

JOSH GREEN, M.D.
GOVERNOR

SYLVIA LUKE
LIEUTENANT GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION

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DEPT. COMM. NO. 267

December 22, 2022

The Honorable Ronald D. Kouchi
President and Members of the Senate
Thirty-Second State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Scott K. Saiki
Speaker and Members of the
House of Representatives
Thirty-Second State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Kouchi, Speaker Saiki, and Members of the Legislature:

For your information and consideration, I am transmitting a copy of the Department of Taxation's 2022 Cash Economy Enforcement Act Report, as required by section 231-81(c), Hawaii Revised Statutes (HRS).

In accordance with section 93-16, HRS, I am also informing you that the report may be viewed electronically at: http://tax.hawaii.gov/stats/a5_1annual/.

If you have any questions or concerns, please feel free to call me at (808) 587- 1540.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary S. Suganuma", is written over a printed name and title.

Gary S. Suganuma
Director

C: Josh Green, M.D., Governor
Sylvia Luke, Lieutenant Governor
Legislative Reference Bureau (Attn: Karen Mau)
Leslie H. Kondo, State Auditor
Luis Salaveria, Director of Finance, Department of Budget and Finance
Stacey A. Aldrich, State Librarian, Hawaii State Public Library System
David Lassner, Ph.D., President, University of Hawai'i

Enclosure

DEPARTMENT OF TAXATION

ANNUAL REPORT REQUIRED BY ACT 134, SLH 2009, SECTION 9 For the period from July 1, 2021 through June 30, 2022

Submitted to the Thirty-Second State Legislature
Regular Session of 2023

Act 134, Session Laws of Hawaii 2009, also known as the "Cash Economy Enforcement Act" (hereinafter sometimes referred to as the "Act"), requires at Section 9 of the Act, that the Department of Taxation (Department) report the following information to the Legislature:

- I) The state resources committed to implementing the Cash Economy Enforcement Act;
and
- II) The additional tax revenues raised as a result of the Act.

The Special Enforcement Section (SES) was established to enforce the Act. Its goal is to ensure that all sectors of Hawaii's economy, especially those that conduct a significant portion of business transactions in cash ("cash economy"), pay their fair share of taxes. In FY 2016, SES was given additional responsibilities for ensuring that short-term vacation rental operators comply with the state's transient accommodations tax laws and in FY2022 the authority of SES to examine any sector of Hawaii's economy for non-compliance was clarified and codified.

BACKGROUND

The Cash Economy Enforcement Act provided the Department with unique resources to increase taxpayer compliance in the area of the "cash economy" by educating taxpayers about their tax obligations and by conducting civil tax investigations. The Act executes its mandate through the Special Enforcement Section, which is a specialized unit within the Department's Compliance Division comprised primarily of civil investigators.

The Department was authorized at Section 2 of the Act, codified as Section 231-83(b), Hawaii Revised Statutes (HRS), to utilize new hires, as well as existing labor resources to staff the SES operations. Furthermore, Section 2 of the Act authorized the Department to identify the proceeds of SES operations to substantially fund the unit. The SES is allowed to identify taxes collected from any taxpayer, assessment, investigation, or collection as a matter of the SES, which may then be deposited into the Tax Administration Special Fund, codified as HRS §231-85. Within the Tax Administration Special Fund's expenditure authority, the Department was initially allowed to retain the first \$500,000 to fund the Section's operations, with the remaining fiscal year collections being deposited into the General Fund.

Section 8 of the Act authorized establishing 6 new full-time equivalent (FTE) positions that may be filled by investigators, investigator assistants, licensed attorneys, or other support staff, in addition to using current personnel. In subsequent years, the legislature incrementally authorized the Department to retain additional funds and establish additional positions, currently

up to \$2,000,000 and 13 FTE positions, to support SES's operations and help with enforcement of Transient Accommodations Tax laws, codified as HRS §235-20.5.

ACTIVITIES AND ACCOMPLISHMENTS

SES's FY 2022 accomplishments include:

- Reviewed 142 complaints and referrals provided by the public and other departments and utilized investigative and analytical methods to identify business operators showing indications of noncompliance with GET and/or TAT laws and evaluated for possible investigation.
- Using various investigative techniques, conducted tax investigations of varying complexities to identify income sources and determine the amount of income subject to taxation.
- Requested and secured voluntarily filed GET and/or TAT returns and tax payments. When a return could not be secured from the taxpayer, referred the matter and evidence of income subject to tax to Office Audit for assessment.
- Furthered projects on vacation rental/transient accommodation businesses utilizing publicly available and confidential database sources to develop leads on taxpayers who appear to be out of compliance with GET and TAT laws. These projects include subpoenaed information obtained from Airbnb, as well as resources made available by the Tax System Modernization Program (TSM). As a result, significant numbers of leads have been and continue to be generated showing unreported and under-reported income subject to GET and TAT. Revenue from investigation of these leads amounted to approximately \$12.3M in TAT and related GET revenue collected for FY 2022, an increase over last fiscal year of more than \$3.5M.
- Continued and expanded investigations of on-line retail and service companies which had heretofore been a neglected sector of the economy, in order to ensure they paid their fair share of taxes. Due primarily to a focus on large internet companies, non-TA related GET revenue collections grew to over \$28.4M in FY 2022, an increase over last fiscal year of more than \$3.4M.

I. STATE RESOURCES COMMITTED TO IMPLEMENTING THE CASH ECONOMY ENFORCEMENT ACT AND OTHER ACTIVITIES

In FY 2022, SES incurred the following expenditures to support its compliance activities:

<u>Category</u>	<u>FY 2022</u>
Personnel Costs	\$760,964
Other Expenses	<u>160,702</u>
Total Expenditures	\$921,666
No. of Staff	7

II. ADDITIONAL REVENUES RAISED BY THE CASH ECONOMY ENFORCEMENT ACT

In FY2022 SES continued the revenue gains it made in the previous fiscal year. SES Total Impact Revenue¹ grew to \$40,768,932 in FY2022, as compared with \$33,773,110 in FY 2021. This represents a 20.7% increase in total revenue over the previous fiscal year. Of the GET revenue collected, \$28,424,615 derived from non-TA related sources. As was the case last year, accounting for the majority of this total was revenue derived from online retail and service companies, a sector that has received increasing focus from SES in an effort to ensure this segment of the economy pays its fair share.

With regard to TAT revenue, SES's efforts this past fiscal year resulted in \$7,737,168 collected, an increase of \$1,497,305 over the previous year (a 24% increase). When \$4,607,149 of GET collections related to transient accommodations are added in, total revenue attributable to SES's efforts with regard to transient accommodations amounts to \$12,344,317.

While the persistence of the Covid-19 pandemic led to the continued suspension of field visits to businesses and vendor events, in FY2022 SES was able to initiate enforcement of HRS §237-4D requiring host/operators or transient accommodations display their tax registration number in on-line advertisements for the accommodations they rented. As a result of this effort, 97 citations were issued for violations in FY2022.

Details of SES's performance compared with the previous fiscal year are as follows:

	<u>FY 2022</u>	<u>FY 2021</u>
Number of Events Visited Throughout the State	0*	0*
Businesses Educated on Compliance of Tax Laws	0*	0*
Complaints Received and Reviewed	142	271
Number of Investigations Completed	192	522
General Tax ² Revenue Collected from Delinquent Returns	\$5,814,800	\$5,388,494
TAT Revenue Collected from Delinquent Returns	<u>4,803,465</u>	<u>4,834,190</u>
Total Tax Collected from Delinquent Returns	\$10,618,265	\$10,222,684
General Tax Impact Revenue Collected	\$33,031,764	\$27,533,247
No. of Taxpayers Remitting General Tax Payments	1,200	1,610
Average General Tax Impact Revenue Collected per T/P	\$27,527	\$17,101
TAT Impact Revenue Collected	\$7,737,168	\$6,239,863

¹ SES Measures its accomplishments by determining the actual tax collections that were remitted by taxpayers on delinquent returns secured by SES. In addition, SES is credited with tax collections remitted by taxpayers for a post compliance period of 18 months after they were brought into tax compliance. This is because had SES not brought the taxpayer into tax compliance, there is a strong likelihood that their non-compliance would have continued indefinitely. Delinquent period tax collections and post compliance period collections aggregate to Impact Revenue.

No. of Taxpayers Remitting TAT Payments	648	656
Average TAT Impact Revenue Collected per T/P	\$11,940	\$9,512
Total Impact Revenue Collected from Taxpayers	\$40,768,932	\$33,773,110

	<u>FY 2022²</u>	<u>FY 2021²</u>	<u>FY 2020</u>
Complaints Received	142	271	349
Businesses Educated on Tax Compliance	0	0	698
Number of Site Visits Throughout the State	0	0	94
GET Impact Revenue Collected	\$33,031,764	\$27,533,247	\$7,189,003
TAT Impact Revenue Collected	<u>7,737,168</u>	<u>6,239,863</u>	<u>3,674,285</u>
Total Impact Revenue Collected from Taxpayers	\$40,768,932	\$33,773,110	\$10,863,288
Total Tax Collected from Secured Delinquent	\$15,178,904	\$10,570,924	\$6,051,938

² In FY2022 and FY2021, the numbers for Businesses Educated on Tax Compliance, and the Number of Site Visits Throughout the State, are reflective of the continued suspension of SES site visits to businesses and vendor events due to the Covid-19 pandemic.