

HB 1600

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



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DIRECTOR OF TAXATION

SANDRA L. YAHIRO
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DEPARTMENT OF TAXATION
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**SENATE COMMITTEE ON WAYS & MEANS
TESTIMONY REGARDING HB 1600 HD 1
RELATING TO THE GENERAL EXCISE TAX**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 24, 2009
TIME: 9:30AM
ROOM: 211

This measure amends HRS § 237-24.7 by adding language to broaden the common paymaster exemption to all related persons.

The Department of Taxation (Department) **requests amendments.**

CONCERNED WITH UNBUDGETED REVENUE LOSS, AS AMENDED—The Department has strong concerns with the current version of this measure, which is to extend the related entities provision to a broader classification of entities for any amount of payroll, payroll taxes, or benefits. Currently, only those transactions that meet the federal common paymaster definition are exempt from the general excise tax. The purpose of the general excise tax is to tax the proceeds received by an entity whether or not those proceeds are received from related entities, except for the very narrow provisions of HRS § 237-23.5. The fact that proceeds are taxed multiple times under the basic purpose of a general excise tax (*i.e.*, every time income passes through an entity) is nothing more than a cost of doing business in this manner. To extend the related entities exemption beyond its current exemption defeats the purpose of the gross receipts tax.

OFFSET THE REVENUE LOSS BY MAKING CLARIFICATIONS—The Department suggests that the Legislature consider clarifying the current related entities exemption regarding the term "management." If this term is clarified to ensure that property management does not come within the meaning of this term, it is likely that the extension of the related entities exemption contained in the measure can be revenue neutral.

REVENUE IMPACT— The annual revenue loss of this bill is estimated at about \$3 million per year or more since the new draft broadens the definition of "related person."



**Testimony to the Senate Committee on Ways and Means
Tuesday, March 24, 2009
9:30 a.m.
Conference Room 211**

**RE: HOUSE BILL NO. 1600 HD1 RELATING TO THE GENERAL EXCISE
TAX**

Chair Mercado Kim, Vice Chair Tsutsui, and Members of the Committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). The Chamber supports HB 1600 HD1.

The Chamber is the largest business organization in Hawaii, representing more than 1,100 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

This bill would expand the sorts of intercompany transactions exempt from GET under the common paymaster exemption. It would probably benefit family-owned businesses where one related entity handles payroll for another. These types of transaction are already exempt from GET for affiliates sharing 80% common ownership, but this bill would expand the exemption to include affiliates sharing only 50% common ownership and certain family relationships.

Businesses are already struggling to stay afloat and trying their best in continuing to provide benefits to their employees and avoiding job cuts during these tough economic times. Merely keeping up with operating expenses is difficult, especially for small family businesses.

Therefore, we believe this measure will alleviate some of the difficulties that local family-owned businesses are facing during this tough economic period.

We respectfully request that the committee passes this measure. Thank you for the opportunity to submit testimony.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Exempt related persons

BILL NUMBER: HB 1600, HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 237-24.7 to provide that the general excise tax shall not be applicable to amounts received by one related person from another related person; provided that such amount shall only include the actual amount of payroll, payroll taxes, and employee benefits. "Related person" shall mean persons falling within a relationship under IRC section 267(b).

This act shall not be repealed when that section is repealed and reenacted by section 2 of Act 239, SLH 2007, on December 31, 2009.

EFFECTIVE DATE: July 1, 2009

STAFF COMMENTS: The legislature by Act 351, SLH 1989, exempted from the general excise tax amounts received by hotel operators from the hotel owner as reimbursement of sums paid by the operator for employee wages, salaries, payroll taxes, insurance premiums, and benefits. The act was adopted to eliminate the double taxation of payroll costs paid by hotel owners to hotel operators. Subsequently, similar treatment was extended to operators of orchards under Act 252, SLH 1992.

This double taxation occurs when the income received and handled by the operator on behalf of the owner incurs the 4% tax which is due on those gross receipts. This income then is used to pay the operator for the operator's employees as well as the operator's management fee. The amount paid to the operator is then subject to the 4% general excise tax on the entire amount including that which will be disbursed as payroll and employee benefits. Thus, the cost of payroll for the employees must account for an additional 4% even though it was already taxed under the general excise tax when the income was received from the customer.

While this measure proposes to exempt from the general excise tax amounts received by a one related person from another related person and such amounts are only the actual amounts received as payroll, payroll taxes, and employee benefits, the adoption of this measure would prevent the taxation of amounts that are merely reimbursements. 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.

While the measure defines "related persons" as that provided for under IRS section 267(b), if the intent of the measure is to establish an exemption for related family members, then IRC section 267(b) should be limited to include "members of a family under IRC section 267(b)(1)," since other sections of IRC section 267(b) also include 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

HB 1600, HD-1 - Continued

(or combination thereof).

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.

Digested 3/23/09



A Hawaii Limited Liability Partnership.

March 23, 2009

Honorable Senator Donna Mercado Kim, Chairman
Senate Ways and Means Committee
Hawaii State Capitol, Room 210
415 South Beretania Street
Honolulu, HI 96813

Re: HB 1600

Dear Senator Mercado:

I, Alan M. L. Yee, am a tax partner in KMH LLP, a CPA firm. I am writing this testimony in favor of HB 1600 as it relates to general excise tax that clarifies the interpretation of related entities under Section 237-23.5.

Businesses have structured themselves with multiple entities to maximize liability protection and to have one entity be responsible for all internal cost so as to keep operational costs down. There is an uncertainty by practitioners as to the definition of related entities so in order to clarify the law I am in favor of the proposed amendments under HB 1600 with reference to Section 237-24.7 Hawaii Revised Statutes whereby additional amounts of **non taxable items** should include the new paragraph (11) under section two (2) which states.

Notwithstanding section 237-23.5, amounts received by one related person from another related person; provided that any amount shall include the actual amount of payroll, payroll taxes, employee benefits and other administrative and overhead expenses. For the purpose of this paragraph, "related persons" mean persons falling within a relationship set forth under Section 267(b) of the Federal Internal Revenue Code.

Please support House Bill 1600.

Sincerely,

A handwritten signature in cursive script that reads "Alan M. L. Yee".

Alan M.L. Yee
Partner

March 20, 2009

FAX: 586-6659

Senator Donna Mercado Kim, Chairman

Senate Ways and Means Committee

Re: HB 1600

Dear Chairman Kim:

I, Douglas D. Wilson, am a small business man and am writing this testimony in favor of HB 1600 as it relates to general excise tax that allows a broader interpretation of exempt related parties to include individuals related both directly and indirectly.

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 with reference to Section 237-24.7 Hawaii Revised Statutes whereby additional amounts of non taxable items should include the new paragraph (11) under section two (2) which states.

Notwithstanding section 237-23.5, amounts received by one related person from another related person; provided that any amount shall include the actual amount of payroll, payroll taxes, employee benefits and other administrative and overhead expenses. For the purpose of this paragraph, "related persons" means persons falling within a relationship set forth under Section 267(b) of the Federal Internal Revenue Code.

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,



Address: P. O. Box 583, Volcano, HI. 96785

586-6659

Re: HB 1600

TO WHOM IT MAY CONCERN:

I, THOMAS G. CABRINHA, am a Certified Public Accountant and am writing this testimony in favor of HB 1600 as it relates to general excise tax that allows a broader interpretation of exempt related parties to include individuals related both directly and indirectly.

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 with reference to Section 237-24.7 Hawaii Revised Statutes whereby additional amounts of **nontaxable items** should include the new paragraph (11) under section two (2) which states.

Notwithstanding section 237-23.5, amounts received by one related person from another related person; provided that any amount shall include the actual amount of payroll, payroll taxes, employee benefits and other administrative and overhead expenses. For the purpose of this paragraph, "related persons" mean persons falling within a relationship set forth under section 267(b) of the Federal Internal Revenue Code.

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,

 3/23/09

Thomas G. Cabrinha
P. O. Box 1381
Honolulu, Hawaii 96807

Darryl P. Wong, CPA

1836 Punahou Street
Honolulu, Hawaii 96822

Senate Sergeant-At-Arms/Fax: 586-6659

March 20, 2009

**To: Senator Donna Mercado Kim, Chairman
Senate Ways and Means Committee**

Re: HB 1600

I, Darryl P. Wong, am a CPA and am writing this testimony in favor of HB 1600 as it relates to general excise tax that allows a broader interpretation of related parties to include individuals related both directly and indirectly.

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 with reference to Section 237-24.7 Hawaii Revised Statutes whereby additional amounts of non taxable items should include the new paragraph (11) under section two (2) which states.

Notwithstanding section 237-23.5, amounts received by one related person from another related person; provided that any amount shall include the actual amount of payroll, payroll taxes, employee benefits and other administrative and overhead expenses. For the purpose of this paragraph, "related persons" means persons falling within a relationship set forth under Section 267(b) of the Federal Internal Revenue Code.

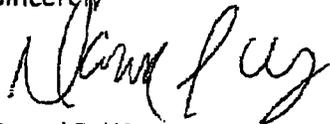
Many family and closely held businesses are made up of several companies with one company handling the staffing and overhead expenses for the other related income producing companies. The problem results when only those owned 80% by common owners are exempt from being taxed. Many larger corporations 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, and Company "A", "B" and "C" all own separate real estate any reimbursements from Company "C", Childrens company to Company "A" will have to pay GET under current interpretation by the State. Because Company "C" is not directly related as required under State Law, all expenses reimbursed including rent, overhead, office expenses and payroll used to help operate "C" Company would be taxed to Company "A". I feel this is not the intent of the tax law where we look to tax small family companies that are related directly or indirectly. Therefore I believe the amendment above to the Hawaii Revised statutes is necessary. As a means of operating efficiently and building equity for the children and a family business, companies that do work for other related (directly and indirectly) should not be burdened with additional taxes by the State

Please support House Bill 1600.

Sincerely



Darryl P. Wong

Address: 1836 Punahou Street , Honolulu, Hi. 96822