

# **BIA-HAWAII**

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*"Building Hawaii's Future Today"*

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August 3, 2011

Mr. Randall Iwase, Chair  
2010-2012 Tax Review Commission  
Hawaii State Department of Taxation  
Via email: [Titin.L.Sakata@hawaii.gov](mailto:Titin.L.Sakata@hawaii.gov)

**RE: Communication on Fiscal and Construction Industry Impact of Act 105**

Dear Chair Iwase and Members of the Tax Review Commission,

I am Karen Nakamura, Executive Vice President and Chief Executive Officer of the Building Industry Association of Hawaii (BIA-Hawaii). Chartered in 1955, the Building Industry Association of Hawaii is a professional trade organization affiliated with the National Association of Home Builders, representing the building industry and its associates. BIA-Hawaii's mission is to develop resources and expertise in the construction industry in Hawaii to enhance the quality of life for the people of Hawaii through promotion of best practices in construction tailored to the needs and constraints of our home state.

BIA-Hawaii recognizes the important role the Tax Review Commission plays in the development of tax policy in Hawaii. The Commission's reports often frame the discussion and debate within the Legislature, as well as among the people of the State of Hawaii, on tax issues. Because of the very important role played by the Commission, BIA-Hawaii would like to raise an issue which calls into the question the fairness of the existing tax structure.

Session Laws of Hawaii of 2011 Act 105 (Act 105) was passed into law prior to the convening of the current Tax Review Commission and without the Commission's input. Of important, Act 105 temporarily suspended "*Amounts deducted from the gross income received by 4 contractors as described under section 237-13 (3) (B).*" Exempted from this law were construction contracts executed prior to July 1, 2011, which do not allow for the contractor to pass the cost of tax increases on to the project's owner.

Due to the pyramiding effect of the general excise tax, Act 105 effectively creates a distortion in the marketplace which disfavors smaller contractors and creates disincentives against the hiring of independent subcontractors. This is not fair for the construction industry and disproportionately impacts smaller local construction business.

Smaller contractors are likely to use independent subcontractors for a higher proportion of a project than larger contractors, who are more likely to directly employ skilled tradesmen. Below is an illustration of this disparate impact created by Act 105. In this hypothetical, Contractor 1 is a larger contractor which employs many of its own tradesmen and, therefore, utilizes fewer independent subcontractors. Contractor 2 is a smaller contractor which hires independent subcontractors more frequently.

	<b>Contractor 1 Larger contractor (uses subcontractors for 50% on the contract work)</b>		<b>Contractor 2 Smaller contractor (uses subcontractors for 80% on the contract work)</b>	
	<b>Before Act 105</b>	<b>After Act 105</b>	<b>Before Act 105</b>	<b>After Act 105</b>
Total Construction Cost Pre-Tax (Incl. Subcontractors)	100,000.00	100,000.00	100,000.00	100,000.00
Subcontracted Portion	50,000.00	50,000.00	80,000.00	80,000.00
GE Tax Paid by General Contractor (assuming 4% rate)	2,000.00	4,000.00	800.00	4,000.00
GE Tax Paid by Subcontractors (assuming 4% rate)	2,000.00	2,000.00	3,200.00	3,200.00
Total GE Tax Rate Paid for \$100,000.00 Job	4,000.00	6,000.00	4,000.00	7,200.00
Effective GET Rate on project	4.0%	6.0%	4.0%	7.2%
Percentage Increase in tax paid by General Contractor	-	100%	-	400%

The hypothetical illustrates how Act 105 imposes a greater GET tax increase on the smaller contractor who utilizes independent subcontractors more frequently. The effective tax rate on the project, if built by the smaller contractor, is 20% higher than the effective rate on the project built by the larger contractor. Furthermore, the effective GET increase on the smaller contractor is four times that of the larger contractor.

Furthermore, larger subcontractors who have better access to legal and accounting consultants will likely be able to utilize entities such as LLC's and limited partnerships to further minimize the impact of Act 105 on their competitiveness in this very challenging construction market.

This disparity raises the question: what justification can there be to impose a higher effective tax rate on a small business simply because it is small?

BIA-Hawaii respectfully request that the Commission review Act 105's suspension of the GET exemption for payments to subcontractors not simply because it is inherently unfair to the construction industry and imposes a further drag on Hawaii's economy, but because of its disparate impact on small business.

BIA-Hawaii is working to collect data from its members as the impact of Act 105 unfolds and welcomes the Tax Review Commission's input on the scope and methods of data gathering so that it may serve to advance the Commission's review.

Thank you for the opportunity to submit our comments. BIA-Hawaii looks forward to working with the Commission and hopes to be of service in its deliberations.

Sincerely,

A handwritten signature in black ink that reads "Karen T. Nakamura". The signature is written in a cursive, flowing style.

Karen T. Nakamura  
EVP/CEO  
BIA-Hawaii