



CERTIFIED PUBLIC ACCOUNTANTS

Tax News Flash

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Government Agencies Haven't Yet Dodged Bullet on 1099 Reporting

In our [H.R. 4 Legislative Update](#) on April 14th, we reported that business entities and renters obtained some relief from Form 1099 reporting requirements.

Government entities have been potentially subject to these requirements longer, however – and recent events, including a rulemaking notice issued last Friday, tell us that their day of reckoning is drawing closer.

IRC §3402(t), added by §511 of the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 209-222, May 17, 2006), imposes a requirement for government agencies not only to issue Forms 1099 to their payees, but also to withhold 3% of all reportable payments and turn that money over to the IRS (with some limited exceptions, see below).

Section 3402(t) was to be effective for payments made after Dec. 21, 2010. However, §1511 of the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, Feb. 17, 2009, also known as ARRA) amended the effective date of §3402(t) withholding so that it applies only to payments made after Dec. 31, 2011.

In Treasury Decision (T.D.) 9524 (May 6, 2011), IRS issued final regulations deferring this requirement for one more year. Therefore, the withholding obligation generally applies to payments made after Dec. 31, 2012.

Once effective, the federal government and the government of every state, political subdivision of a state, and instrumentality of a state or state subdivision (including multi-state agencies) making certain payments to a person providing any property or services will have to deduct and withhold tax from that payment in an amount equal to 3% of the payment. The withholding requirement will also apply to a payment made in connection with a government voucher or certificate program that functions as a payment for property or services.

Withholding would not apply to any payment:

- (1) subject to withholding under any other provision of Chapter 3 (dealing with withholding on nonresident aliens and foreign corporations), or Chapter 24 (dealing with collection of income tax at source on wages);
- (2) subject to backup withholding under IRC §3406 and from which amounts are being withheld under that section;
- (3) of interest;
- (4) for real property;
- (5) to any other governmental entity (including any Indian tribal entity), a tax-exempt entity, or a foreign government;
- (6) made under a classified or confidential contract described in IRC §6050M(e)(3);
- (7) made by a political subdivision of a state (or any state instrumentality) that makes less than \$100 million of these payments annually;
- (8) made in connection with a public assistance or public welfare program for which eligibility is determined by a needs or income test;
- (9) to any government employee, with respect to services as an employee; or
- (10) as a grant, which is defined for this purpose as “a transfer of funds by a government entity to a recipient (which may be a state government, local government, or other recipient) pursuant to an agreement reflecting a relationship between the government entity and the recipient when the principal purpose of the relationship is to transfer a thing of value to the recipient to carry out a public purpose of support or stimulation authorized by law instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the government entity, and substantial involvement is not expected between the government entity and the recipient when carrying out the activity contemplated in the agreement.”

There are other possible exceptions listed in Reg. §31.3402(t)-4.

State government agencies paying out more than \$100 million a year would be well advised to prepare to deal with this requirement.

Correction to Legislative Update Regarding Rental Motor Vehicle Tax

In our [Final Decking Legislative Update](#), we reported:

- [SB 1324](#) (TRN-8) would have made the \$3 per day tax on rental motor vehicles permanent. This bill died. The tax will drop back down to \$2 per day on September 1, 2011.

This item was incorrect. Although SB 1324 did in fact die, the tax-hike component of the bill found its way into another vehicle that didn't start out as a tax bill but nevertheless found its way to the Governor's desk.

[HB 1039](#) proposed to provide rent relief to airport concessionaires that have a guaranteed rent formula with the State. The idea was that it wouldn't be fair to charge them the same guaranteed rent formula while tourist numbers plummet as a result of the Japan mega-quake and associated tsunami.

The same bill also hoists the rental motor vehicle tax from \$3 per day to \$7.50 per day until June 30, 2012. On July 1, 2012, the tax drops back down – to \$3. Thus the \$3 charge is indeed made permanent; the \$2 per day becomes history.

Accuity regrets the error.

There is also one more update in that same subject area:

- [SB 1327](#) (TRN-13) allows DOT to increase the passenger facility charges without a public hearing. This bill has been signed into law.

[SB 1324 STATUS: DEAD](#)

[HB 1039 STATUS: CD 1 ENROLLED TO GOVERNOR](#)

[SB 1327 STATUS: ACT 41, MAY 4, 2011](#)

Information on these and other bills moving through the Legislature may be obtained from the Legislature's web site, www.capitol.hawaii.gov. Or click on the links in this message.

General Excise Tax on Tsunami Insurance Payments

Questions have come up regarding how the Hawaii General Excise Tax (GET) treats insurance payments following a natural disaster such as the tsunami generated by Japan's 9.0 magnitude earthquake on March 11, 2011.

- If it is a life insurance payment, there is no GET. (HRS §237-24(1)-(2).)
- If it is an accident or health insurance payment, there is no GET. (HRS §237-24(3).)
- If it is a payment because of casualty to buildings, furniture, fixtures, or equipment, then there is no GET also. Tax Information Release (TIR) 92-7 states that the GET consequence is determined by what kind of income would be realized if the damaged article were sold. Because sale of these items would normally be exempt casual sales, the casualty insurance proceeds should also be exempt.
- If it is a payment under business interruption coverage, then the payment is taxable, according to TIR 92-7. But the GET treatment might not be the same as the income replaced. Insurance payments are classified as All Other income, taxed at 4% or 4.5%. They never qualify for the 0.5% rate, even though the business normally receives income taxed at 0.5%. This is because the insurance company isn't reselling any product or service, where the business' normal customers might be.

- Finally, if it is a payment for casualty to inventory, then the payment is taxable so you would apply the same rules as business interruption proceeds, according to TIR 92-7; BUT if it is because of a natural disaster, another rule, HRS §237-24.7(6), kicks in to make the income exempt. Announcement 2011-6, section V, clarifies that the tsunami following the Japan mega-quake was a natural disaster qualifying for this treatment.

If you have questions about any of these news items,
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 Tom Yamachika at
(thomas.yamachika@accuityllp.com)



First Hawaiian Center, 999 Bishop Street, Suite 1900, Honolulu, HI 96813
Ph: (808) 531-3400 | Fax: (808) 531-3433

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