

A Bill for an Act Relating to Tax Administration.

*Be It Enacted by the Legislature of the State of Hawaii:*

SECTION 1. In all tax systems, government administrators are continually working to reduce tax noncompliance known as the “tax gap.” In the United States, the tax gap, which is the difference between the amount of tax that is required to be reported and timely paid and the amount of tax that is actually reported and paid, is estimated to be almost \$400,000,000,000 per year. Of this tax gap, it is further estimated that about \$200,000,000,000, or half of the tax gap, is composed of what is known as the “cash economy.” Hawaii’s annual tax gap is estimated to be about \$2,000,000,000 in unreported and unpaid taxes with approximately \$1,000,000,000 attributed to the cash economy. Focusing resources on shoring up compliance in this area should be a priority.

Cash-based transactions are a fundamental part of any economy. As the oldest form of payment, cash continues to dominate many facets of the local economy. Cash is inherently private, efficient, and predictable for both purchaser and seller. However, cash transactions are also the simplest means of underreporting or non-reporting for tax purposes, because no bank, no means of electronic oversight, and no intermediary maintains records of the movement of funds from one pocket to another.

As stated by former Internal Revenue Service Commissioner Mark Everson, “[t]he vast majority of Americans pay their taxes accurately and are short-changed by those who don’t pay their fair share. The magnitude of the tax gap highlights the critical role of enforcement in keeping our system of tax administration healthy.” By focusing resources on the cash economy, the department of taxation can ensure fairness in the tax system for those that comply without raising taxes or otherwise substantially burdening Hawaii’s economy as a whole.

The purpose of this Act is to provide the department of taxation with the necessary resources and tools to target high-risk, cash-based transactions to shore up confidence in Hawaii’s tax system for those that do comply. Importantly, the legislature intends that the enforcement resources provided focus on the civil collection and enforcement nature of Hawaii’s tax laws. In an effort to demonstrate the targets of this undertaking, this Act defines “cash-based business” for enforcement purposes, and the department of taxation is directed to focus on such businesses. At the same time, education is equally important as enforcement. Therefore, this Act requires the department of taxation to reach out to industry groups, specific demographics in the economy, and practitioners to educate taxpayers on their tax responsibilities.

This Act shall be known as the “Cash Economy Enforcement Act of 2009.”

SECTION 2. Chapter 231, Hawaii Revised Statutes, is amended by adding sixteen new sections to be appropriately designated and to read as follows:

**“CIVIL COMPLIANCE; SPECIAL ENFORCEMENT SECTION**

**§231-A Special enforcement section; created.** There is created within the department of taxation the special enforcement section to carry out civil enforcement efforts as directed by the director of taxation. The director may staff the section as the exigencies of the public service may require.

**§231-B Special enforcement section; functions, powers, and duties.** The special enforcement section shall have the following functions, powers, and duties:

- (1) Investigate reported or suspected violations of tax laws for civil enforcement purposes, including through covert means, with a stated priority of investigating cash-based businesses as defined in section 231-I;
- (2) Enforce the tax laws by issuing, enforcing, or executing citations, fines, infractions, assessments, liens, levies, writs, warrants, injunctions, or other process;
- (3) Serve as fraud referral specialists to assist in the development and review of fraud cases for appropriate disposition of potentially fraudulent activities, including referral to criminal investigators and assessment of civil fraud penalties; provided that personnel assigned to the special enforcement section may not participate in any criminal investigation;
- (4) Organize and hold public informational meetings on issues of tax laws, including compliance deficiencies in segments of the economy, and undertake any other activities to encourage taxpayers, practitioners, or others to maintain responsibility and compliance with their tax obligations;
- (5) Coordinate with other sections or divisions within the department of taxation, other departments or branches of the state government, any branches of the county government, or the federal government on matters relating to civil enforcement of the tax laws, including joint investigations, information-sharing arrangements, or concurrent collection efforts; provided that personnel assigned to the special enforcement section may not participate in any criminal investigation;
- (6) Compile information received by third parties, including taxpayers, competitors, government agencies, confidential sources, or public sources and delegate this information within the department for proper handling. Proper handling may include referral internally to other civil or criminal enforcement sections;
- (7) Conduct investigations, research, and studies of matters relevant to the complex or sensitive civil enforcement of the tax laws; and
- (8) Perform such other acts as may be incidental to the exercise of the functions, powers, and duties set forth in this section or as otherwise directed by the director of taxation.

**§231-C Investigators and personnel, appointment and power.** (a) The director of taxation may appoint, commission, or detail to the special enforcement section one or more persons as investigators, investigator assistants, and other support staff as the exigencies of the public service may require. Investigators may be legal or accounting professionals; provided that their primary duty is to conduct investigations pursuant to the authorities of the special enforcement section and they shall not conduct or participate in criminal investigations of the tax laws or render legal advice. Investigators may serve process and apply for and execute search warrants or writs of entry pursuant to section 231-D but shall not otherwise have the powers of a police officer or deputy sheriff.

(b) Notwithstanding any other law to the contrary relating to employment, bargaining, labor, or compensation rights or duties, any person appointed, commissioned, or detailed to the special enforcement section:

- (1) May be an employee of the department in any capacity, including exempt from or subject to chapters 76 and 89 as an employee of the department;
- (2) Shall be exempt from chapters 76 and 89 for purposes of their appointment, commission, or detail capacity as investigator, whether full-time, part-time, or temporary;
- (3) May be appointed, commissioned, or detailed in any capacity, and whose appointment, commission, or detail may be dismissed at the pleasure of the director of taxation;
- (4) If appointed, commissioned, or detailed on a temporary basis, shall have the right to return to the person's same position or to a related position in the same class or division within the department when the person's appointment expires. The return rights provided under this section shall apply to persons exempt from or subject to chapters 76 and 89; and
- (5) May be paid overtime as prescribed by an applicable collective bargaining agreement or existing policy for excluded employees. The compensation rights under this section shall apply to persons exempt from or subject to chapters 76 and 89.

**§231-D Right to inspection of books, records, and premises; warrants and writs; levy and seizure.** (a) Upon presenting credentials, the special enforcement section may examine any books, papers, records, and any article or item of business transacted of any person engaged in business in this State to verify the accuracy of the reporting and payment of the taxes imposed by law. Every person in possession of any books, papers, records, or articles or items of business transacted, and the person's agents and employees, shall provide the special enforcement section the means, facilities, and opportunities for the examinations upon request, to the extent reasonably possible under the circumstances.

(b) The special enforcement section may inspect the operations, premises, and storage areas of any person engaged in business in this State during regular business hours.

(c) The special enforcement section may inspect the operations, premises, and storage areas of any person engaged in business in this State at any time, without notice, upon the issuance of a warrant or writ of entry based upon probable cause of a violation under title 14. The determination of probable cause for purposes of this section shall be made based upon the standard of probable cause for an administrative or civil search or seizure. Application for a search warrant or writ of entry under this section shall be made by making a declaration, under oath, which includes the following:

- (1) The taxpayer's form of business;
- (2) The taxpayer's interest in and address of the premises sought to be searched;
- (3) Whether permission to search the premises has been requested in advance of requesting the warrant or writ;
- (4) The particular books, records, items, articles, assets, or contraband reasonably believed to be on the premises; and
- (5) The alleged violation reasonably believed to have occurred, including nonpayment of taxes; and, if searching or seizing in furtherance of collection, identification of the assets reasonably believed to be on the premises.

The special enforcement section may apply to the circuit court where the person is located for issuance of such warrant or writ. The special enforcement section may execute warrants or writs of entry. Any police officer, criminal inves-

tigator, or deputy sheriff of this State or any county shall be required to render assistance and aid to the special enforcement section in executing warrants and writs, upon request. Criminal law enforcement agencies that assist the special enforcement section may be compensated, as determined by the director; provided that no person or agency shall be compensated on the basis of a specific percentage or fraction of the money collected from taxpayers.

(d) The special enforcement section's ability to inspect shall include inspection of all statements, books, papers, and records in whatever format, including electronic format, articles or items of business transacted, including inventory, supplies, stock, and cash on hand, pertaining to the sales or other business activities of any person to verify the accuracy of the reporting and payment of taxes imposed by law.

(e) The special enforcement section may seize and levy any assets in the custody or control of any person pursuant to this chapter, and subject to all rights of appeal set forth herein.

**§231-E Identification of cash-economy cases; retention of funds.** Notwithstanding any law to the contrary, each fiscal year, the special enforcement section may identify any taxpayer, assessment, investigation, or collection matter as a matter of the special enforcement section. All revenues collected from special enforcement section matters shall be deposited into the tax administration special fund.

**§231-F Violent interference with a tax official.** Any person who interferes, hinders, obstructs, prevents, or impedes any investigator or employee of the department with violence or threat of violence, shall be guilty of a class C felony and, upon conviction, shall be subject to one or any combination of the following:

- (1) A fine of not more than \$4,000;
- (2) Imprisonment for not more than three years; or
- (3) Probation;

provided that a corporation shall be fined not less than \$10,000.

This section shall be construed in accordance with regulations and judicial interpretations given to similar provisions of the Internal Revenue Code.

## CASH ECONOMY ENFORCEMENT; CITATIONS

**§231-G Citations for violations; deposits.** (a) The special enforcement section may issue cease and desist citations to any person if the special enforcement section has cause to believe the person has violated, is violating, or is about to violate any provision of title 14 or administrative rule adopted thereunder. A cease and desist citation may include a monetary fine for any unlawful act.

(b) The department may recommend legislation defining the circumstances and the civil monetary fines citable for unlawful actions under title 14.

(c) Any fine assessed under this section shall be a matter of the special enforcement section under section 231-E and shall be retained and deposited into the tax administration special fund.

(d) Any fine assessed shall be due and payable thirty days after issuance, subject to appeal rights provided under subsection (e); provided that if payment of the fine is determined to be in jeopardy, such fine shall be payable immediately and shall be immediately collected. A finding of jeopardy shall be made in writing, setting forth the specific reasons for the finding. The finding of jeopardy shall be subject to immediate appeal under subsection (e), and at the taxpayer's request the appeal shall be expedited and heard as soon as reasonably practica-

ble. Any amount of fine collected under jeopardy shall only be returned upon a finding by the director of taxation or the circuit court that there was no violation of title 14 pursuant to appeal rights provided under subsection (e).

(e) Cease and desist citations may be appealed to the director of taxation or the director's designee, and the determination of the director may be appealed to the circuit court, pursuant to chapter 91.

**§231-H Cash-based businesses; injunction.** The special enforcement section, with the director of taxation's approval, may bring civil actions in the circuit court where the cash-based business is located to enjoin any unlawful act under title 14, including any administrative rule adopted thereunder, by a cash-based business. To the extent provided by statute, the special enforcement section may include in any action an assessment of a monetary fine.

**§231-I Cash-based business; defined.** For purposes of sections 231-G to 231-P, "cash-based business" means any person who operates a business, including for-profit or not-for-profit, where transactions in goods or services are exchanged substantially for cash and where the business is found, based upon reasonable cause including observation or evidence, to have met one of the following factors:

- (1) Is found to have substantially underreported or misrepresented the proper amount of tax liability on any return or other submission to the department. For purposes of this paragraph, an amount has been substantially underreported if the amount properly includible on the return or submission is in excess of twenty-five per cent of the amount stated on the return or submission;
- (2) Is required to be licensed, registered, or permitted under title 14 and is in fact not so licensed, registered, or permitted;
- (3) Has a past pattern of noncompliance of obligations under title 14;
- (4) Does not have a fixed and permanent principal place of business;
- (5) Has not obtained any required tax clearance;
- (6) Has failed to maintain adequate books and records, or those records required to be maintained by law or administrative rule;
- (7) Does not accept checks or electronic payment devices for business transactions; provided that a business may establish reasonable criteria for accepting personal checks;
- (8) Offers price differentials or otherwise deviates from usual business practices when the business transaction substantially involves payment of cash, except where there is a bona-fide business reason for a price differential, such as the avoidance of merchant fees imposed by credit card companies; or
- (9) Any other factor relevant to describing a cash-based business capable of noncompliance as determined by the director of taxation and issued pursuant to a tax information release;

provided that a business shall not be deemed to have met any of these factors while a genuine dispute as to that factor is pending in a contested case before any administrative agency or in any court.

**§231-J Failure to produce license upon demand.** Every person required to be licensed or permitted under title 14, whether or not so licensed or permitted, shall be required to produce the license or permit upon demand by the special enforcement section. Failure to produce the license or permit upon demand shall be unlawful. Any person who violates this section shall be subject to a fine not to exceed \$500; provided that if the person is a cash-based business, the fine shall

not exceed \$1,000. It shall be an absolute defense to this section if the person produces a license or permit number on file with the department and the department confirms that the person associated with the number is true and accurate.

**§231-K Failure to keep adequate books and records.** It shall be unlawful for any person required under title 14 to keep books or records to fail to produce the books or records upon demand by the special enforcement section, or as soon thereafter as is reasonable under the circumstances. Any person who violates this section shall be subject to a fine not to exceed \$1,000; provided that if the person is a cash-based business, the fine shall not exceed \$2,000.

**§231-L Failure to record transaction by receipt.** It shall be unlawful to conduct more than ten taxable business transactions per day in cash and fail to provide a receipt or other record of the transaction when the means for issuing a receipt or recording the transaction are available. Each day a person is in violation of this section shall be treated as a separate violation. Any person who violates this section shall be subject to a fine not to exceed \$1,000; provided that if the person is a cash-based business, the fine shall not exceed \$2,000.

**§231-M Failure to record transaction by register.** It shall be unlawful to conduct more than ten taxable business transactions per day in cash and fail to record the transaction in a cash register when the means for recording the transaction in a cash register are available. Each day a person is in violation of this section shall be treated as a separate violation. Any person who violates this section shall be subject to a fine not to exceed \$1,000; provided that if the person is a cash-based business, the fine shall not exceed \$2,000.

**§231-N Tax avoidance price fixing.** It shall be unlawful for any person to sell, offer to sell, or otherwise convey more than one price for any business to be transacted when the lower price is offered if the transaction is paid for in cash. It shall not be an offense under this section if a business charges a higher price for legitimate business purposes, such as for the purpose of recovering any charges assessed the business, including for facilitating electronic payment. Any person who violates this section shall be subject to a fine not to exceed \$2,000; provided that if the person is a cash-based business, the fine shall not exceed \$3,000.

**§231-O Possession of currency for tax avoidance purposes.** It shall be unlawful for any person engaged in business in this State to possess currency in the form of coin or note, where the possession is for tax avoidance purposes. It shall be the department's burden to establish that currency is possessed for tax avoidance purposes; provided that circumstantial evidence may be used by the department in any proceeding. Any person who violates this section shall be subject to a fine not to exceed \$2,000; provided that if the person is a cash-based business, the fine shall not exceed \$3,000.

**§231-P Interference with a tax official.** It is unlawful for any person to intentionally interfere with, hinder, obstruct, prevent, or impede any investigator, auditor, collector, or other employee of the department from obtaining license information, books, records, articles, or items of business transacted, or other information or property rightfully entitled the department. Any person who violates this section shall be subject to a fine of not more than \$2,000. It shall be an absolute defense to the fine under this section that the person acted with good cause.”

SECTION 3. Chapter 237, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

**“§237- Reporting requirement for contractors on federal construction projects.** All persons who do not possess a valid license under this chapter at the time of the contract award and who contract with the federal government for any construction project located in the State shall report to the department, on forms prescribed by the department, its estimated gross receipts or any other information requested by the department on the prescribed form, from the construction project within thirty days of the contract being awarded. Failure to report as provided in this section shall result in a penalty of \$1,000 per month, or fraction thereof, for each month that a failure to report exists; provided that the maximum penalty allowed under this section in the aggregate shall not be more than \$6,000.”

SECTION 4. Section 231-1, Hawaii Revised Statutes, is amended by amending the definition of “person” to read as follows:

““Person” [as used in sections 231-34, 231-35, and 231-36] includes one or more individuals, a company, corporation, a partnership, an association, or any other type of legal entity, and also includes an officer or employee of a corporation, a partner or employee of a partnership, a trustee of a trust, a fiduciary of an estate, or a member, employee, or principal of any other entity, who as such officer, employee, partner, trustee, fiduciary, member, or principal is under a duty to perform and is principally responsible for performing the act [~~in respect of which the violation occurs~~].”

SECTION 5. Section 235-20.5, Hawaii Revised Statutes, is amended to read as follows:

**“§235-20.5 Tax administration special fund; established.** (a) There is established a tax administration special fund, into which shall be deposited [fees]:

- (1) Fees collected under sections 235-20, 235-110.9, and 235-110.91[; and penalties];
- (2) Penalties collected under section 2 of Act 206, [H]Session Laws of Hawaii 2007[;]; and
- (3) Revenues collected by the special enforcement section pursuant to section 231-E; provided that in each fiscal year, of the total revenues collected by the special enforcement section, all revenues in excess of \$500,000 shall be deposited into the general fund.

(b) The moneys in the fund shall be [~~expended by the department to offset the costs associated with;~~] used for the following purposes:

- (1) Issuing comfort letters[;], letter rulings, written opinions, and other guidance to taxpayers;
- (2) Administering the tax [credit] credits under [section] sections 235-110.9[;including issuing certificates; and
- (3) Issuing certificates under section] and 235-110.91[;]; and
- (3) Administering the operations of the special enforcement section.”

SECTION 6. Section 237-9, Hawaii Revised Statutes, is amended to read as follows:

**“§237-9 Licenses; penalty.** (a) Except as provided in this section, any person who has a gross income or gross proceeds of sales or value of products upon which a privilege tax is imposed by this chapter, as a condition precedent

to engaging or continuing in such business, shall in writing apply for and obtain from the department of taxation, upon a one-time payment of the sum of \$20, a license to engage in and to conduct such business, upon condition that the person shall pay the taxes accruing to the State under this chapter, and the person shall thereby be duly licensed to engage in and conduct the business. ~~[Any person licensed or holding a license under this chapter before January 1, 1990, shall pay a one-time license renewal fee of \$20 on or before January 31, 1990, as a condition precedent to engaging or continuing in business.]~~ The license shall not be transferable and shall be valid only for the person in whose name it is issued and for the transaction of business at the place designated therein. The license may be inspected and examined, and shall at all times be conspicuously displayed at the place for which it is issued.

(b) Licenses and applications therefor shall be in such form as the department shall prescribe, except that where the licensee is engaged in two or more forms of business of different classification, the license shall so state on its face. The license provided for by this section shall be effective until canceled in writing. Any application for the reissuance of a previously canceled license identification number after December 31, 1989, shall be regarded as a new license application and subject to the payment of the one-time license fee of \$20. The director may revoke or cancel any license issued under this chapter for cause as provided by rules adopted pursuant to chapter 91.

(c) Any person who receives gross income or gross proceeds of sales or value of products from engaging in business in the State and who fails to obtain a license or receives gross income or gross proceeds of sales or value of products from engaging in business in the State without a license required under this section may be fined not more than \$500; provided that a cash-based business may be fined not less than \$500 and not more than \$2,000, as determined by the director or the director's designee. The penalty under this subsection shall be in addition to any other penalty provided under law and may be waived or canceled upon a showing of good cause.

~~(e)~~ (d) If the license fee is paid, the department shall not refuse to issue a license or revoke or cancel a license for the exercise of a privilege protected by the First Amendment of the Constitution of the United States, or for the carrying on of interstate or foreign commerce, or for any privilege the exercise of which, under the Constitution and laws of the United States, cannot be restrained on account of nonpayment of taxes, nor shall section 237-46 be invoked to restrain the exercise of such a privilege, or the carrying on of such commerce.

~~(d)~~ (e) The director may permit a person engaged in network marketing, multi-level marketing, or other similar business to obtain the license required under this section for purposes of becoming a tax collection agent on behalf of its direct sellers. The tax collection agent shall report, collect, and pay over the taxes due under this chapter and chapter 238 on behalf of its direct sellers who are covered by the tax collection agreement. The tax collection agent's direct sellers shall be deemed to be licensed under this chapter; provided that the licensure shall apply solely to the business activity conducted directly through the marketing arrangement. Under this section, a tax collection agent shall:

- (1) Notify all of its direct sellers making sales in the State that it has been designated to collect, report, and pay over the tax imposed by this chapter and chapter 238 on their behalf on the business activity conducted through the marketing arrangement;
- (2) If required by the director as a condition of obtaining the license, furnish with the annual return, a list (including identification numbers) of all direct sellers for the taxable year who have been provided (by the tax collection agent) information returns required under



[section] Section 6041A of the Internal Revenue Code of 1986, as amended, and any other information that is relevant to ensure proper payment of taxes due under this section; and

- (3) Be personally liable for the taxes due and collected under the tax collection agreement if taxes are collected, but not reported or paid, together with penalties and interest as provided by law.

[(e)] (f) For the purposes of this section:

“Cash-based business” has the same meaning as in section 231-I.

“Consumer product” shall include tangible consumer products and intangible consumer services.

“Direct seller” means any person who is engaged in the trade or business of selling (or soliciting the sale of) consumer products:

- (1) To any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis, that the director prescribes by rule adopted pursuant to chapter 91, for resale other than in a permanent retail establishment;
- (2) Other than in a permanent retail establishment; provided that:
  - (A) Substantially all the remuneration (whether or not paid in cash) for the sale of consumer products is directly related to sales or other output rather than to the number of hours worked; and
  - (B) The sales of consumer products by the person are performed pursuant to a written contract that provides that the person will not be treated as an employee with respect to those sales for federal or state tax purposes.

“Direct seller” includes individuals who realize remuneration dependent on the productivity of other individuals in the marketing arrangement.

“Network marketing” or “multi-level marketing” means a marketing arrangement in which consumer products are distributed and sold to or through direct sellers.”

SECTION 7. Section 237-12, Hawaii Revised Statutes, is amended by amending subsection (b) to read as follows:

“(b) In the case of any person entitled to the protection of section [237-9(e);] 237-9(d), the tax shall be collected only through ordinary means.”

SECTION 8. The department of taxation may establish six new full-time equivalent (6.0 FTE) positions that may be staffed by investigators, investigator assistants, licensed attorneys, or other support staff, in addition to using current and existing employees of the department of taxation, to staff the special enforcement section established in section 2 of this Act as the exigencies of the public service may require.

SECTION 9. The department of taxation shall report to the legislature no later than thirty days prior to the convening of each regular session the state resources committed to implementing this Act, and the additional revenues raised therefor.

SECTION 10. This Act does not affect rights and duties that matured, penalties that were incurred, and proceedings that were begun, before its effective date.

SECTION 11. In codifying the new sections added to chapter 231, Hawaii Revised Statutes, by section 2 of this Act, the revisor of statutes shall

substitute appropriate section numbers for the letters used in designating and referring to the new sections in this Act.

SECTION 12. Statutory material to be repealed is bracketed and stricken. New statutory material is underscored.<sup>1</sup>

SECTION 13. This Act shall take effect upon its approval; provided that:

- (1) The amendments made to section 235-20.5, Hawaii Revised Statutes, by this Act shall not be repealed when section 235-20.5, Hawaii Revised Statutes, is reenacted on January 1, 2011, pursuant to section 8 of Act 206, Session Laws of Hawaii 2007;
- (2) Sections 231-F, 231-J, 231-K, 231-L, 231-M, 231-N, 231-O, and 231-P, Hawaii Revised Statutes, in section 2 of this Act shall take effect on July 1, 2009; and
- (3) This Act shall be repealed on June 30, 2014, and section 235-20.5, Hawaii Revised Statutes, shall be reenacted in the form in which it read on the day prior to the effective date of section 8 of Act 206, Session Laws of Hawaii 2007; provided further that sections 231-1, 237-9, and 237-12(b), Hawaii Revised Statutes, shall be reenacted in the form in which they read on the day prior to the effective date of this Act.

(Approved June 18, 2009.)

**Note**

1. Edited pursuant to HRS §23G-16.5.