



CERTIFIED PUBLIC ACCOUNTANTS

## *Hawaii Tax News Flash*

### *In This Acuity Update:*

- The GET Protection Act: Guidance Released

### **The GET Protection Act: Guidance Released**

[HB 2595 CD1](#), originally sponsored by the Department of Taxation and signed into law as Act 155, denies the benefit of any lower rate, credit, deduction, or income split, unless the taxpayer files a return within one year after the return is due.

It would also impose personal liability against a “responsible person” in a business that fails to pay the general excise tax, just as the IRS does for businesses that withhold tax from employees and fail to pay that tax over to the government.

The Department of Taxation recently released anxiously awaited guidance, namely Tax Information Release 2010-5 on this act, which it called the “General Excise Tax Protection Act.”

### **Denial of General Excise Tax Benefits**

The first part of the Act denies the benefit of any statutory exemption, reduced rate, or income splitting provision to any taxpayer who is required to obtain a GET license and file an annual GET return but doesn’t do so within a year after the annual GET return is due.

#### *Are benefits denied if a taxpayer fails to report income, or gets an audit adjustment?*

The TIR first makes clear that the denial of benefits is triggered by *not filing an annual return* within a year after it is due. Denial of benefits is *not* triggered by underreporting, or failing to report, income on an annual return that is filed, either on time or within a year of the due date. There are, of course, other penalties for underreporting or failure to report income.

#### *Are benefits denied if a taxpayer fails to claim the benefits?*

The TIR states that the benefits *can* be claimed on an amended return, or upon audit. This is in contrast with most credits available against *Hawaii net income tax*, which must be claimed within a year or are forever waived.

#### *What about if the taxpayer files all required periodic returns (Form G-45) but not the annual (G-49)?*

The statute is very clear that benefits can be denied if the *annual* return isn’t filed. The Department did not choose to make an exception for this circumstance.

#### *Does everyone have to file general excise tax returns now or risk massive assessments later?*

No. The Department says that taxpayers won’t have to file returns to report certain types of income, and the Department won’t go after persons whose only income is of these kinds. Here’s the list of the “no-report” safe harbors:

Safe Harbor 1: Income that the State can’t tax because of federal law. This includes:

- a. Any income, if the taxpayer doesn't have nexus with the State.
- b. Interest paid by federal agencies (31 U.S.C. §3124, see TIR 84-1).
- c. Charges for air transportation of passengers or cargo (49 U.S.C. §40116), which does not extend to ground transportation of the same passengers or cargo to or from a flight.
- d. There are other specialized federal exemptions.

Safe Harbor 2: Income from a person who is not "engaging" in business under HRS §237-2.

- a. Income from "casual sales" is covered under this provision.
- b. "De minimis" amounts of income also should be covered, such as a trustee or fiduciary who serves in fewer than four capacities in a year and earns less than \$1,200 (HAR §18-237-13-06.05(c)(3)).
- c. Interest on a personal savings account, and interest earned by a nonprofit association or a trust on funds held for safekeeping (TIR 42-74 and TIR 94-1), are also considered nonbusiness.

Safe Harbor 3: Income excluded from "gross income" under HRS §237-3(b). This includes:

- a. Income from sales of stocks, bonds, or commodity futures.
- b. Income from the sale of land in fee simple. Note that leasehold sales may need to be examined to see if there is taxable prepaid rent buried in the sale price.
- c. Dividends.
- d. Cash discounts or trade-ins (these may be thought of as adjustments to the sale price).
- e. Provision of engineering, construction, maintenance, or managerial services between members of an affiliated public service company group. (If you aren't a public utility this does not apply to you.)

Safe Harbor 4: Income on which Public Service Company Tax is paid – on Form U-6.

Safe Harbor 5: Amounts received by tax-exempt organizations described in §237-23(a)(3) to (6), provided that the organization is exempt from filing federal Form 990 or 990-EZ. More on this later in this article.

Safe Harbor 6: Amounts exempt under HRS §237-24(1) through (7). This includes:

- a. Life insurance proceeds.

- b. Amounts received under life insurance, endowment, or annuity contracts, either during the term or at maturity or upon surrender of the contract.
- c. Compensation for personal injuries, death, or sickness. This includes insurance proceeds, worker's compensation, or legal damages. Note that damages for *lost income* might not be covered if the income would be GET taxable.
- d. Gifts, devises, or inheritances. This includes donative transfers whether accomplished while the donor is alive or upon the donor's death.
- e. Amounts received as compensatory damages for any tort injury to the person, or to the person's character reputation, or received as compensatory damages for any tort injury to or destruction of property. However, *punitive damages* or *breach of contract* damages are GET taxable.
- f. Salaries or wages. Rule of thumb: If the amounts are reported on a W-2, no GET return is needed.
- g. Alimony and other similar payments and settlements.

Safe Harbor 7: Income exempt under HRS § 237-24.8(a), which applies to income reported on a Form F-1 for financial institutions.

Safe Harbor 8: Income exempt under HRS § 237-29.7, which applies to insurance companies.

Safe Harbor 9: Income received by credit unions chartered under Chapter 412, HRS, and exempt from tax as provided in HRS § 412:10-122.

Safe Harbor 10: Any other amounts, persons, or transactions as determined by the Director to be made by subsequent Announcement or Tax Information Release.

**IMPORTANT: FOR THE SAFE HARBOR TO APPLY, THE TAXPAYER HAS TO WIN ON THE ISSUE.** Example 1 of the TIR is a taxpayer who sells tangible personal property to retailers in Hawaii. The taxpayer reasonably believes that there is no nexus with the State but loses. *Result:* Because the 0.5% wholesale rate is a GET benefit, the benefit will be denied (effective July 1, 2010) and all of the sales proceeds will be taxed as 4% retail sales. *Defense:* If the taxpayer instead obtained a GET license and filed timely annual returns claiming no nexus, the auditor *would not* be able to reclassify all of the income to retail.

Thus, if there is any doubt about whether the taxpayer is receiving *only* no-report income, consider getting a GET number and filing an annual return.

#### ***What about charities and other nonprofit organizations?***

Charities and similar nonprofit organizations typically receive three types of income:

1. Gifts, contributions, and dues;
2. Fees for activities that further the organization's exempt purpose (for example, tuition where the taxpayer is a school); or

3. Fundraising, where the activity generating the income doesn't contribute to the organization's exempt purpose other than by raising funds to support it (for example, a doughnut sale).

Of these three classes of activities, the first is always exempt and the third is always taxable. The second class of activities is exempt if the organization is registered with the Department on Form G-6 or G-6S.

Now, how does the GET Protection Act apply to such an organization?

Income that is in Category 1 is always exempt; it is also no-report because of Safe Harbor 6. Entities that have only this type of income don't need to file a GET return.

Income in Category 2 is exempt if the organization is registered. It will be no-report under Safe Harbor 5 if the organization is exempt from filing Form 990 or 990-EZ. Thus, if the organization

- Normally receives gross receipts of \$25,000 or less and files the e-postcard, Form 990-N;
- Is a subordinate organization included in a group return; or
- Is a church, including their integrated auxiliaries, and conventions or associations of churches;

then no annual filing is required to preserve any GET benefits related to Category 2 gross income.

Also, it is important to remember that not all Federally tax-exempt organizations, and not all State tax-exempt organizations, are included in the safe harbor. These organizations should get GET licenses and file annual returns. For example:

- A social club exempt under IRC §501(c)(7) is not exempt for GET purposes and should get a GET license and file annual returns unless it only receives no-report income.
- A perpetual care fund established for a cemetery, and exempt under HRS §237-23(a)(9), is considered exempt for State purposes but is not covered by Safe Harbor 5 and should get a GET license and file annual returns unless it only receives no-report income.

## Personal Liability

The second part of Act 155 states that GET is collected in trust for the State, and that key individuals may be held personally liable for the tax if it is not paid to the State.

### *Who are key individuals?*

The TIR states:

Persons subject to personal liability under Act 155 are the following persons typically involved in the financial management of taxpayers: any officer, member, manager, or other person having control or supervision over amounts of gross proceeds or gross income to be held in trust; as well as any person who is charged with the responsibility of filing or paying general excise taxes.

The liability of these key individuals is limited to the extent the person was in control or in a capacity of supervision, responsibility, or duty to act for the taxpayer.

***Does personal liability apply whenever GET is unpaid?***

No. The Department must prove a *willful failure*. To prove that a person acted willfully, the Department must show that the person voluntarily and intentionally violated a known legal duty.

The Department stated that it will utilize case law and regulations interpreting Sections 6672 and 7202 of the Internal Revenue Code (with respect to civil and criminal penalties for willful failure to pay over taxes held in trust) in construing the willful standard contained in Act 155.

Thus, if a taxpayer in good faith computes its tax liability, is audited, and the Department assesses a deficiency that the taxpayer can't pay, personal liability probably will not apply. Case law under section 6672 also establishes that even negligence on the part of the key individual is generally not enough. However, a person who "knows that the withheld funds are being used for other corporate purposes, even if he or she thoroughly expects sufficient funds to be available for payment when the due date actually arrives," *Maggy v. United States*, 560 F.2d 1372, 1375 (9th Cir. 1977), may be on the hook.

Personal liability under Act 155 can be asserted for tax, penalties, and interest due on gross income received after July 1, 2010.

***Does personal liability apply whenever Use Tax is unpaid?***

Although Use Tax is generally regarded as a complement to GET because it is assessable against the buyer whenever the seller is not subject to GET, Act 155, as currently written, *does not* apply to Use Tax.

In any event, your client service team at Accuity can bring you the resources that you may need. Please do not hesitate to contact your client service team for more information or Thomas Yamachika at [thomas.yamachika@accuityllp.com](mailto:thomas.yamachika@accuityllp.com)



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