



CERTIFIED PUBLIC ACCOUNTANTS

Tax News Flash

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Announcing the 2011 Hawaii Tax CD (again)

As in prior years, we have been developing and will share with clients and friends the Hawaii Tax CD. In this, the fifth year Accuity is publishing this reference tool, we include information released by the Department of Taxation, other state agencies, the counties, and Accuity. It is fully paperless and easily searchable. Some of the information on this CD is difficult to find elsewhere.

As with last year, we are making our CD available *upon request*. There is no charge. If you are interested in getting one, please send an email with your name, company name, and physical mailing address (there is too much information to email) to [Lehua Thompson](#).

The First Law with Tax Effect: Act 1 of 2011

On Feb. 23, 2011, Gov. Abercrombie signed [SB 232](#), Relating to Civil Unions, which then became Act 1, Session Laws of Hawaii 2011. Sections 3, 4, and 5 of Act 1 amend the tax administrative law, the income tax law, and the estate tax law to provide that civil unions are to be treated for tax purposes the same as persons in a legal marital relationship. Act 1 takes effect for taxable years beginning on or after January 1, 2012.

Legislative Update: First Crossover

A large number of bills are now being considered by our Legislature this year. Many of them look a lot like last year's bills warmed over. At the end of the day, many of them will result in people paying more. Here is a selection of these bills. It is not a comprehensive list.

For those unfamiliar with the process, all bills must be considered by both the House and the Senate. House Bills are introduced in the House and are heard there first, and then go to the Senate if they survive. Senate Bills, conversely, cross over to the House if they survive. This year, the deadline for first crossover is March 10th.

Once a bill has crossed over into the other chamber, many things can happen. If it is approved by the second chamber intact, it goes to the Governor. If it is amended, the chamber of origination can agree to the amendment, which sends the bill to the Governor, or disagree, in which case both chambers have the opportunity to appoint a Conference Committee to hash out their differences. If this happens, the Conference Committee can report out a conference draft, which then is voted on by both chambers and if approved the bill goes to the Governor. Or, the conferees could agree that

the originating chamber would take back its disagreement. All of this must happen by the end of April if a bill is to pass.

Once the Governor gets bills, he can sign them, veto them, or let them become law without signature. This process usually happens in June and July.

The list of tax bills being considered will shrink as time goes on, as more and more bills fall by the wayside. We'll remove dead bills from our list as well, but we all need to remember that any dead bill can be "revived" by inserting its substance into another bill that is still moving. The status of the bills shown in this message was as of March 6, 2011; the current status of any bill can be viewed by clicking on the links in this message.

The Abercrombie Omnibus Revenue Raiser

We start our list with a bill sponsored by the Abercrombie Administration (also known as TAX-10) containing a number of revenue raisers the Governor mentioned in his State of the State address. Major features of the bill include:

- Employer funded pensions that are now exempt will become taxable;
- The amount of state tax will become nondeductible, which means it will be added back to state taxable income;
- The state income tax exclusion for copyright royalties and similar income will go away, meaning it will be taxable the same as it is for federal purposes;
- The transient accommodations tax on time share occupants (the "TOT") will be hoisted 2 percentage points to mirror the transient accommodations tax increase on hotels enacted last year; and
- The TOT tax base will be tripled.

As introduced, the bills were [SB 1319](#) and [HB 1092](#). House Finance passed an amended version of the omnibus bill, allowing pensions to be taxed and requiring a state tax add-back when the recipients have federal AGI over a certain level (\$100,000 single, \$150,000 head of household, \$200,000 married filing jointly). Finance also split off the TOT rate change into [HB 809](#) without changing the TOT tax base. Senate Ways and Means split the bill into at least two pieces, [SB 162](#) (pensions) and [SB 570](#) (state tax deduction).

[SB 1319 STATUS: DEAD](#)

[HB 1092 STATUS: HD 1 PENDING CROSSOVER VOTE BY FULL HOUSE](#)

[HB 809 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE](#)

[SB 162 STATUS: WAM DEFERRED MEASURE, LIKELY DEAD](#)

[SB 570 STATUS: SD 2 PENDING CROSSOVER VOTE BY FULL SENATE](#)

Adoption of Federal Tax Changes – or Lack Thereof

Every year, the Department of Taxation submits, and the Legislature considers, a bill that would adopt some or all of the Federal changes that took place in the past year. This year's bill (known as TAX-01) is no different. It proposes that Hawaii decouple from some of these federal changes. The current bills ([SB 1316](#), [HB 1089](#)) are both alive and propose nonconformance in these areas:

- Limitation on itemized deductions, sometimes known as the "itemized deduction phaseout" under IRC section 68 (Federal removed the phaseout beginning in 2010, State keeps it)

- Itemized deduction for general sales taxes (Federal allows a taxpayer to deduct sales taxes instead of income taxes, State allows a deduction for income taxes only...and might not even allow that because of other bills)
- Section 179 expensing (State only allows \$25,000, with a phaseout beginning at \$200,000 worth of section 179 property)

SB 1319 STATUS: SD 1 PENDING CROSSOVER VOTE BY FULL SENATE

HB 1089 STATUS: HD 1 PENDING CROSSOVER VOTE BY FULL HOUSE

Sweet or Sinful? Still Taxable

This proposal from the Governor's Office (GOV-05): a tax on sugary beverages, supposedly to discourage childhood obesity, and a 50% increase in the liquor tax. The House version, [HB 1062](#), is dead. The Senate version, [SB 1289](#), is moving forward, only with the liquor tax provision, where liquor tax is increased by an unspecified amount. So sweet stuff is safe for now, but adult beverages aren't.

SB 1289 STATUS: SD 2 PENDING CROSSOVER VOTE BY FULL SENATE

HB 1062 STATUS: DEAD

Don't Kick People When They're Already Down!

Act 166, Session Laws of Hawaii 2009, imposed new tax penalties similar to penalties imposed under federal law. However, while federal law prohibits the stacking of penalties, Act 166 did not. Indeed, we have seen a case where an auditor assessed 70% penalties (25% failure to file + 25% negligence + 20% substantial underpayment) against a small business owner. Ouch! [SB 1356](#), which is crossing over to the House, removes the stacking. Interestingly, the Department *supported* the intent of the bill, but asked for a delayed effective date to make appropriate changes in its computer system.

SB 1356 STATUS: SD 1 CROSSED OVER TO HOUSE

Let's Take All of the Credits Away...

[HB 1270](#) contains a list of exemptions and credits from the net income tax, general excise tax, public service company tax, bank franchise tax, and liquor tax. Under the bill, all of the above would be studied, and if no further legislative action is taken they are all repealed on December 31, 2012.

[HB 566](#), specifically relating to the renewable energy technologies credit, would sunset the credit on January 1, 2017, and would delay any payouts for refundable tax credits claimed in 2012 to July 1, 2013. Other significant changes include that the refundable credit could only be claimed in the second taxable year following the year in which the creditable cost was incurred (note that this bill language conflicts with subsection (f) of the existing statute, which says that credits are waived unless claimed within one year), and that the credit may not be claimed by nonresident individuals. In the meantime DBEDT would be tasked with completion of an assessment on the effectiveness and ongoing need for the credit.

HB 1270 STATUS: HD 1 PENDING CROSSOVER VOTE BY FULL HOUSE

HB 566 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE

...But We Can Add Some New Ones

In the meantime, several bills are poised to add new credits to the tax system or increase ones already there.

[HB 1551](#) would add a credit for a qualified media infrastructure project of an unspecified amount (HD 1 used 25% for qualified costs for construction on Oahu and 40% for costs on the Neighbor Islands). The goal there is to have a production or post production facility built in the State, as there is none now. Relativity Media submitted a detailed presentation on the bill and was able to get high-profile testifiers such as former President Bill Clinton to back it.

[HB 1642](#) and [SB 753](#) would extend the refundable Tax Credit for Research Activities (HRS §235-110.91) another five years to December 31, 2015. The House version would establish an annual statewide aggregate cap on the credit in an unspecified amount. The Senate version adds “extensive” reporting requirements.

[SB 654](#) would provide an “Ohana Residential Housing Income Tax Credit,” equal to 2% of the purchase price of a qualified principal residence, but capped at \$6,000. The credit would be awarded for a principal residence that is “constructed from the ground up,” and would be payable over two taxable years beginning with the year in which a binding contract to build the residence was signed. The credit would be limited to residences costing \$625,000 or less, and would be unavailable to individuals with a Hawaii AGI of more than \$75,000 (\$150,000 for joint filers).

[SB 769](#) would provide a hotel and resort property construction or renovation tax credit. At present the amount of the credit is unspecified. Only construction or renovation costs incurred before January 1, 2015 would be eligible.

[SB 831](#) would establish a state credit paralleling the federal New Markets tax credit (IRC §45D). It would be the same amount as the federal credit, but only projects in Hawaii would be eligible. The credit would be nonrefundable but could be allocated between partners in a partnership without regard to IRC §704(b)(2), just like how the Qualified High Technology Business investment credit used to be. This credit would also be usable against the bank franchise and insurance premium taxes. For individuals, the passive credit limitations would apply.

[HB 1551 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE](#)

[HB 1642 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE](#)

[SB 753 STATUS: SD 2 PENDING CROSSOVER VOTE BY FULL SENATE](#)

[SB 654 STATUS: SD 1 PENDING CROSSOVER VOTE BY FULL SENATE](#)

[SB 769 STATUS: SD 1 PENDING CROSSOVER VOTE BY FULL SENATE](#)

[SB 831 STATUS: SD 2 PENDING CROSSOVER VOTE BY FULL SENATE](#)

More GET Pyramiding Relief for Related Entities?

Almost 20 years ago, the Hawaii Supreme Court told us that the general excise tax applies whenever one company does something for another one, even if the two companies happen to be related. The Legislature reacted a few years later by exempting a limited amount of intercompany charges: charges for administrative, legal, and accounting services and interest charges (HRS §237-23.5(a)) and reimbursements for “common paymaster” charges where, say, one employee works for corporations A and B but one corporation cuts the employee’s paycheck and the other one reimburses part of that cost (§237-23.5(b)). Charges for information technology services between related entities were added to the exemption by the landmark technology incentive law, Act 221 of 2001. Nevertheless, the exemption has its limits. The related company exemption does not apply to so-called line services such as marketing and repairs, and the common paymaster exemption technically applies only to corporations because of restrictions in the federal regulation (Treas. Reg. §31.3121(s)-1(b)) the law incorporates by reference.

[HB 848](#) addresses these limitations by adding maintenance services, repairs, and maintenance expenses paid on behalf of affiliates to the list of exempt amounts in §237-23.5(a), and adding a new subsection (c) to address common paymaster situations where the related companies are not all corporations.

HB 848 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE

We Have So Many Pesky GET Exemptions...So Let's Take Them Away (Redux)

[HB 799](#) contains a list of exemptions from the general excise tax, use tax, and the public service company tax. Under the bill, amounts previously exempted would instead be taxed at 2% during calendar year 2012, 3% during calendar year 2013, and 4% from January 1, 2014 to June 30, 2015. Among the exemptions that would be subject to the new tax rates are:

- The deduction by a contractor for amounts paid to a subcontractor (HRS §237-13(3))
- The partial deduction a sublessor gets for lease rent paid for the space subleased (§237-16.5)
- Several exemptions under the general excise and use taxes relating to transportation, such as stevedoring, tugboat, and towage services (§237-24.3(4)), rent for aircraft engines (§237-24.3(12)), and commercial aircraft operation (§237-24.9)
- The exemption for gross proceeds of shipbuilding and ship repair (§237-28.1)
- The exemption for gross proceeds of qualified activities conducted in enterprise zones (unless already qualified by DBEDT as of Jan. 1, 2012), including gross proceeds of contractors who construct within such zones

Does this sound familiar? It should be – it's similar to HB 2877 (2010) which we thought was killed and buried last year. However, the choice of exemptions on the chopping block seems to be smarter, as the following exemptions are spared:

- The exemption for exported goods and services.
- The exemption for certain intercompany services and interest between related entities.
- The exemption for exempt activities of tax-exempt organizations such as charities.
- The exemption for the sale of tangible personal property to the U.S. Government and state-chartered credit unions.
- The exemptions for amounts paid by hotel operators, orchard operators, and professional employment organizations as wages and benefits.

A provision grandfathers all exemptions for income earned under a binding written contract in force on July 1, 2011.

HB 799 STATUS: HD 1 PENDING CROSSOVER VOTE BY FULL HOUSE

Conveyance Tax on a Real Property Holding Entity (Redux)

Chapter 247, HRS, imposes a conveyance tax on the transfer of real property. The tax was recently increased multiple times...but is imposed only on the transfer of realty. It used to be possible to

avoid the tax by transferring an entity that was holding the land, rather than the land itself. [HB 1180](#) would impose a transfer tax on the sale or transfer of a controlling interest in an entity which possesses an interest in real property. The transfer tax would be imposed at the conveyance tax rates.

In addition, the bill would impose conveyance tax at the lowest rate on property conveyed by operation of a merger or consolidation; by a dissolving limited partnership to a corporate general partner owning 90%; or to an organization for purposes of low income housing development. Those three categories of conveyances are exempt under present law.

The bill also provides that the tax would not apply where there is no change in beneficial ownership, for example a transfer to an entity wholly owned, directly or indirectly, by the same common ownership as the transferor.

This, too, is a warmed-over bill from last year. See HB 1921 (2010).

HB 1180 STATUS: HD 1 PENDING CROSSOVER VOTE BY FULL HOUSE

Dot-com Nexus: Click Through and Be Taxable (Redux from 2009)

When sellers of goods and services that are not in Hawaii attempt to sell in Hawaii, the U.S. Supreme Court has said that our state is without power to tax those sellers unless they have “nexus” with our state. Nexus is generally understood to include having persons or property within the state, or an independent contractor hired to solicit business within the state. [HB 1183](#) is an attempt to define what that nexus is, and, like a few other states, is taking the position that nexus is established when a company pays a local seller to directly or indirectly refer potential customers, including by a link on the local seller’s internet website. The current version of the bill requires sellers who don’t pay general excise tax on sales to Hawaii residents to supply the names of those residents and the dollar amount of all such sales to the Department.

You may remember that a couple of years ago, a similar bill, HB 1405 (2009), was sent to Governor Lingle. Many of the click-through companies, such as Amazon.com and Overstock.com, made it very clear that their Hawaii affiliates would immediately be terminated unless the bill was vetoed. The Governor [did veto the bill](#), and the veto was not overridden. This year’s version of the bill does not seem to strengthen the State’s position by giving presumptive taxpayers a “reporting option.” If under the U.S. Constitution the State of Hawaii is precluded from using its police power to impose a tax upon a presumptive taxpayer, how could it be able to use that same police power to force it to tattle on local customers?

HB 1183 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE

General Excise Tax as a Trust Fund Tax (About Face?)

Act 155, SLH 2010, denies any taxpayer 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. See HRS §§237-9.3 and 237-41.5.

This bill passed over opposition by business groups, nonprofits, and others. This year, [SB 778](#), which will cross over to the House, would repeal Act 155.

SB 778 STATUS: SD 1 PENDING CROSSOVER VOTE BY FULL SENATE

And...Now a Special Fund for DBEDT? (Redux)

HB 782, the stated purpose of which is to ensure that the Department of Business, Economic Development, and Tourism (DBEDT) has adequate funding to continue to provide services and programs promoting economic development, imposes a surcharge of \$20 on certain fees or services charged by the Departments of Taxation, Labor, Commerce and Consumer Affairs, and Land and Natural Resources, and the PUC, between July 1, 2011, and June 30, 2015. Those surcharge revenues are to be deposited into a new special fund which will be used to pay for the operations of DBEDT.

This bill appears to be a resurrected version of HB 1926 (2010).

Another variation on the theme is provided in **HB 986**, which allows DBEDT to impose unspecified surcharges for film permits and TV and film production tax credit applications and add those to its special fund.

HB 782 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE

HB 986 STATUS: HD 2 PENDING CROSSOVER VOTE BY FULL HOUSE

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.

If you have questions about any of these news items, your client service team at Acuity 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@acuityllp.com)



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