

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: ADMINISTRATION, Requires Additional Tax Clearances for Contractors

BILL NUMBER: SB 397, SD-1

INTRODUCED BY: Senate Committee on Public Safety, Intergovernmental, and Military Affairs

EXECUTIVE SUMMARY: Requires contractors and subcontractors to submit tax clearances as a condition of obtaining building permits for private developments exceeding a certain value. Requires contractors and subcontractors to submit additional tax clearances before final inspection of private developments exceeding a certain value. Contractors already need tax clearances to obtain and renew their licenses, and to bid or receive final payment on state or county government contracts. It is questionable whether these additional clearances are justified given the massive delays in the permitting process that already exist.

SYNOPSIS: Adds a new section to chapter 46 providing that no building license is to be granted for a private development valued at greater than \$_____ unless tax clearances for state and federal tax are presented for the contractor and any subcontractors.

Provides that the director of taxation may waive the IRS tax clearance requirement if the director determines that it is the best interest of the State.

Any assignment of a contract for a private development valued at greater than \$_____ shall require the assignee to present a bulk sales certificate if required, or tax clearance as above if a bulk sales certificate is not required, to the state or county contracting officer or agent.

Requires all state and county contracting officers or agents to withhold final inspection of a private development valued at greater than \$_____ until the receipt of the most recent tax clearances from the director of taxation and the Internal Revenue Service on behalf of the building contractor and any subcontractors.

Does not apply if the contractor is current under a payment plan with the taxing authority, or if the taxes are being contested in an administrative or judicial appeal.

An officer or employee of any governmental agency who intentionally or knowingly violates any provision under this section shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

EFFECTIVE DATE: July 1, 2019.

STAFF COMMENTS: In general, a tax clearance is issued when a taxpayer has filed all required returns and has paid all tax assessed on those returns.

Tax clearances are now required to obtain or renew a contractor's license under Hawaii Admin. Rules section 16-77-8(b)(2) and 16-77-55(b)(2). Contractor's licenses are renewed during each even-numbered year. Section 444-15, HRS.

One of the primary uses of a tax clearance is to allow persons to bid on, and receive final payment on, a contract with state or county government. HRS section 103D-328, however, provides for two exceptions: (1) if the taxpayer is in good standing on a payment plan with the tax agency; and (2) if the taxpayer is contesting the validity of a tax debt in an administrative or judicial appeal. This bill is consistent with those exceptions.

We are concerned that this bill may be overkill given that contractors are required to obtain tax clearances every two years anyway, and it may further burden a permitting and inspection process that is already fraught with delays. The Department might be able to turn around the applications quickly given that they are to be filed in electronic form, but the county inspecting and permitting agencies are still going to have to wait for the clearances and incorporate that verification step into their own processes.

Digested 2/17/2019

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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Wednesday, February 20, 2019
Time: 10:05 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 397, S.D. 1, Relating to Contracting

The Department of Taxation (Department) offers the following comments on S.B. 397, S.D. 1, for the Committee's consideration.

S.B. 397, S.D. 1, adds a new requirement for all contractors and subcontractors applying for a building license for private developments exceeding an unspecified amount to submit tax clearances as a condition to obtain the license. A summary of key provisions of this bill are as follows:

- Requires all contractors and subcontractors applying for a building license for private developments exceeding an unspecified amount to submit tax clearances from the Department and the Internal Revenue Service (IRS);
- Requires the license issuing officer to verify that all contractors and subcontractors have filed all tax returns due, and that all taxes, interest, and penalties have been paid;
- Authorizes the Director of Taxation to waive the IRS tax clearance requirement if the Director determines that it is in the best interest of the State;
- Authorizes the Department to require applications for tax clearances to be submitted through electronic means;
- Requires all assignees of a contract for a private development exceeding an unspecified amount to obtain a bulk sales certificate if required under Hawaii Revised Statute (HRS) section 237-43 or tax clearances if the bulk sales certificate is not required;
- Requires the contractors and subcontractors to submit the most recent tax clearances as a condition of final building inspection;
- Exempts the tax clearances requirement if the Department certifies that the contractor or subcontractor is in good standing under a plan in which delinquent taxes, interest, and penalties are being paid to the Department or the IRS;
- Imposes a penalty of not more than \$1,000 or imprisonment of not more than one year, or both, to any officer or employee of any governmental agency that intentionally violates the new requirement under this bill;

- Exempts the tax clearances requirement during the period that the validity of the taxes, penalties, or interest is being contested in an administrative or judicial appeal with the Department of IRS;
- Appropriates an unspecified amount from the general funds to the counties for the enforcement of this bill; and
- Is effective July 1, 2019.

First, the Department notes that this bill is very similar to the requirement to obtain tax clearances for certain contracts with the state and counties set forth in HRS section 103-53. However, the term “most recent tax clearances” as required by subsection (c) of this bill is not defined. Thus, the Department suggests stating a specific period, similar to HRS section 103-53(c).

Second, the Department also notes that every two years, the State Contractors License Board requires contractors to renew their contractor’s licenses, and one of the requirements to renew the license is to submit a tax clearance certificate.

Third, the Department appreciates the Senate Committee on Public Safety, Intergovernmental and Military Affairs’ amending the measure to give the Department the authority to require applications for tax clearances under this measure be submitted through electronic means prescribed by the Department.

Finally, the Department respectfully requests that the effective date of the measure be made January 1, 2020 to allow the Department sufficient time to prepare for the changes proposed by this measure.

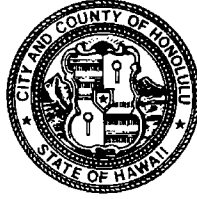
Thank you for the opportunity to provide comments on this measure.

DEPARTMENT OF PLANNING AND PERMITTING
CITY AND COUNTY OF HONOLULU

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February 20, 2019

The Honorable Donovan Dela Cruz, Chair
and Members of the Committee on Ways and Means
Hawaii State Senate
Hawaii State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Dear Chair Dela Cruz and Committee Members:

**Subject: Senate Bill No. 397, SD 1
Relating to Contractors**

The Department of Planning and Permitting (DPP) **opposes** Senate Bill No. 397, SD 1, which would tie building permit issuance to state and federal tax compliance by contractors and subcontractors. This compliance check must be done for each building permit application.

We assume reference to a "building license" is a reference to a county building permit.

While adding the requirement for tax clearances will add county costs to permit issuance, our department is not equipped to determine whether "all contractors and subcontractors have filed all tax returns due...and that all taxes, interest, and penalties levied...have been paid." We are not tax assessors nor tax collectors.

As a counter measure, we suggest that tax compliance be added to the requirements for state contractors' licenses. We already have an electronic link to the Department of Commerce and Consumer Affairs' list of licensed contractors. This change would not affect our operations as we already check to confirm that contractors listed on building permit applications have valid state licenses through this electronic link.

Please hold Senate Bill No. 397, SD 1.

Thank you for the opportunity to testify.

Very truly yours,

A handwritten signature in black ink, reading "Kathy K. Sokugawa".

Kathy K. Sokugawa
Acting Director