	<u>\$ 2,771,881,205</u>	<u>100.00%</u>	<u>\$ 2,758,541,258</u>	<u>100.00%</u>

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

Trends in General Fund Revenue



OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 1997

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(1) Net Income</p> <p>Chapter 235 — Section 235-1 to 235-130</p>	<p>Tax rates for individuals as well as estates and trusts range from 2.0% to 10.0% of taxable income. The allowable standard deduction amounts vary by filing status. The standard deduction amount for married filing joint return or surviving spouse with dependent child is \$1,900; single is \$1,500; head of household is \$1,650; and married filing separately is \$950. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000.</p>	<p>Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$1,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. For employers whose liability for taxes withheld exceeds \$100,000 a year, withholding returns due monthly on or before the 10th day of the following calendar month. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.</p>	<p>In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th.</p>
<p>(2) Estate and Transfer (for decedents dying after 6/30/83)</p> <p>Chapter 236D — Section 236D-1 to 236D-18</p>	<p>Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For nonresident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions.</p> <p>For generation-skipping transfers after June 30, 1994, a tax in an amount equal to the federal credit is imposed on every generation-skipping transfer of (1) property located in Hawaii and (2) property from a resident trust.</p>	<p>Report (Form M-6) must be filed by person responsible for filing federal Estate Tax Return (federal Form 706). No report required and no tax due when federal Form 706 not required. To obtain release of property, file Request for Release (Form M-6A).</p> <p>Report (Form M-6GS) must be filed by person responsible for filing Generation-Skipping Transfer Tax Return for Distributions (federal Form 706GS(D)) or Generation-Skipping Transfer Tax Return for Terminations (federal Form 706GS(T)).</p>	<p>On or before the due date for filing federal Form 706, including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p> <p>On or before the due date for filing federal Form 706GS(D) or 706GS(T), including extensions of time; provided extension is submitted to Hawaii within 30 days of issuance.</p>
<p>(3) General Excise (Gross Income)</p> <p>Chapter 237 — Section 237-1 to 237-49</p>	<p>This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 1/2 of 1% on wholesaling and intermediary services, producing, manufacturing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at .15%. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>
<p>(4) Transient Accommodations Tax</p> <p>Chapter 237D — Section 237D-1 to 237D-16</p>	<p>This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 6%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units.</p>	<p>Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.</p>	<p>At time of filing returns.</p>

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(5) Use Chapter 238 — Section 238-1 to 238-16	This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: 1/2 of 1%, if for resale at retail; 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.	At time of filing returns.
(6) Public Service Company Chapter 239 — Section 239-1 to 239-11	Nature of Tax—(1) Public utility business in lieu of general excise and real property taxes. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, 1/2 of 1%. (iii) All other revenues: If ratio of net to gross income is 15% or less, 5.885%; for each 1% increase in ratio of net to gross, rate increase .2675%. (2) Motor carrier, common carrier by water and contract carrier business (other than motor carrier business) in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from motor carrier, common carrier by water and contract carrier business for preceding calendar year. For exception, see sections 239-9 and 239-11. (b) Rate: 4% of gross income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations Chapter 241 — Section 241-1 to 241-7	(1)(a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. Specific exempt activities are enumerated under chapter 237. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 1¢ per gallon on aviation fuel; an initial 1¢ per gallon on diesel oil, liquefied petroleum gas for operation of an internal combustion engine and from 24.8¢ to 32.5¢ per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 24.8¢ to 32.5¢ per gallon on diesel oil and from 17¢ to 22¢ per gallon on liquefied petroleum gas used to operate motor vehicles upon the public highways, however, they are not required to pay these additional taxes if purchasers furnish Exemption Certificates, Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways or diesel oil and liquefied petroleum gas used for motor vehicles not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5¢ per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon “dealers” as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. Act 89, SLH 1994, increases the liquor tax rate each fiscal year from July 1, 1995, to July 1, 1998, for the 6 liquor categories by 1% on distilled spirits and 1.25% for the remaining categories of liquor. The liquor tax rate adjustment provision is repealed. For the period beginning July 1, 1997, to June 30, 1998, the tax rates per wine gallon are \$5.92 on distilled spirits, \$2.09 on sparkling wine, \$1.36 on still wine, \$.84 on cooler beverages, \$.92 on beer other than draft beer, and \$.53 on draft beer.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(10) Cigarette and Tobacco Chapter 245 — Section 245-1 to 245-15	“Wholesalers” as defined in the law and certain others must pay an excise tax on sale or use of tobacco products, equal to 40% of the wholesale price, and a fixed tax rate of 3¢ on each cigarette. Act 331, SLH 1997, increases the cigarette tax from 3¢ to 4¢ per cigarette after August 31, 1997; and 5¢ per cigarette after June 30, 1998. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year.	Returns filed on or before the last day of the following calendar month.	At time of filing returns.
(11) Conveyance Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property. The rate is 10¢ per \$100 of the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction. (Documents of certain conveyances are exempted.)	A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.	At time of filing the certificate, but no later than 90 days after the taxable transaction.
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax Chapter 251 — Section 251-1 to 251-15	There is a rental motor vehicle surcharge tax of \$2 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$1,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
<p>(13) Unemployment Insurance</p> <p>Chapter 383 — Section 383-1 to 383-176</p>	<p>This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.40%.</p> <p>There is a .05% employment and training fund assessment on taxable wages paid to all employees by employing units with contribution rates greater than 0.00% but less than 5.40%. Act 194, SLH 1997, temporarily suspended this assessment from July 1, 1997 through December 31, 1998.</p>	<p>Returns filed on or before the last day of the month following the taxable quarter.</p>	<p>At time of filing returns.</p>
<p>(14) Insurance Premiums</p> <p>Chapter 431 — Section 431:7-201 to 431:7-207</p>	<p>Tax on insurance companies (Underwriters) based on premiums received in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.</p>	<p>Monthly/Quarterly interim statement is due on or before the last day of the calendar month following the month/quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.</p>	<p>At time of filing statements.</p>

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