

Hawaii Tax Developments



updated: August 12, 2009

A large sea turtle is swimming in the center of the frame, its head and front flippers visible. In the background, another smaller sea turtle is visible swimming away. The water is a clear, light blue.

Presented By Accuity LLP

Tom Yamachika, Principal

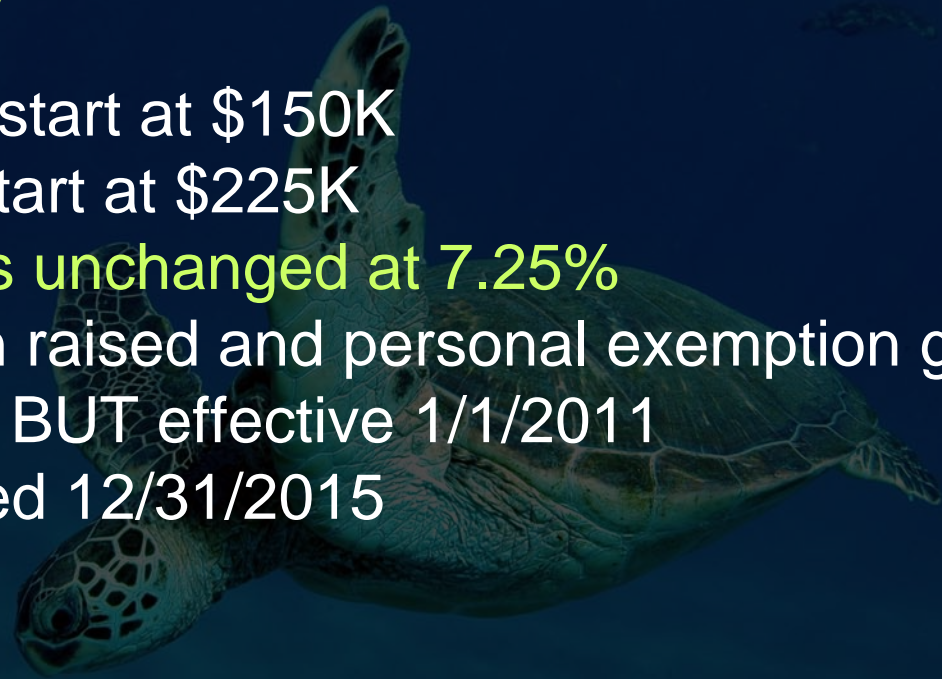
Pursuant to the provisions of Treasury Circular 230 and comparable State law, any tax advice contained in this presentation is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or any comparable state law, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

- **Higher Taxes**

- “Temporary” ?!?!
 - Most States Doing Same Thing
 - It’s Law Now, and We Need to Deal With It

- **More Action to Come**

- COR May 28th – Forecast –9%, Down From –5%
 - \$185 Million Hole
 - COR Next Meets on Aug 27th

- New Rates effective 1/1/2009 – **We Are Now #1!**
 - \$300K-\$350K (MFJ) at 9%
 - \$350K-\$400K at 10%
 - \$400K+ at 11%
 - Single – new rates start at \$150K
 - HOH – new rates start at \$225K
 - **Capital gains rate is unchanged at 7.25%**
 - Standard deduction raised and personal exemption goes up (\$1040 to \$1144) – BUT effective 1/1/2011
 - Entire bill is repealed 12/31/2015
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• Important Takeaways!

- Estimates not based on 100% PY must be redone
- No penalty for payments due before 8/6/2009 if the ONLY reason for underpayment was the tax increase (Announcement 2009-4)
- 3Q and 4Q estimates (due Sept. and Jan.) must consider the new rates (also affected by personal exemption phaseout in Sp. Sess. Act 14)
- We do not expect the programming on DOTAX computers to change so if you get penalty notices be prepared to argue
- This does not affect the 90% Rule on extensions
 - Extension will be revoked if 90% of tax due is not paid in by 4/20/2010

- New Rates effective 7/1/2009
 - Top rate on single-family or condo unit ineligible for H/O exemption
 - Was 35 basis points
 - Now 125 basis points for Actual and Full Consideration > \$10M
 - Top rate on all other property (owner occupant + commercial)
 - Was 30 basis points
 - Now 100 basis points for AFC > \$10M
- **“Cliff” application – if you hit a higher bracket the highest rate is applied to the WHOLE amount**
 - Investor property selling for \$3,999,999
 - Tax is ~\$24,000
 - Investor property selling for \$4,000,000
 - Tax is \$34,000

Transient Accommodations Tax Increase (Act 61)

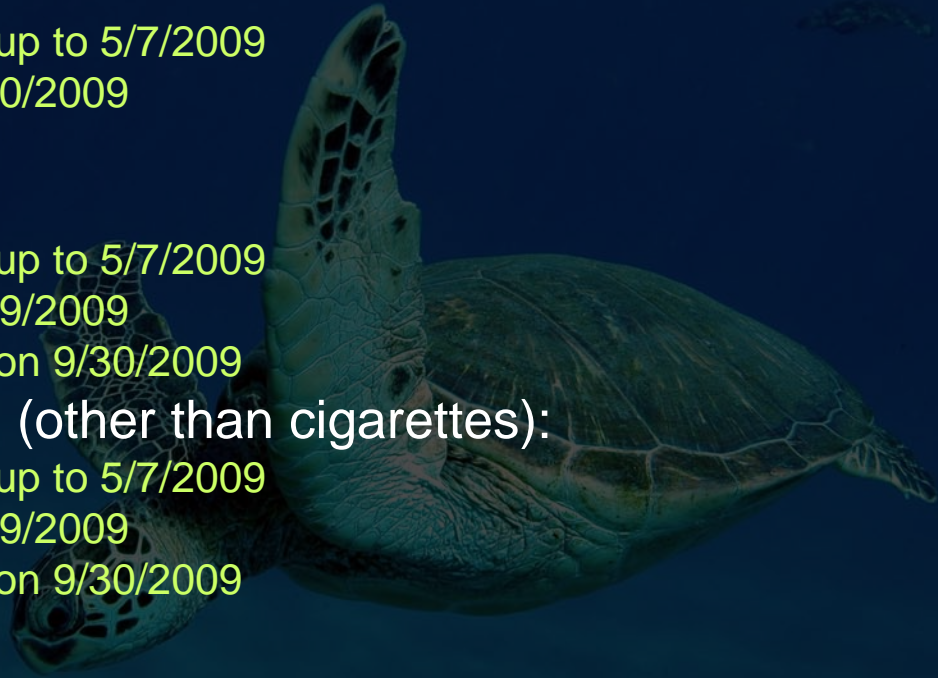
- Effective 7/1/2009: 8.25%
- Effective 7/1/2010: 9.25%
- Theoretically this ends on 6/30/2015
 - But the TAT itself was intended to be temporary and it was enacted in 1986.
- Transient Occupancy Tax (TOT) is unchanged at 7.25%
- Note: Announcement 2009-24 has been issued – the new rates apply regardless of what the form says; new forms have been issued

Tobacco Tax Increases (Acts 56 and 58)

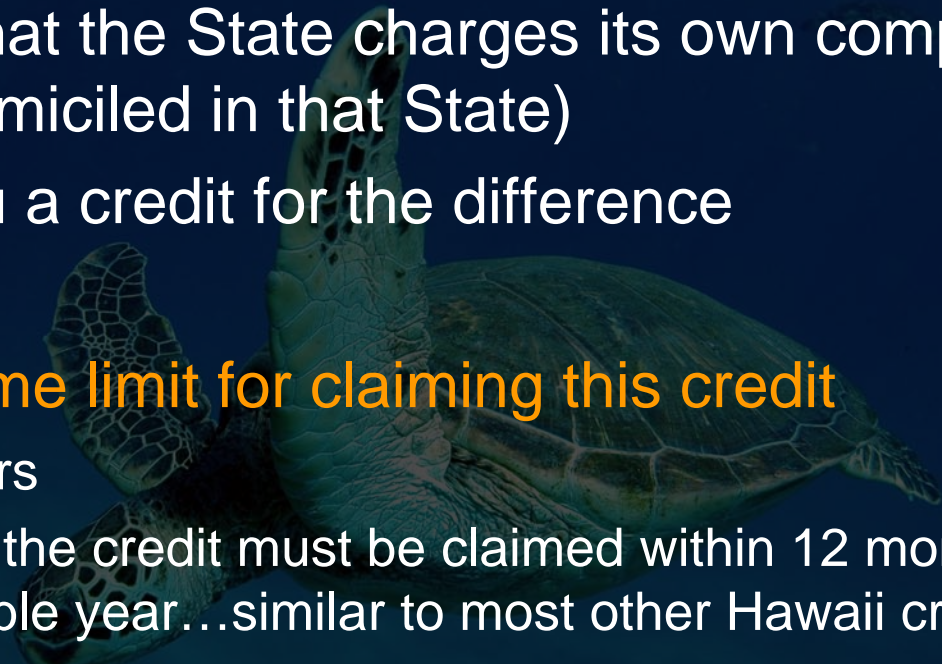
- Cigarettes under current law:
 - 10¢ per stick now
 - 11¢ on 9/30/2009
 - 12¢ on 9/30/2010
 - 13¢ on 9/30/2011
- Under new law:
 - 13¢ per stick on 7/1/2009
 - 14¢ per stick on 7/1/2010
 - 15¢ per stick on 7/1/2011
- “Little cigars” are now taxed as cigarettes.
- Other tobacco products:
 - Currently taxed at 40% of wholesale price
 - Increases to 70% of wholesale price eff. 9/30/2009
 - Cigars taxed at 50% of wholesale price eff. 9/30/2009
- Transition issues!
 - The repeal of the OLD rate is effective immediately
 - The NEW rate has an effective date
 - Does this mean that there is a period for which there is no tax?


Tobacco Tax Increases (Acts 56 and 58)

- Transition Issues Resolved (Announcement 2009-5):
- “Little Cigars”
 - 40% of wholesale price up to 5/7/2009
 - NO TAX 5/8/2009 to 9/30/2009
 - 11¢ on 10/1/2009
- Cigars
 - 40% of wholesale price up to 5/7/2009
 - NO TAX 5/8/2009 to 9/29/2009
 - 50% of wholesale price on 9/30/2009
- Other tobacco products (other than cigarettes):
 - 40% of wholesale price up to 5/7/2009
 - NO TAX 5/8/2009 to 9/29/2009
 - 70% of wholesale price on 9/30/2009



- If you owe them, you pay 8% (no change)
- If they owe you, they pay 4% (used to be 8%)
- Effective for refund claims made on or after 1/1/2009
- **Make sure the correct taxpayer is filing returns!**
 - Doctor creates Professional Corporation
 - Doctor forgets to tell insurers that the Corp. has been formed
 - Doctor reports income for GET purposes under Corp.
 - DOTAX gets 1099-MISC with Doctor's SSN (instead of corporation's FEIN)
 - DOTAX issues assessment against Doctor for unpaid GET, with massive penalties
 - It may have been a "wash" before, but isn't now!

- If you are incorporated or domiciled in Hawaii
 - If you are exposed to another State's premium tax and that tax is more than what the State charges its own companies (incorporated or domiciled in that State)
 - Hawaii will give you a credit for the difference
 - **Act concerns the time limit for claiming this credit**
 - Formerly three years
 - Effective 7/1/2009, the credit must be claimed within 12 months after the end of the taxable year...similar to most other Hawaii credits
 - For CY 2007 or CY 2006, any claims needed to be in the door by 6/30/2009
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- Environmental Response Tax hiked to \$1.05 per barrel of oil (was \$0.05)
 - Former draft preserved the GET exemption for ethanol blended fuel.
 - That went away...
 - GET exemption expires 6/30/2009
 - Effective 7/1/2009
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- QHTB Investment Credit for investments 5/1/2009+
 - Mandatory 1:1 (no special allocations, no 2:1)
 - Mandatory 35-25-20-10-10 (no front loading)
 - Cannot offset more than 80% of liability
 - No carryover
 - Ann. 2009-23 Ex. 3: 5/1/2009+ investment credits are used first
 - Applies to Income, Franchise, and Premium Taxes
- Wired Credit for expenditures 5/1/2009+
 - Cannot offset more than 80% of liability
- Capital Goods Excise Tax Credit for property P/I/S 2009
 - No Credit for property P/I/S 5/1/2009+
 - Ann. 2009-23: Property P/I/S 1/1/2009-4/30/2009 is still eligible

- Preparer penalties (similar to IRC §6694)
- Penalties for promoting abusive tax shelter (~IRC §6700)
- Penalties for erroneous claims for refunds or credits (~IRC §6676)
- Additional penalty of 20% for substantial understatement
- Six year statute of limitations on assessment when there is a substantial omission
- No need to have court pre-determine falsity or fraud for unlimited statute of limitations on assessment of tax; but burden of proof on State
- Department of Taxation authorized to undertake temporary rulemaking; rules to be effective for 18 months
- Failure to withhold is a criminal offense (class C felony)
- **New 15 year collection statute of limitations for most tax types; previously unlimited**

- DOTAX to implement an Appeals-type program
- DOTAX must adopt rules providing examples and safe harbors to explain new penalty provisions
- Tax advice shall be disclosed to the public (~IRC §6110) – seems to override existing statute (HRS §231-19.5)
- DOTAX must provide a taxpayer with a closing audit letter at the conclusion of a tax audit

Note: white provisions (previous page) were asked for by Department of Taxation. Green provisions (both pages) were added by the Legislature.

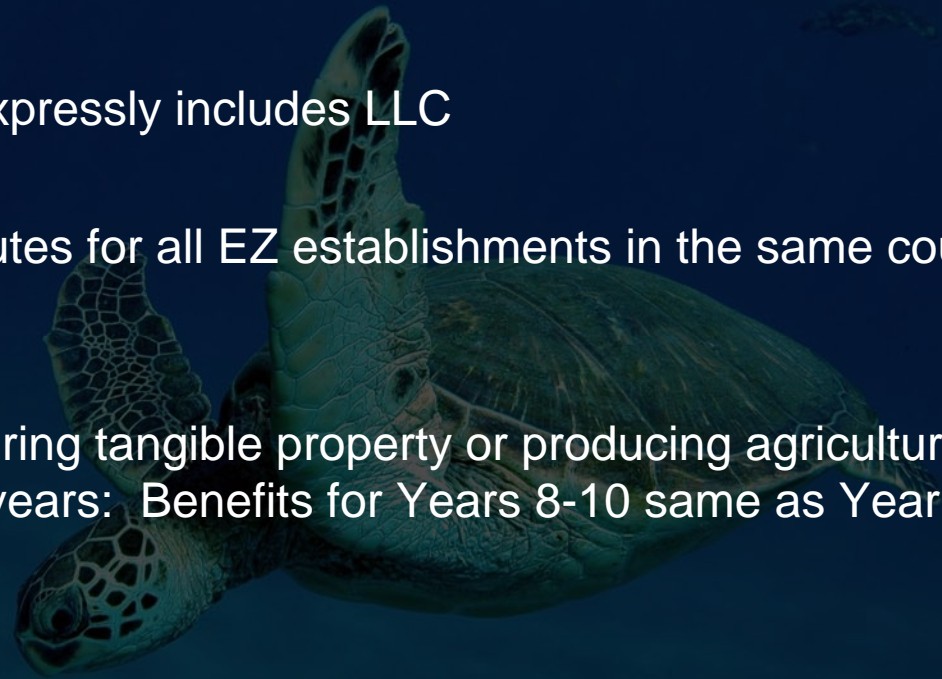
- No surprises
- Although a previous draft attacked the exemption for pensions > \$50K, pensions are spared this time
- Will not pick up:
 - Bonus depreciation
 - Enhanced §179
 - Federal disaster relief
- IRC §6501(e) (six year statute of limitations for substantial omission) is made effective
- Bill effective 7/1/2009, but we pick up federal changes when they are effective, under HRS §235-2.5(a)(3).
- For more details see Announcement 2009-10

- Establishes a special enforcement section in DOTAX. Primary targets will be **cash-based businesses**, defined as meeting **one or more** of:
 - Substantially underreported or misrepresented the proper amount of tax liability – more than 25%.
 - Must be licensed, registered, or permitted under the tax laws, and isn't.
 - Past pattern of noncompliance of obligations under the tax laws.
 - Does not have a fixed and permanent principal place of business.
 - Has not obtained any required tax clearance.
 - Failed to maintain adequate books and records, or records required to be maintained by law or rule.
 - Does not accept checks or electronic payment devices for business transactions.
 - Offers price differentials when the business transaction substantially involves payment of cash.
 - DOTAX can add to this list.
 - Exceptions are provided for bona fide business needs.

- Fines are provided for any or all of the following, where the **fine is enhanced for a cash-based business**:
 - Failure to produce a tax license upon demand. (\$500/\$1,000 for a cash-based business)
 - Failure to keep books and records, or to produce them upon demand. (\$1,000/\$2,000)
 - Failure to record transaction by receipt. (\$1,000/\$2,000)
 - Failure to record transaction by register. (\$1,000/\$2,000)
 - Offering a lower price if the transaction is paid for in cash. (\$2,000/\$3,000)
 - Possession of currency for tax avoidance purposes. (\$2,000/\$3,000)
 - Exceptions are provided for bona fide business needs.

- Reporting Requirement for **Contractors** on **Federal Construction Projects**
 - Persons who do not possess a GET License at the time of the award of a federal construction contract must report to DOTAX:
 - The **estimated gross receipts** from the contract, and
 - Any **other information** required by DOTAX.
 - Note that **withholding tax** is required on employees who are brought in to do the job. (HAR §18-235-61-04(b)(1))
 - **60 day “grace period”** is given for employers other than construction contractors.
 - Contractors must withhold from the **first day** when the project is in Hawaii.
 - For more information see Announcement 2009-8

- Date for payment of periodic General Excise Tax pushed back to **20th** day of the month (was last day)
 - **Transition relief** (Announcement 2009-11):
 - For reporting periods ending on or before **12/31/2009**, no penalty if the G-45 is filed by the old deadline (end of following month)
 - Penalties will be imposed beginning 2/22/2010 (2/20 is a Saturday)
- Department also may require any **mandatory e-filer** for federal purposes to e-file for State purposes
 - Will be applied to employers making Federal payroll tax deposits on the **3-day rule** (Ann. 2009-11) (“semi-weekly schedule depositor”)
 - Such employers must make State payroll tax deposits on the same 3-day rule, and via EFT, effective **1/1/2010**

- Eligible business now includes development, sale, production of, or R&D related to, genetically engineered medical, agricultural, or maritime biotechnology products.
 - Qualified business now expressly includes LLC
 - Qualification tests: Attributes for all EZ establishments in the same county are considered together.
 - EZ benefits for manufacturing tangible property or producing agricultural products are extended 3 years: Benefits for Years 8-10 same as Year 7
 - Effective 7/1/2009
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- A taxpayer can elect to reduce the credit by 30% and the reduced amount becomes refundable. **(SOLAR ONLY, includes solar thermal and photovoltaic)**
- For certain **individual** taxpayers the credit amount is refundable without the reduction: **(SOLAR OR WIND)**
 - AGI \$20,000 or less (\$40,000 for MFJ)
 - All income is excludable pension
- The credit is reduced or eliminated if the taxpayer is installing the system to comply with HRS §196-6.5, which requires a solar water heater in order to get a building permit.
- Effective for taxable years beginning on or after 1/1/2009
- Also see: Announcement 2009-9

- HB 1405 “Amazon.com Nexus” **VETOED**
 - Out-of-state sellers presumed taxable if soliciting business with Web link from in-state business partner, \$10,000 in referred business
 - Presumptive nexus if a business solicits 20 in-state residents or has Hawaii source income \$100,000+
- SB 1678 Streamlined Sales Tax Project **VETOED**
 - Not effective until federal law is passed overturning *Quill Corp. v. North Dakota*
- Act 70 (SB 427) TRICARE
 - Clarifies that the support contractor is:
 - Taxable on its fee
 - Not taxable on reimbursements to health care providers
 - Effective 7/1/2009, repealed on 12/31/2013

- Act 84 (HB 35) General Income Tax Credit – \$1 for 2009
- Act 165 (HB 1495) Repeals Deduction for Wagering Losses
 - Those 1099's from Vegas are now going to stick, eff. 1/1/2009
- Special Session Act 14 (HB 1544) Phase-Out of Personal Exemption
 - Phase-out starts at 75% of the federal level in place on 7/1/2008
 - NOTE: Only affects personal exemption, not itemized deductions
- Act 198 (HB 371) Fuel Tax
 - Boosts tax on naphtha fuel for a power generating facility from 1¢ per gallon to 2 ¢ per gallon effective 7/1/2009
- Act 183 (HB 1809) Electronic Waste
 - New fee of \$2500/yr on retailers of TV's, effective upon approval

- Act 184 (SB 470) Liquor Establishments
 - Allows liquor establishments to renew liquor licenses without tax clearance if they enter into a payment plan with DOTAX
- Act 181 (HB 1550) Tax Sheltered Annuities
 - If tax sheltered annuity funds representing employee pretax contributions are rolled over into the state Employees' Retirement System, the rollover will be taxable for state purposes
 - Closes a loophole
 - Distributions from ERS are income tax exempt
 - But other retirement plan payments are exempt only if they came from employer contributions

- Not an amnesty program
- Similar to voluntary disclosure
 - No penalties
 - Interest charged at 4% (half of it is waived)
 - Taxpayer waives all appeal rights as to the \$ tendered
 - Department retains the right to audit but can only assess penalties on any further deficiency
- Tax returns must be prepared and submitted, and all required fees and interest tendered, by **June 26, 2009**
 - No extensions
 - No installment payments
 - Revenue must be in the door
 - If you miss something, the benefits of the program are denied and they keep the money

- All state employees will be furloughed 3 days a month under Gov's plan
 - Court has issued restraining order against the plan
- Departments are now discussing how to implement
- Multiple departments including DOTAX are considering shutting down the Keelikolani Building for three Fridays every month
 - The departments are looking at savings on power / air conditioning by closing the *whole building*

TIR 2009-2: Sourcing Services Income

- Local contractor K hires an Oregon archeologist, TP, to do an impact study for a local project. TP spends 60 hours in Hawaii and 140 hours in Oregon.
- TIR 98-9 and TIR 2001-2 state that GE tax is imposed on TP on the charge for the 60 hours (30% of the total); Use tax is imposed on K with respect to the 140 hours spent out of state (70% of the total).
- TIR 2009-2 states that if the taxpayer has nexus, the place of performance is irrelevant because we look at where the services are intended to be consumed. Thus GET is imposed on TP with respect to **100%** of the total billed to K. No use tax is imposed on K.
- **TIR 2009-2 revokes TIR 98-9 and TIR 2001-2 retroactively to all open years without limit.**
- There are active cases in the pipeline involving contractors and service providers where K is the U.S. Government.

- Contact your client service team member
- Tom Yamachika, Principal (531-3417)
- Wendell Lee, Partner in Charge, Tax (531-3400)
- Kent Tsukamoto, Managing Partner (531-3400)

