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DEPARTMENT OF TAXATION
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**HOUSE COMMITTEE ON FINANCE
TESTIMONY REGARDING HB 1600
RELATING TO THE GENERAL EXCISE TAX**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: FEBRUARY 26, 2009

TIME: 11 AM

ROOM: 308

This measure amends HRS § 237-23.5 by adding language to subsections (a) and (b), and adding an entirely new subsection (c), which extends the common paymaster exemption to all related persons and not just corporations.

The Department of Taxation (Department) **offers comments.**

TECHNICAL COMMENT – The language added to subsection (a) adds confusion and ambiguity to the statute. It is not entirely clear what is meant by this sentence:

"This chapter shall not apply to amounts received, charged or attributable to services furnished by one related entity under section 267 of the Internal Revenue Code, as amended, to another related entity under section 267 of the Internal Revenue Code, as amended ..."

The inclusion of this phrase is problematic because both "services" and "related entities" are specifically defined by section 237-23.5(a). To include this reference to the Internal Revenue Code could create differing sets of definitions for the terms in this statute and lead to confusion.

TECHNICAL COMMENT – The second paragraph of subsection (c) is confusing. The Department recommends the following language in its place:

The exemption allowed by this subsection shall not apply to amounts received which are used to pay the common paymaster's overhead costs such as the salaries of its own employees.

The Department recognizes that the language in the bill was taken from § 237-23.5's subsection (b); however, the Department believes subsection (b)'s language is also confusing and recommends

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making the changes above in subsection (b) as well.

The Department is not clear what the intent of this bill is. The Department needs to understand the problem this bill is trying to fix before the Department can adequately comment on this bill.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Expand common paymaster exemption

BILL NUMBER: SB 769; HB 1600 (Identical)

INTRODUCED BY: SB by Chun Oakland 3 Democrats and 1 Republican; HB by Say

BRIEF SUMMARY: Amends HRS section 237-23.5 to provide that the general excise tax shall not be applicable to amounts received by one related entity under IRC section 267 to another IRC section 267 entity. The chapter shall not apply to amounts received by a common paymaster that are disbursed as remuneration to employees of two or more related persons where the common paymaster is making such remunerations on behalf of the related persons. Such amounts received or disbursed by the common paymaster shall include payments of payroll taxes and employee benefits that the common paymaster is making on behalf of the related persons and which payments are for the employees being remunerated.

Requires each related person using a common paymaster or multiple common paymaster to keep separate payroll records and other documentation required to prove the existence of concurrent employment. The records and documents shall be available for inspection by the director of taxation during normal business hours.

Defines “common paymaster” and “related persons” for purposes of the measure.

EFFECTIVE DATE: July 1, 2009

STAFF COMMENTS: Currently the common paymaster general excise tax exemption is applicable to: (1) an affiliated group of corporations within the meaning of section 1504 (with respect to affiliated group defined) of the federal Internal Revenue Code of 1986, as amended; (2) a controlled group of corporations within the meaning of section 1563 (with respect to definitions and special rules) of the federal Internal Revenue Code of 1986, as amended; (3) those entities connected through ownership of at least **eighty** percent of the total value and at least **eighty** percent of the total voting power of each such entity (or combination thereof), including partnerships, associations, trusts, S corporations, nonprofit corporations, limited liability partnerships, or limited liability companies; and (4) any group or combination of the entities described in paragraph (3) constituting a unitary business for income tax purposes.

The proposed measure expands the common paymaster provisions to include IRC section 267 entities. While section 267 entities are entities connected through ownership of at least **fifty** rather than **eighty** percent of the total value and at least **fifty** rather than **eighty** percent of the total voting power of each such entity (or combination thereof), if this measure is adopted and expands the common paymaster general excise tax exemption, such transactions should be examined to ensure that only those common paymaster transactions are exempt. Further, as drafted, the changes being proposed in this bill may have unintended consequences for those companies that meet the eighty percent test insofar as the application of Code sections 1504 and 1563. Instead of tagging the Section 267 entities onto the common

paymaster provisions, consideration might be given to adding a new paragraph to HRS section 237-24.7 where the reimbursement of payroll and employee benefits by a related company is addressed. It should be noted that when the common paymaster provisions were established by Sections 1504 and 1563 in 1988, the eighty percent ownership was a critical test as to the applicability of the exemption. To now dilute that test raises questions about the appropriateness of the exemption.

If, in fact, this is a simple reimbursement of costs for payroll and employee benefits without any additional consideration, then the transaction is already exempt under HRS Sec. 237-20, provided there is no additional fee or remuneration for the disbursing paymaster for providing that service. Therefore, it appears that these particular related companies are indeed compensating the paymaster for this service and, therefore, are seeking this special treatment.

Digested 2/25/09

VIA FACSIMILE
586-6201

VIA E-MAIL
repmoshiro@capitol.hawaii.gov

TO: Representative Marcus R. Oshiro
Chairman, Committee on Finance
FR: Darryl P. Wong
DT: February 25, 2009
RE: **HB 1600**

To Whom It May Concern

I, Darryl Wong am a CPA and am writing this testimony in favor of HB 1600 as it relates to general excise tax.

Today small businesses are struggling to operate as efficiently as possible without incurring additional costs that could burden the family business. In order to clarify the law so there is no misinterpretation by the tax department, I am in favor of clarifying the tax law as proposed

Many family and closely held businesses are made up of several companies with one company handling the staffing and overhead expenses for the other related income producing companies. Herein lies the problem whereby only those owned 80% by common owners are exempt from being taxed. So in a case where Company "A" (Common Paymaster) and Company "B" are owned by Husband and Wife and Company "C" is owned by Son and Daughter, these companies would not all be considered related and exempt for Excise Tax purposes if payroll and other operating expenses were reimbursed by Company "B" and "C" to Company "A". Only those expenses reimbursed by Company "B" would be exempt because it is 80% or more owned by Company "A" owners. As a means of operating efficiently and building equity for the children and a family business, the husband and wife put a business into their children's names and have Company "A" handle the management for Company "C" rather than have a separate payrolls for Companies "A", "B" and "C." We wish to eliminate the ambiguous interpretation by the State as it defines related parties and include related parties as defined under federal statutes section 267 of the IRC. In doing so we can assure related companies that do work for other related companies are not burdened with additional taxes by the State

The current tax law in Hawaii is unclear on how to treat related companies and transactions that take place between related companies. Through the adoption of section 267 of the IRC Code into the HRS section 237-23 as it relates to general excise tax law, related parties will not have to pay GET between related (direct and indirect) parties as it relates to reimbursable expenses. Under the current law the State has sometimes taken the position to tax some related party transaction and this reformation will eliminate the inconsistent treatment of related party transactions.

Please support House Bill 1600.

Sincerely,



Darryl P. Wong
1836 Punahou Street, Honolulu, Hi. 96822

JAMES W. Y. WONG

2359 A Round Top Drive, Honolulu, Hawaii 96822 – Phone: (808) 946-2966 – Fax: (808) 943-3140

February 25, 2009

**VIA FACSIMILE
586-6201**

Representative Marcus R. Oshiro
Chairman, Committee on Finance
Hawaii State Capitol, Room 306
Honolulu, Hawaii 96813

RE: HB1600

Dear Representative Oshiro:

I, James W. Y. Wong, am a CPA and am writing this testimony in favor of HB 1600 as it relates to general excise tax.

Small businesses are struggling to keep operational costs down as much as possible to survive. In order to clarify the law so there is no misinterpretation by the tax department, I am in favor of clarifying the tax law as proposed under HB 1600.

Many family and closely held businesses are made up of several companies with one company handling the staffing and overhead expenses for the other related income producing companies. The problem results when only those owned 80% by common owners are exempt from being taxed. Many larger corporations who plan their corporate structure avoid the trap through planning but most small business are not sophisticated to find potential misinterpretations of the General Excise Tax law as it relates to related parties by the Tax Office Staff.

So in a case where Company "A" (Common Paymaster) and Company "B" are owned by Husband and Wife and Company "C" is owned by Son and Daughter, these companies would not all be considered related and exempt for Excise Tax purposes if payroll and other operating expenses were reimbursed by Company "B" and "C" to Company "A". Only those expenses reimbursed by Company "B" would be exempt because it is 80% or more owned by Company "A" owners. As a means of operating efficiently and building equity for the children and a family business, the husband and wife put a business into their children's names and have Company "A" handle the management for Company "C" rather than have a separate payrolls for Companies "A", "B" and "C." I wish to eliminate the ambiguous interpretation by the State as it defines related parties and include related parties as defined under federal statutes section 267 of the IRC. In doing so we can assure related (directly and indirectly related) companies that do work for other related companies are not burdened with additional taxes by the State

The current tax law in Hawaii is unclear on how to treat related companies and transactions that take place between related companies. Through the adoption of section 267 of the IRC Code into the HRS section 237-23 as it relates to general excise tax law, related parties will not have to pay GET between related (direct and indirect) parties as it relates to reimbursable expenses. Under the current law the State has sometimes taken the position to tax some related party transaction and this reformation will eliminate the inconsistent treatment of related party transactions. Please support House Bill 1600.

Sincerely


James W. Y. Wong

FINTestimony

From: mailinglist@capitol.hawaii.gov
Sent: Wednesday, February 25, 2009 9:11 AM
To: FINTestimony
Cc: eds@hthcorp.com
Subject: Testimony for HB1600 on 2/26/2009 10:00:00 AM

Testimony for FIN 2/26/2009 10:00:00 AM HB1600

Conference room: 308
Testifier position: support
Testifier will be present: No
Submitted by: Ed Saunders
Organization: HTH Corporation - Pagoda Hotel and Floating Restaurant
Address: 1525 Rycroft Street Honolulu, Hawaii 96814
Phone: 808-941-6611
E-mail: eds@hthcorp.com
Submitted on: 2/25/2009

Comments:

Re: House Bill 1600

Dear Representative Marcus Oshiro (Chair of Finance Committee) and Representative Angus McKelvey (Chair EBM Committee),

We here at Pagoda Hotel are a small family owned business and we fully support House Bill 1600. Through the adoption of section 267 of the IRC Code into the HRS section 237-23 as it relates to general excise tax law, related parties would not have to pay General Excise Tax between related parties as it relates to reimbursable expenses. I hope you will support this bill as we, small businesses, try to stay competitive in these difficult economic times.

Sincerely,

Ed Saunders
General Manager