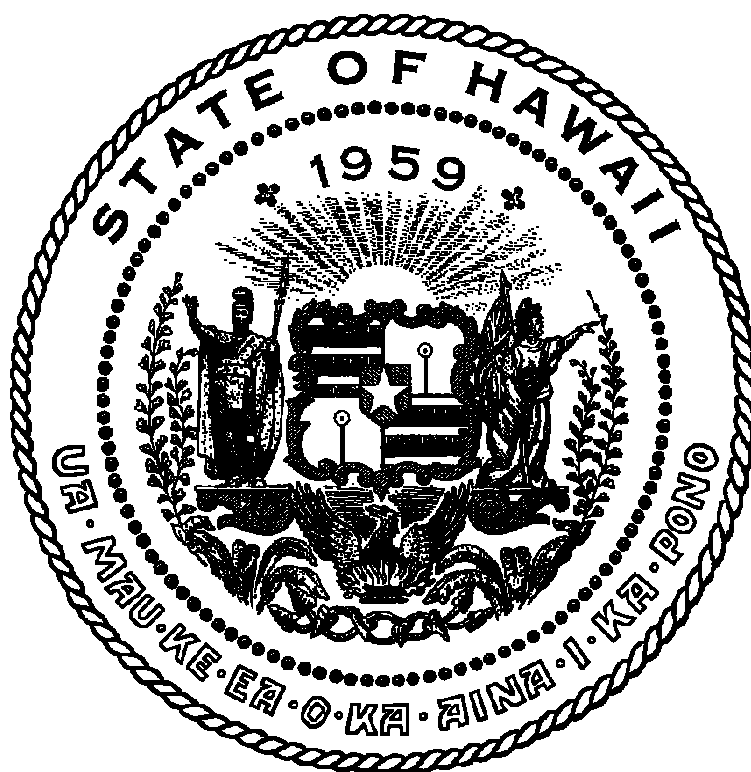


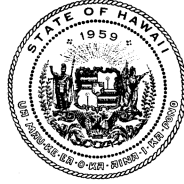
DEPARTMENT OF TAXATION STATE OF HAWAII



ANNUAL REPORT 2006–2007

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



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December 4, 2007

The Honorable Linda Lingle
Governor, State of Hawaii
Executive Chambers
State Capitol, Fifth Floor
Honolulu, HI 96813

Dear Governor Lingle:

I am pleased to present you with this summary of the major accomplishments of the Department of Taxation for the fiscal year ending June 30, 2007.

The success of the project to administer the county surcharge on the State's general excise tax on behalf of the City and County of Honolulu was due to an extraordinary effort by the entire Department. The Department conducted extensive outreach activities to gather input and inform and educate the public about the new tax. We appreciate the support provided by the Lingle-Aiona Administration and the Legislature to carry out our new responsibility.

I would also like to specifically mention the significant improvements in customer services, particularly in the telephone call answer rate during the January through June filing season, increases in the number of audits completed and dollars assessed by both office and field auditors, and continued increases in the amount of delinquent taxes collected.

A total of \$5.3 billion was collected in fiscal year 2007. Although not a State tax realization, the \$53.8 million of county surcharge tax collected on behalf of the City and County of Honolulu is included in the collection totals. Out of the total tax collected, \$4.6 billion (or 86.3%) was deposited into the State General Fund.

The Department also provided technical and administrative support to the 2005–2007 Tax Review Commission, and conducted a number of studies for the Commission. The 2005–2007 Tax Review Commission completed its report on December 1, 2006, and dissolved upon adjournment sine die of the 2007 legislative session.

In closing, I acknowledge the diligent work of the Department's employees and managers during the past fiscal year. With the forecasted slowing of the growth rate of the State's economy, we understand that the task of collecting the tax revenue that sustains State government operations will be more challenging. We will nonetheless strive to continue providing the highest possible level of service to the public.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kurt Kawafuchi". The signature is fluid and cursive, written over a white background.

KURT KAWAFUCHI
Director of Taxation

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THE YEAR IN REVIEW

TAX SERVICES AND PROCESSING DIVISION

The Tax Services and Processing (TSP) Division consists of three branches: 1) Document Processing, 2) Taxpayer Services, and 3) Revenue Accounting. Each branch's objectives are unique to its specific functions, with an overall division objective to perform all functions relating to the centralized processing, editing, and controlling of tax information through paper documents or electronic data; receiving, securing, depositing, and accounting for tax payments; and functions relating to account management, licensing, and providing taxpayer services to the public.

Using process change, technology, and our strategic vision, the TSP Division continues to improve upon the Department's Integrated Tax Information Management System (ITIMS) technology platform, especially in terms of our very successful ITIMS Imaging System (IIS). As tax returns are received and sorted, an increasing number of selected returns and payments were made available in fiscal year (FY) 2007 to be scanned into digital images and stored in a repository as they are processed. These on-line images of tax returns and payments are quickly retrieved by users directly from the tax account, greatly enhancing the Department's ability to resolve taxpayer issues quickly across all island offices in Hawaii with the click of a button.

In FY 2007, over 3.2 million selected returns and payments were processed through the IIS, of which 39% represented prior year returns that were made available to be instantaneously retrieved as digital images. IIS continues to assist customer service staff through on-line image retrieval and has substantially improved the processing of returns and payments. Through the IIS state-of-the-art scanning and character recognition technology, the Department continues to reduce the time required in data entry. In FY 2007, the IIS processing of returns and payments represented 58% of the total volume, a significant increase of 50 percentage points over the 8% in FY 2006. As additional forms are migrated from the current key-from-paper technology, the Department will continue to reduce the turnaround times for the posting of paper returns and processing of refunds.

A new telephone system was implemented in FY 2007, which provides taxpayers with information as to their position number in the holding queue and the expected waiting time in terms of minutes. Music is now played in the holding queue while a taxpayer is waiting to be serviced, and the Department now has the ability to queue calls to a customer representative that is specialized in a particular area along with many more features. An automated feature has also been added that allows taxpayers to check on the status of general excise tax payments and refunds.

Beginning December 1, 2006, Act 131, Session Laws of Hawaii (SLH) 2005, required all retailers of tobacco products to obtain a permit for each business location before March 1, 2007. Notices were mailed to all 2,031 identified retailers of tobacco products during the first week of September 2006. As of June 30, 2007, 850 applications were received for 1,403 business locations and 100% of the permits (1,403) were timely issued.

Document Processing Branch

The major objective of the Document Processing (DP) Branch is to process all tax returns and documents in an orderly and controlled manner; receive, secure, deposit, and account for tax payments; and store, file, and retrieve such documents.

For FY 2007, the DP Branch processed 3,462,860 returns and payments, of which 634,670 (19%) were electronically transmitted. The DP Branch processed approximately 1.41 million payments during the year with the Electronic Funds Transfer (EFT) program collecting payments of over \$2.61 billion dollars.

The Joint Electronic Filing Program (JELF) with the Internal Revenue Service (IRS) is in its seventh year. The JELF program allows certain taxpayers who file the N-11 or N-15 individual income tax return forms to file their Hawaii returns electronically. We increased our participation from 190,305 returns filed electronically last year to 234,735 returns filed electronically this year, representing a 23.3% increase.

Taxpayers may also file their returns through the Department's website. Taxpayers filed 138,785 returns on our website during FY 2007. Electronically filed returns allow data to flow into internal systems with a minimal amount of manual contact, which enhances operational efficiency.

Taxpayer Services Branch

The major objectives of the Taxpayer Services (TPS) Branch are three-fold: 1) to provide efficient customer assistance and information on all taxes administered by the Department (Customer Inquiry); 2) to perform computer-based error correction activities to allow for expedient processing, posting or updating of tax returns, payments, and other documents (Account Management); and 3) to process, issue, and update all licenses and permits issued by the Department in a timely and efficient manner (Licensing).

Customer Inquiry: 2007 Tax Season Telephone Call Statistics

During the January through June 2007 income tax filing season, the total number of calls received was 181,663, of which 47,756 calls (26%) were handled by the Interactive Voice Response (IVR) automated system and 114,820 calls (63%) were handled by tax representatives. As a result, the overall call answer rate for the 2007 tax season was 90%, which was significantly higher than the 50% call answer rate for the same period in 2006 and which dramatically exceeded the 32% call answer rate for the same period in 2005.

The primary reasons for the extreme variance in the call answer rate during the 2005, 2006, and 2007 tax seasons are directly related to: 1) the implementation of the second major ITIMS component (business taxes) in late 2004, which affected the 2005 tax season; 2) the

implementation of IIS in late 2005, which affected the 2006 tax season; and 3) the implementation of the new county surcharge tax in January 2007.

These major system implementations and tax law changes had a significant impact on the call volume as various informational letters were mailed out to the taxpayers and major modifications were made to key tax forms.

However, with the additional temporary staffing hired to assist with phone calls, extended telephone hours provided to the public, heavier usage of the automated income tax refund status telephone option, and the addition of a new general excise tax return and payment status option to the telephone system, the overall call answer rate went from 32% in 2005, to 50% in 2006, to 90% in 2007. The significant decrease in the total calls received for the 2007 tax season, as compared to the prior two years, is directly attributable to the decrease in repeat callers as temporary staffing was increased and any wait time in the holding queue reduced to a minimum, as well as the more customer-friendly new telephone system.

<u>Year*</u>	<u>Total Calls Received</u>	<u>Total Calls Answered</u>	<u>Overall Call Answer Rate</u>
2007	181,663	162,576	90%
2006	299,582	148,981	50%
2005	346,972	111,846	32%

* Represents the six-month tax season period of January through June for each of the years shown.

Account Management: Error Correction Statistics

For FY 2007, the Account Management Section corrected and posted to the Integrated Tax Processing System (ITPS) nearly 200,000 returns, payments, and other tax forms that were "worklisted" or removed from the processing cycle due to critical errors. For FY 2006, over 150,000 returns and payments were corrected and posted by this work unit resulting in a productivity increase of 33%. With the implementation of the new imaging system this fiscal year, the Account Management team was able to post returns quicker because analysis could be done online instead of waiting for hard copies of the returns to be manually retrieved by the File Maintenance Section.

Licensing: Statistics on Processing Business License Applications/Cancellations

For the fiscal year ending June 30, 2007, the Licensing Section processed over 32,000 registrations for general excise tax licenses, more than 17,000 cancellations, and renewals of 52 liquor permits, 144 fuel permits, and 70 tobacco permits. Additionally, this section very successfully implemented the retail tobacco permitting process in late 2006, which included their active participation in informational briefings, the development of the identified tobacco retailers database in cooperation with the Department of the Attorney General and the Department of Health, the mailing of notification letters with the applications, the processing of applications, and the issuance of 1,403 permits.

Expedited registration with multiple venues also continues to be a priority for the Section, which includes but is not limited to:

- Enhancing the Hawaii Business Express on-line application process to allow a direct feed of data and fees into the computer system, thus eliminating daily manual downloads of paper documents and data (development occurred in FY 2006 with implementation in FY 2007).
- Extending Licensing services to include applications received at the Maui Business Action Center in early 2007.

Revenue Accounting Branch

The major objective of the Revenue Accounting (RA) Branch is the maintenance of revenue control and subsidiary ledgers. This requires control and responsibility for all adjustments, error resolutions, accounting, and reconciliation functions of all tax revenues statewide. This objective also includes the preparation of the Preliminary Report, Statement of Tax Operations (STO), and related reports. Secondary functions of this branch include statewide processing and manual accounting activities of all miscellaneous taxes except the estate and transfer tax; control and accounting for all tax refunds, statewide, that are created by either overpayment or adjustment; maintaining the manual accounting system for statewide protested payments and tax appeals; and handling all refund exception activities, statewide (e.g., returned checks, tracers, forgeries, etc.).

Each month, the RA Branch prepares the Preliminary Report, which is a monthly statewide summary of all the revenues received by the Department net of tax refunds. The Preliminary Report must be prepared by the 5th working day of each month. The RA Branch also prepares the STO, which is a formal and detailed statewide report based on the Preliminary Report. The STO must be prepared by the 10th working day of each month. The RA Branch has met these urgent goals each month.

COMPLIANCE DIVISION

The objective of the Compliance Division is to maximize taxpayer compliance with Hawaii's tax laws in a consistent, uniform, and fair manner. The Compliance Division is composed of the Oahu Office Audit Branch, Oahu Field Audit Branch, Oahu Collections Branch, and the Maui, Hawaii, and Kauai District Tax Offices. There are three programs established in the Division to meet the objectives of our voluntary compliance, self-assessment system. These three programs are: auditing/examination, collection, and taxpayer services (information dissemination).

Auditing/Examination

To support the voluntary compliance, self-assessment system of taxation, both the Office Audit and the Field Audit units performed the following examinations and audits during the fiscal year.

	<u>Office Audit</u>		<u>Field Audit</u>	
	Number of Audits <u>Completed</u>	Dollars <u>Assessed</u>	Number of Audits <u>Completed</u>	Dollars <u>Assessed</u>
Oahu	7,592	\$ 21,608,533	218	\$ 120,827,178
Maui	2,038	6,759,494	28	2,216,689
Hawaii	1,292	1,624,580	39	1,785,254
Kauai	<u>1,525</u>	<u>3,397,694</u>	<u>33</u>	<u>895,853</u>
Total FY 2007	12,447	\$ 33,390,301	318	\$ 125,724,974
Total FY 2006	<u>9,977</u>	<u>28,632,627</u>	<u>291</u>	<u>75,164,257</u>
Difference	2,470	\$ 4,757,674	27	\$ 50,560,717

Both the Office Audit and Field Audit units reflected increases in the number of audit cases closed as well as in the dollars assessed. The Office Audit units' exceptional 24.8% increase in the number of assessments is due to the current selection of cases in such areas of non-compliance as refundable income tax credits, the withholding of State income tax on the sale of Hawaii real property by nonresident persons (HARPTA), selected professions, and others. The Field Audit units were able to increase the number of audits closed by 9.3% despite the loss of staff and the training of new staff.

The Office Audit and Field Audit units also increased the amount they collected upon the closing of their audits, and prior to any billing notices being sent, from \$32.9 million in FY 2006 to \$36.7 million in FY 2007.

Criminal Tax Unit

The Criminal Tax unit increased its activities during the fiscal year and was able to obtain indictments and complaints against 43 taxpayers. These activities resulted in \$235,000 in judicial fines and \$2.5 million in tax assessments. In addition, \$2.0 million in taxes, penalties, interest charges, and fines were collected.

Special Projects

The Oahu Field Audit Branch conducted the following special projects during the fiscal year:

- Federal Contractors Project: This project, which targets unlicensed contractors working on federal installations, was started in 1996 and is an ongoing activity. This fiscal year, 17 audits were completed and resulted in \$20.4 million in assessments.
- Mainland Audit Project: During this fiscal year, 5 cases involving large taxpayers located in the continental U.S. were completed and resulted in \$0.3 million in assessments.
- Referral Cases from Criminal Investigation Unit: During this fiscal year, 64 cases that were originally considered for possible criminal prosecution or that arose pursuant to a criminal investigation were completed and resulted in \$1.2 million in assessments.

- Research Tax Credit: During this fiscal year, 2 cases involving taxpayer claims for the tax credit for research activities were completed and resulted in \$1.0 million in assessments.

Delinquent Tax Collections

The operations of the Compliance Division's Tax Enforcement Program, which consists of the Oahu Collections Branch and the Collections Sections in the Maui, Hawaii, and Kauai District Tax Offices, resulted in several positive increases in key performance measurements. The most notable increase was in the amount of delinquent tax cash collections, which rose by \$20.7 million from \$182.2 million in FY 2006 to \$202.9 million in FY 2007, an 11.4% increase.

A table of major performance measures for FY 2007 is presented below:

<u>Measure</u>	<u>FY 2007</u>	<u>FY 2006</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Total Delinquent Tax Balance (\$ Millions)	\$ 343.8	\$ 319.7	\$ 24.1	7.5
Total New Delinquent Referrals (\$ Millions)	\$ 381.9	\$ 243.8	\$ 138.1	56.6
Total Cash Collected (\$ Millions)*	\$ 202.9	\$ 182.2	\$ 20.7	11.4
Uncollectible Tax Write-Offs (\$ Millions)	\$ 16.8	\$ 8.4	\$ 8.4	100.0
Payment Plans Initiated	17,875	14,438	3,437	23.8
Tax Liens Filed	5,899	5,744	155	2.7
Levies Served	4,675	3,025	1,650	54.5

* The Total Cash Collected for FY 2006 was revised.

Taxpayer Assistance Provided

During FY 2007, the neighbor island district office personnel assisted taxpayers properly file numerous tax returns and other documents over the telephone, at the service counter, and via correspondence. The Oahu Office Audit, Field Audit, and Collection units also provided support services to the neighbor island district tax offices and the Oahu TPS Branch when requested.

The following summarizes the taxpayer assistance activities of the Maui, Hawaii, and Kauai District Tax Offices:

	<u>FY 2007</u>	<u>FY 2006</u>	<u>Difference</u>	
			<u>Amount</u>	<u>%</u>
Counter	75,313	69,882	5,431	7.8
Phone Services	54,061	58,340	(4,279)	(7.3)
Tax Clearances	3,336	5,524	(2,188)	(39.6)
Correspondence	8,329	16,903	(8,574)	(50.7)

The reduction in telephone services, tax clearances, and correspondence is due to the centralization of these processes within the Oahu TSP Division and increased efficiencies in processing resulting from the scanning of returns and improvements to electronic filing and mail processing.

The assistance provided to taxpayers is part of the Compliance Division's continuing emphasis on taxpayer education and problem resolution in all its contacts with taxpayers. The Compliance Division continues to believe in the importance of maintaining taxpayers' willingness to accurately and voluntarily comply with the State tax laws. This "taxpayer enabling and empowering activity" will continue to be emphasized.

STAFF OFFICES

Administrative Services Office

Fiscal Office

The Administrative Services Office submitted the biennium budget for FYs 2008 and 2009 to the 2007 Legislature. For FYs 2008 and 2009, \$25.8 million and \$25.5 million, respectively, was appropriated to the Department.

In discharging its duties and responsibilities, the Department of Taxation incurred operating expenses of \$27.2 million for FY 2007.

Personnel Management

For FY 2007, the Department was authorized 372.5 positions, up from 366.5 positions the previous year. Employees were geographically distributed as follows: Oahu, 305.5; Hawaii, 27; Maui/Molokai, 24; and Kauai, 16.

Personnel actions included 24 new civil service hires, 9 retirements, 304 temporary hires, 19 promotions, 9 transfers, and 16 resignations. Other personnel actions included temporary assignments of employees to higher levels.

STAFFING PATTERN
(Number of Authorized Permanent Positions)

<u>By Organization/Operating Program</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Headquarters Administration	67.0	67.0	57.0
Tax Services and Processing Division	110.0	110.0	88.5
Compliance Division	<u>195.5</u>	<u>189.5</u>	<u>186.5</u>
TOTAL	372.5	366.5	332.0

Rules Office

The Rules Office is currently comprised of the Rules staff and the Technical Section.

Rules Staff

The Rules staff serves as the Department's advisory arm to the Director of Taxation on tax policy and counsels the Director's Office and Department on legal and tax issues. In addition to drafting, analyzing, and researching Hawaii tax proposals, the Rules staff develops Hawaii tax policy through drafting administrative rules.

For the 2007 legislative session, the Rules staff drafted and submitted 13 administration-sponsored bills. Prior to the start of the legislative session, the Rules staff also reviewed and commented on proposed tax legislation submitted by other executive departments.

After reviewing 3,962 bills introduced to the 2007 Legislature, 1,967 House Bills and 1,995 Senate bills, the Rules staff determined that approximately 450 measures proposed tax law changes and analyzed them in depth. These measures were also tracked throughout the legislative session. The Rules staff prepared 424 written testimonies for measures scheduled for public hearings by legislative committees, 214 for the House and 210 for the Senate. Letters to legislative committee chairs were also drafted after the public hearings to respond to specific questions or to address certain concerns of committee members. In addition, the Rules staff was asked to submit comments and recommendations to the Governor on 37 bills passed by the Legislature with possible impact on the Department.

During the fiscal year, the Rules staff prepared letters for the Governor and the Director, announcements, tax information releases, directives, and other publications.

The Rules staff reviewed and certified 1,594 requests for the High Technology Business Investment Tax Credit and 872 requests for the Credit for Research Activities in accordance with Act 215, SLH 2004. The staff also responded to 72 requests for ruling on qualified high technology business activities.

The Rules staff also testified at legislative committee hearings on behalf of the Director, reviewed rules of other agencies, provided training for Department employees, and spoke at several workshops for practitioners.

Technical Section

The Technical Section answers questions raised in telephone calls, e-mails, and letters, and also develops and revises tax forms and instructions to incorporate annual changes in the Hawaii tax law and federal tax law. During the past year, the Technical Section reviewed 271 tax forms and 45 instructions; developed 5 new tax forms and two new sets of instructions; and terminated one form that it determined was obsolete.

The Technical Section is also responsible for reviewing applications for certain tax exemptions. Staff members approved 152 applications filed by nonprofit organizations for an exemption from the general excise tax and 3,685 conveyance tax exemptions.

The Technical Section staff provided training for Department employees and spoke at several workshops for practitioners and new entrepreneurs. The Technical Section staff also reviews, researches, analyzes and provides comments and recommendations on the technical and procedural aspects of the drafts of legislative bills, administrative rules, and Tax Information Releases.

External Training and Outreach

The External Training and Outreach (ETO) Office is attached to the Director of Taxation and has four main functions. The primary function of the office is to be an operations-oriented tax training resource for the Department. A second function is to promote voluntary compliance by updating and distributing plain-language tax information to the public. A third function is to support the Department's outreach efforts by coordinating the Department's summer and year-end workshops. A fourth function is to serve as a focal point to receive media contacts and help prepare appropriate responses.

The ETO Office continues to promote annual summer and year-end workshops in Honolulu, Lihue, Kona, Hilo, and Kahului. The summer and year-end workshops generally have a combined total of more than 500 attendees, mostly tax practitioners.

The ETO Office assisted the Department with the implementation of the new county surcharge tax by participating in outreach and informational briefings to the general public, newspaper articles, informational videos, and informational flyers to businesses.

The ETO Office also continues to facilitate a dialogue between tax professionals and the Department via the annual practitioners forum, which was held in May 2007.

Information Technology Services Office

The Information Technology Services (ITS) Office is responsible for the development, modification, and maintenance of the Department's computerized tax systems, network, and related components.

Several significant technical implementations were necessitated by the new county surcharge on the State general excise tax, enacted by the City and County of Honolulu pursuant to Ordinance No. 05-027 in accordance with Act 247, SLH 2005. The Department contracted a major enhancement to a computer services vendor, CGI, for the integration of the county surcharge into ITIMS as an entirely new tax type. To further support the implementation of this new tax, ITS Office staff developed a new section on the Department's website for taxpayers to easily access administrative rules, announcements, frequently asked questions (FAQs), streaming videos, and other information about the County Surcharge.

Ongoing ITIMS support includes maintaining the major software and ITIMS application systems, providing production maintenance and system enhancements, and implementing changes due to changes in State tax law. Other major ITIMS-related projects implemented include the new regression testing process for ITPS that improves the delivery of technical changes before beginning system testing, and the addition of a new online ICS function that allows Collection staff to schedule automatic installment plan payments via Electronic Funds Withdrawal (EFW) at the request of the taxpayer.

There were a number of other projects in support of Department operations. Staff IIS training was completed, and assistance with the transition of forms to IIS from the Data Entry and Remittance Processing Systems is continuing. On Oahu, a wireless network was installed in the TPS customer service area so that additional customer service representatives can provide counter service from portable workstation kiosks during peak periods. TPS telephone service has also been enhanced by the addition of the Voice Over Internet Protocol (VOIP) now being used by the new telephone system, the installation of redundancy for both the VOIP and IVR systems, and the enabling of the function allowing taxpayers to obtain automated general excise tax payment and refund status information via the IVR system.

In addition, the ITS Office implemented a new process for downloading data from the IRS, provided special support for the retrieval of data for key audits relating to direct deposit fraud, non-employee compensation fraud, non-filers, and suspicious filers, and drafted a proposal to provide a system backup for the Department's processing applications.

Significant hardware acquisition and upgrading continued with the installation of a tape duplicator to provide off-site backup as well as a high capacity test server for testing the complex software suite used by the Department's large applications. New application servers, network printers, and personal computers were also acquired to replace old and outdated equipment.

Significant system software upgrades were also made. These included an upgrade to Novell ZENworks to improve the system administrators' ability to simultaneously "push" new and

updated software to all departmental computers, and an upgrade to Novell Client to correct security issues and implement network improvements.

Future planned initiatives include installing hardware to improve the performance of ITIMS client and application servers, upgrading the ITIMS application system software suite version levels, and adding new functionality to ICS to support audit and collection activities.

Tax Research and Planning Office

The Tax Research and Planning (TRP) Office prepares analytical and statistical reports on statewide tax collections and income patterns of businesses and households, prepares long-range and short-range forecasts of various tax revenues for State budget planning purposes, develops tax plans to meet administrative policies and programs, and prepares analytical reports on the revenue effects of proposed tax legislation for the governor, legislature, and other agencies.

In FY 2007, the TRP Office published the following annual reports: *Hawaii Income Patterns – Businesses 2002*, July 2006; *Tax Credits Claimed by Hawaii Taxpayers 2004*, January 2007; and *Hawaii Income Patterns – Individuals 2004*, March 2007. In addition, the TRP Office assembled and edited the Department of Taxation's *Annual Report 2005–2006*, which was released in December 2006. The TRP Office also prepared and disseminated monthly preliminary General Fund tax collection reports and monthly final reports on State tax collections and distributions, revenue trends, general excise and use tax collections, fuel tax collections and allocations, liquor tax collections, and tobacco tax collections. Summary final reports were also prepared for both the calendar and fiscal years.

In preparation for and during the 2007 Legislative session, TRP staff reviewed over 600 separate tax-related legislative proposals and prepared revenue impact statements for each new draft or as new information became available.

One of the major responsibilities of the TRP Office is to provide technical and administrative support services for the Council on Revenues (COR). The COR is composed of seven uniquely qualified individuals who are collectively responsible for forecasting State General Fund revenues and the State's total personal income. The COR's General Fund forecasts are required on June 1, September 10, January 10, and March 15, and are considered by the governor and legislature in developing, passing, and administering the State's budget. The COR's personal income forecasts are required on August 5 and November 5; the average annual percentage change in total personal income for the preceding three calendar years is the State growth rate that is in turn used to set the State General Fund expenditure ceiling. TRP staff utilize advanced econometric modeling techniques, State tax data, and other information to prepare materials that assist the COR members arrive at their forecasts. During this fiscal year, the TRP Office initiated the posting of the COR's full reports to the Governor and approved meeting minutes on the COR website.

The TRP Office's commitment of resources to provide technical and administrative support services to the 2005–2007 Tax Review Commission (TRC) intensified during the first half of the

fiscal year. As with all past Commissions, the 2005–2007 TRC was required to conduct a systematic review of the State’s tax structure using such standards as equity and efficiency. The TRC’s report on its evaluation of the State’s tax structure and its recommendations were submitted to the Legislature in December 2006. Of the nine studies undertaken by the Commission, TRP staff conducted six internally. The *Report of the 2005–2007 Tax Review Commission* contained 23 recommendations affecting all Hawaii taxpayers, including individuals, businesses, nonprofit organizations, and tax professionals. Assistance with TRC presentations to the Legislature and other matters continued until the current TRC was dissolved upon adjournment sine die of the 2007 legislative session.

Taxpayer Advocacy Program

The Taxpayer Advocacy Program is administered by the Department's Taxpayer Advocate under the direction of the Director of Taxation. The Taxpayer Advocate assists taxpayers who are not able to resolve their problems through the normal channels. This position is a one-person operation whose main focus is on the needs of the taxpayer on a case-by-case basis.

During FY 2007, the Taxpayer Advocacy Program assisted 321 taxpayers with the resolution of their tax matters. Problems can consist of erroneous billings, non-receipt of refunds, waiver requests for penalty and interest, verifications of tax liabilities, explanations of letters and assessments, non-filed returns, collection issues, delays in responses to inquiries, inability to access the information/communication telephone lines, appeals, and general tax information. Additional cases did not require intervention by the Taxpayer Advocate, but guidance to the appropriate management personnel.

The Taxpayer Advocacy Program also coordinates the Department's joint outreach venture that provides tax services to communities that do not normally have access to these services. A variety of tax services are provided, such as the acceptance of general excise tax license applications, assessment notice explanations, payment plan arrangements, voluntary compliance, penalty and interest waivers, individual income tax and general excise tax return preparation, and assistance with general tax questions.

During the 2007 tax season, the Department partnered with the AARP through their Tax Aide Program to bring tax assistance to the island of Molokai and the Waianae community on Oahu. Under the AARP program, volunteer counselors are trained and IRS-certified to assist the elderly, low-income, limited-English speaking, and/or disabled taxpayers in the preparation of their federal and State income tax returns. The joint outreach assisted approximately 67 taxpayers on Molokai and 79 taxpayers in Waianae. At each outreach event, the Taxpayer Advocate was on hand to assist taxpayers with their questions and with the resolution of their tax concerns.

In general, the majority of the taxpayers were satisfied with the outcome of their cases regardless of whether a decision was made in their favor. The Taxpayer Advocacy Program focuses on taxpayers' needs while maintaining taxpayer confidence that Hawaii's tax laws are administered in a consistent, uniform and fair manner.

MANAGEMENT PERSONNEL
(FY 2006–2007)

OFFICE OF THE DIRECTOR

Director of Taxation..... Kurt Kawafuchi
Deputy Director of Taxation..... Sandra Yahiro

STAFF OFFICES

Rules Officer..... Johnnel Nakamura
 Technical Section Supervisor..... Denise Inouye
Tax Research & Planning Officer..... Tu Duc Pham
 Economist..... Yvonne Chow
Information Technology Services Officer..... Robert Su*
Administrative Services Officer..... Suzanne Efhan
 Personnel Officer..... Sharon Iwamura
Taxpayer Advocate..... Fern Elizares
External Training & Outreach Officer..... Vacant

OPERATIONS STAFF

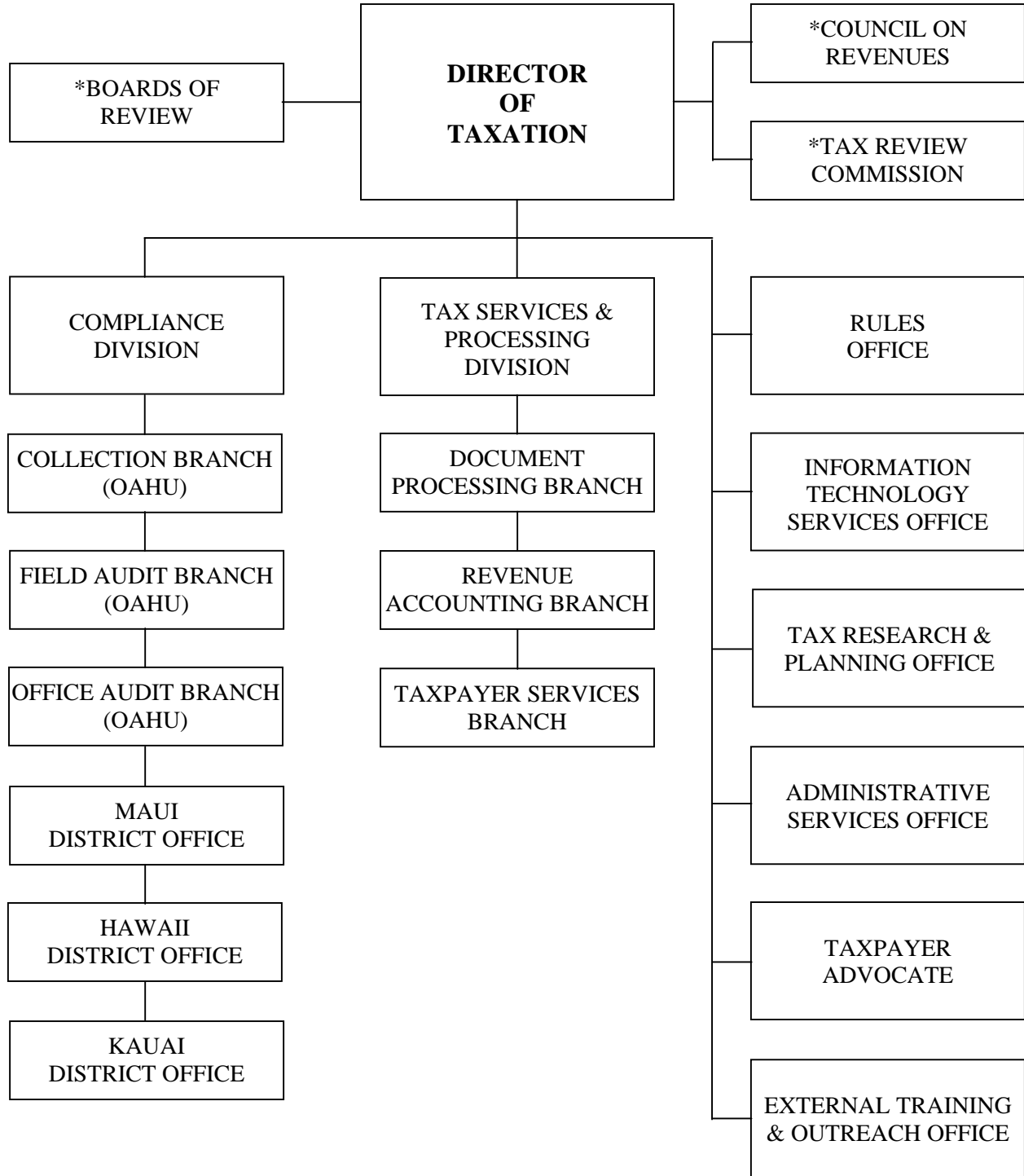
Compliance Division Chief..... Ronald Randall
 Tax Audit Technical Coordinator..... Vacant
 Tax Collection Technical Coordinator..... Wayne Kinoshita
 Oahu Field Audit Branch Chief..... Gayle Nakagawa*
 Oahu Office Audit Branch Chief..... Kenneth Cook
 Oahu Collection Branch Chief..... Lynne Kaneta
 Maui District Tax Manager..... Wayne Fujita
 Hawaii District Tax Manager..... Roy Hamakawa
 Kauai District Tax Manager..... Dulcie Yano

Tax Services and Processing Division Chief..... Joan Bolte
 Taxpayer Services Branch Chief..... Annette Yamanuha
 Document Processing Branch Chief..... Jerry Ebesu
 Revenue Accounting Branch Chief..... Deanne Obatake

*Filled as of October 31, 2007.

ORGANIZATION CHART

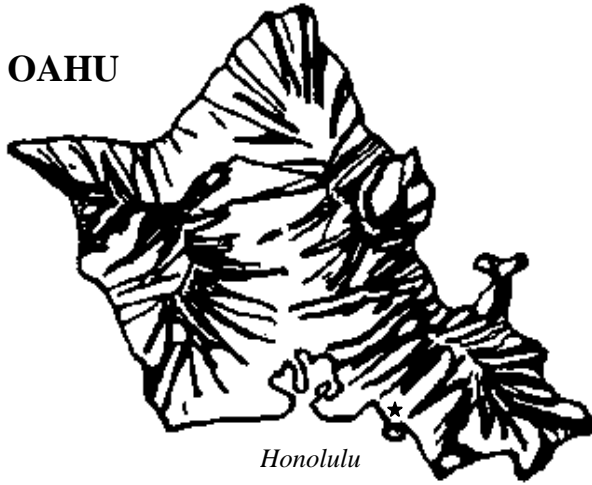
Department of Taxation
State of Hawaii



*For Administrative Purposes

FIRST TAXATION DISTRICT

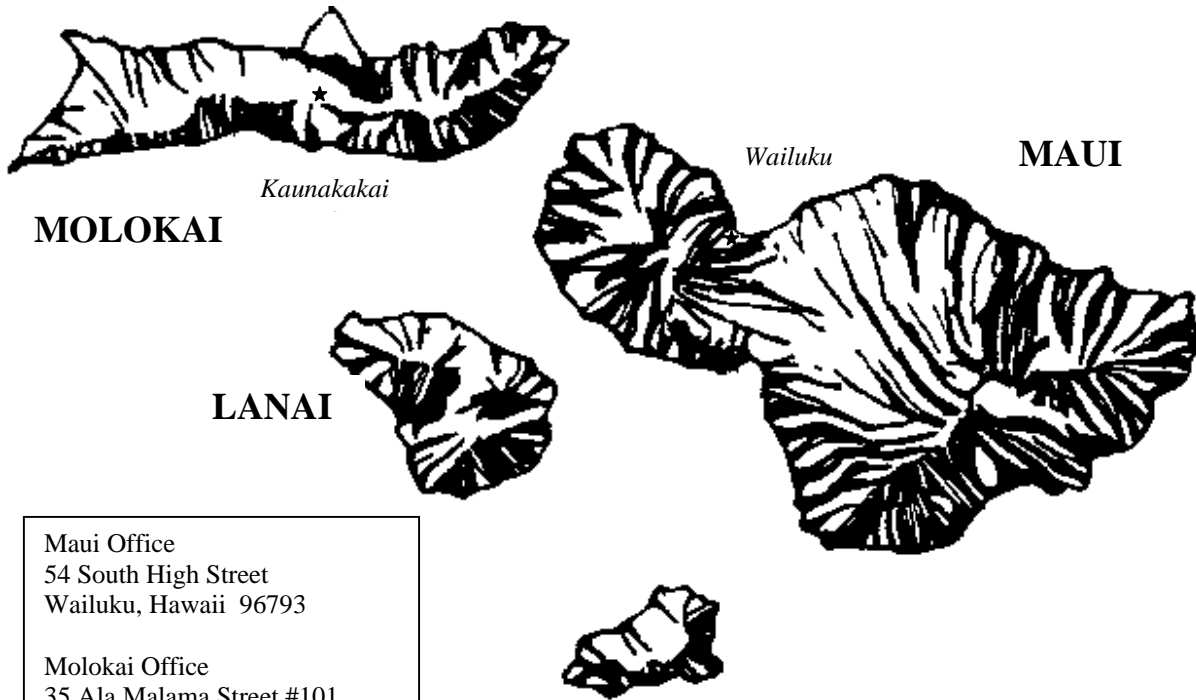
Island of Oahu



Oahu Office
830 Punchbowl Street
Honolulu, Hawaii 96813

SECOND TAXATION DISTRICT

Islands of Maui, Molokai, and Lanai



Maui Office
54 South High Street
Wailuku, Hawaii 96793

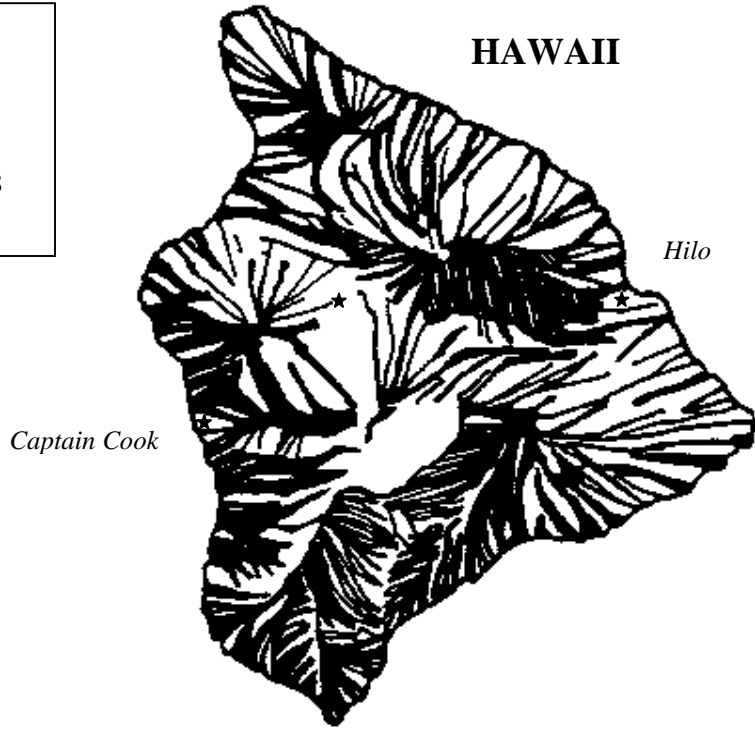
Molokai Office
35 Ala Malama Street #101
Kaunakakai, Hawaii 96748

THIRD TAXATION DISTRICT

Island of Hawaii

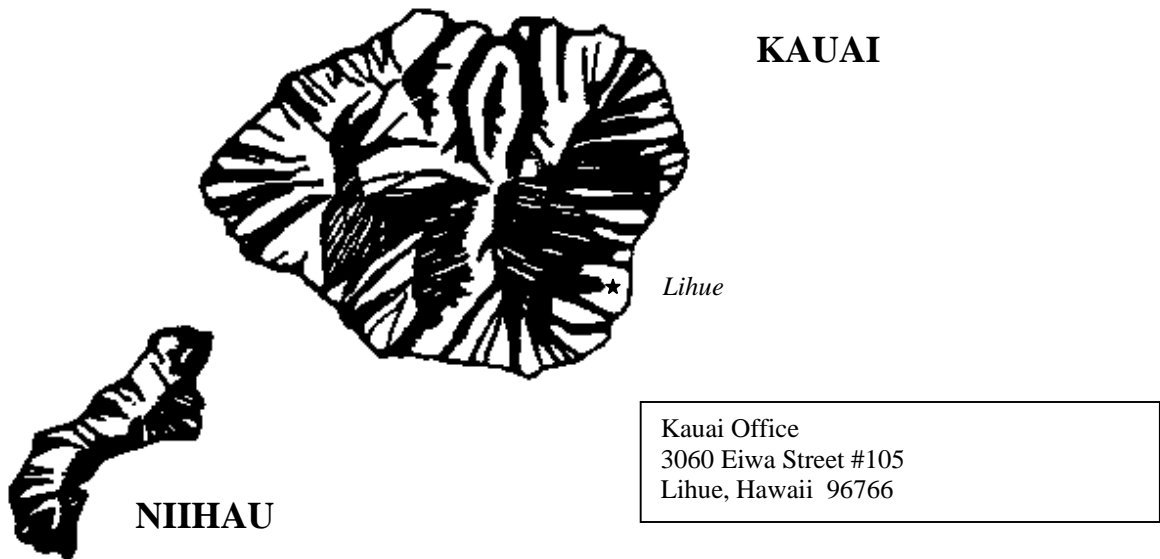
Hilo Office
75 Aupuni Street
Hilo, Hawaii 96720

Kona Office
82-6130 Mamalahoa Highway #8
Captain Cook, Hawaii 96704



FOURTH TAXATION DISTRICT

Islands of Kauai and Niihau



Kauai Office
3060 Eiwa Street #105
Lihue, Hawaii 96766

TAX APPEALS AND LITIGATION

BOARDS OF TAXATION REVIEW

Each taxation district has an administrative (i.e., non-judicial) Board of Taxation Review consisting of five members. Tax disputes that are not resolved at the district tax office level may be appealed to the Board of Taxation Review unless the dispute involves the Constitution or laws of the United States. Statewide, the boards began the fiscal year with 86 pending tax appeals. During FY 2007, 39 new appeals were filed, 32 appeals withdrawn, and 15 appeals settled; a total of 78 appeals to the Boards of Taxation Review were pending at the end of the fiscal year.

The following table details appeals to the Boards of Taxation Review by taxation district:

	Oahu Field Audit	Oahu Office Audit	<u>Maui</u>	<u>Hawaii</u>	<u>Kauai</u>	<u>Total</u>
Appeals Pending (Beginning)	61	13	0	9	3	86
New Appeals	32	0	5	0	2	39
Appeals Withdrawn	30	0	2	0	0	32
Appeals Settled	<u>7</u>	<u>6</u>	<u>2</u>	<u>0</u>	<u>0</u>	<u>15</u>
Appeals Pending (Ending)	56	7	1	9	5	78

CIVIL DECISIONS, SETTLEMENTS, AND OTHER LEGAL MATTERS

During FY 2007, the Tax Division of the Department of the Attorney General closed 314 Department of Taxation-related legal matters, not including legislative matters, which have not yet been closed in the case management system by the Department of the Attorney General's Legislative Division, and all charitable oversight and charitable solicitation-related matters the Tax Division routinely handles.

<u>MATTERS CLOSED</u>	<u>AMOUNTS COLLECTED</u>
Appeals	Tax Appeals
Bankruptcies	Foreclosures
Foreclosures	Bankruptcies
Subpoenas	Trusts
Opinions	Miscellaneous
Contracts	TOTAL
Legislation	
Miscellaneous	

Settled Cases

In the Matter of the Tax Appeal of the Director of Taxation v. ATM Cash Systems, LLC, T.A. No. 06-0029, Tax Appeal Court, State of Hawaii.

Taxpayer paid franchise taxes on the income from an automated teller machine provider service. The Department asserted Taxpayer should have paid general excise taxes and made assessments on the difference. This case has been settled and the tax appeal has been dismissed.

In the Matter of the Tax Appeal of Pacific Marine & Supply Co., Ltd., and Subsidiaries, T.A. No. 06-0089, Tax Appeal Court, State of Hawaii.

Taxpayer filed a refund claim for research credits under § 235-110.91, HRS. The Department asserted the Taxpayer claimed the credit for inappropriate cost items and disallowed the bulk of the refund claim. The parties settled this dispute through mediation conducted by former Judge Gail Nakatani and the tax appeal has been dismissed.

In the Matter of the Tax Appeal of Parsons-UXB Joint Venture, T.A. No. 00-0055, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer additional general excise taxes asserting Taxpayer improperly claimed the subcontractor deduction for services other than contracting. This case has been settled and the tax appeal has been dismissed.

In the Matter of the Tax Appeal of Pitney Bowes, Inc., T.A. No. 03-0182, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer additional general excise taxes based on the difference in income reported on its net income and general excise tax returns. The Department has settled this case. The parties have filed a stipulation to dismiss.

Completed Cases

In the Matter of the Tax Appeal of Honolulu Auto, Inc., T.A. No. 06-0069, Tax Appeal Court, State of Hawaii.

Taxpayer appealed corporate income tax assessments for tax years 2001–2003. The basis of the appeal was left blank in the Notice of Appeal, which was not properly served. The Department filed a motion to dismiss the appeal on the following bases: (i) lack of subject matter jurisdiction as the appeal is untimely; and (ii) the Notice of Appeal is void because it was signed and filed by a person who is not licensed to practice law in the State of Hawaii. The Motion was granted and the appeal was dismissed.

Pending Appeals

Hawaii Supreme Court

In the Matter of the Tax Appeal of Medical Underwriters, S. Ct. No. 27023, Supreme Court of the State of Hawaii.

The Department assessed Taxpayer the four percent general excise tax on income for providing management services to certain insurance companies. Taxpayer argued that it was exempt from the general excise tax because it was an insurance company. After the filing of various motions for summary judgment, the Tax Appeal Court held that Taxpayer was not exempt from the general excise tax and the income it received as commissions or compensation for services rendered as an attorney-in-fact to the insurance companies was taxable at the 0.15 percent general excise tax rate with taxes totaling \$3,943.95. The Department and Taxpayer appealed to the Hawaii Supreme Court.

Intermediate Court of Appeals

In the Matter of the Tax Appeal of Henry F. Johnson and International Resource Recovery, Inc., S. Ct. No. 27738, Intermediate Court of Appeals, State of Hawaii.

After he received an unfavorable ruling from the Board of Review, Taxpayer, a *pro se* litigant, did not prepay his net income taxes earned from his S corporation that performed federal rubbish removal work in Hawaii. The Tax Appeal Court dismissed Taxpayer's case based on Lewis v. Kawafuchi, 108 Haw. 69 (2005). Taxpayer appealed to the Hawaii Supreme Court, who sent the case to the Intermediate Court of Appeals. The Intermediate Court of Appeals dismissed the case. Taxpayer has until September 5, 2007, to file a writ of certiorari to the Hawaii Supreme Court.

Tax Appeal Court, State of Hawaii

In the Matter of the Tax Appeals of Central Pacific Bank, T.A. Nos. 02-0075, 03-0155, and 05-0041, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from assessments of franchise taxes resulting from the disallowance of a deduction for dividends it received from a wholly owned real estate investment trust (REIT). Taxpayer claimed that because IRC § 857(c) (which is operative in Hawaii and denies the deduction for dividends paid by a REIT) refers to IRC § 243 (which is inoperative), it was entitled to take a deduction for \$89 million in dividends it received from a REIT. The Department won a motion for summary judgment and in January 2007, the Taxpayer filed a motion for reconsideration that the Tax Appeal Court has yet to respond to.

In the Matter of the Tax Appeal of Kurt Kawafuchi v. Jeanette Cochrane, T.A. No. 06-0078, Tax Appeal Court, State of Hawaii.

Taxpayer was assessed additional general excise taxes on underreported gross receipts related to the sale of postage stamps and postal services. The Department's assessments were based on the sale of postal stamps and postal services as business activities subject

to the general excise tax. Taxpayer appealed the assessment to the Board of Review and prevailed. The Department appealed the Board of Review's ruling on July 7, 2006.

In the Matter of the Tax Appeal of CompUSA, T.A. No. 05-0065, Tax Appeal Court, State of Hawaii.

The Department assessed use tax on Taxpayer's business income derived from the importation of products for resale to the general public for the period July 1, 1999, through December 31, 2002. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

Costco Wholesale Corp. vs. Director of Taxation, State of Hawaii, Case No. 06-0001, Tax Appeal Court, State of Hawaii.

Taxpayer filed a complaint for a refund of tax payments made under protest for the period from September 1, 1999, through August 31, 2002, inclusive. Taxpayer is challenging the Department's assessment that reclassified certain wholesale transactions to retail transactions; thereby imposing the half percent use tax and four percent general excise tax on the importation and sale of the products to a customer.

Exact Game Fishing, Inc. vs. Department of Taxation, State of Hawaii, Case No. 07-0073, Tax Appeal Court, State of Hawaii.

Taxpayer filed a complaint for a refund of a tax payment made under protest for tax year 2004 claiming that it is exempt from the general excise tax pursuant to the Supremacy and Tonnage Clauses of the U.S. Constitution. Taxpayer filed its 2004 general excise tax return and paid the amount as reported under protest. A motion to dismiss was filed on the basis that there is no dispute between the Taxpayer and Department. The motion is scheduled to be heard on August 20, 2007.

Finest Kind, Inc. vs. Department of Taxation, State of Hawaii, Case No. 07-0074, Tax Appeal Court, State of Hawaii.

Taxpayer filed a complaint for a refund of a tax payment made under protest for tax year 2004 claiming that it is exempt from the general excise tax pursuant to the Supremacy and Tonnage Clauses of the U.S. Constitution. Taxpayer filed its self-assessed general excise tax return and paid the amount as reported under protest. A motion to dismiss was filed on the basis that there is no dispute between the Taxpayer and Department. The motion is scheduled to be heard on August 20, 2007.

In the Matter of the Tax Appeal of Gold Key Lease, T.A. No. 06-0027, Tax Appeal Court, State of Hawaii.

Based on the amounts reported in Taxpayer's income tax returns, the Department assessed Taxpayer for general excise tax on its motor vehicle leasing business. Taxpayer claims that the assessments are incorrect because the auditor inappropriately relied on the amounts reported in its income tax returns as opposed to the worksheets it provided to the auditor.

In the Matter of the Tax Appeal of Hale Kupuna Heritage Home, LLC, T.A. No. 04-0042, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer for Hale Omao Inc.'s general excise tax liabilities and Benjamin and Mary Aranio's income tax liabilities pursuant to HRS § 237-43 (2001) because no bulk sales report was obtained or filed when Taxpayer bought Hale Omao's 84-bed care home business and the Aranios' real property where the care home business is located.

In the Matter of the Appeal of ICH Group, LLC, T.A. No. 05-0070, Tax Appeal Court, State of Hawaii.

Taxpayer filed its Notice of Appeal challenging general excise, use, and income tax assessments for tax years 2001–2003, claiming that: (a) the assessments erroneously treat all amounts deposited into Taxpayer's bank accounts as gross income, although substantial amounts were simply transfers from one bank account held by Taxpayer to another, and thus not includible in gross income; (b) additional amounts were advances from related entities, or repayments of advances to related entities, and were similarly not part of gross income; (c) the assessments wrongly deny tax benefits to which Taxpayer is entitled as an Enterprise Zone business; and (d) the assessments include use tax for which Taxpayer is not actually liable. Trial is currently scheduled for April 14, 2008, and Taxpayer's counsel has filed a motion to withdraw.

In the Matter of the Appeal of Jarrett Technology Solutions, Inc., T.A. Nos. 05-0076 and 06-0068 (Consolidated), Tax Appeal Court, State of Hawaii.

Taxpayer filed two appeals for tax years ending June 30, 2000–2003. Taxpayer claims that: (a) the assessments erroneously treat sales of tangible goods to the federal government as taxable transactions, and/or treat sales of goods as if they were sales of services; (b) the use tax cannot apply to Taxpayer as a seller of goods, where title to the goods passed before the goods arrived in Hawaii and the federal government was the owner of the goods at the time they entered Hawaii; (c) any attempt to apply the general excise tax and use tax to sales at issue of the goods involved violates the Due Process Clause, Commerce Clause, Equal Protection Clause, and/or other clauses or provisions of the United States Constitution, and/or other federal law; and (d) the assessments overstate Taxpayer's actual tax liability by (i) assuming that sales took place in Hawaii when in fact they did not; (ii) assuming that all sales were taxable when in fact most sales were exempt; (iii) wrongly treating wholesale transactions as sales at retail, and by wrongly denying all exemptions applicable to services; (iv) assuming Taxpayer imported goods into Hawaii when in fact they did not; (v) basing the use tax assessments on erroneous numbers and inconsistent methods of computation; and (vi) making assumptions unfavorable to Taxpayer to meet the deadline for assessment. This is a substantiation question. The assessments were made based on information available at that time. Trial is currently scheduled for October 20, 2008.

In the Matter of the Tax Appeal of the Director of Taxation, State of Hawaii v. Donald J. Karleen and Barbara Brown-Karleen, T.A. No. 04-0045, Tax Appeal Court, State of Hawaii.

The Department appealed the Board of Review's decision in favor of Taxpayers. Taxpayers claimed the Residential Construction and Remodeling Tax Credit and the

General Income Tax Credit for tax year 2001. However, it is unclear when Taxpayers made the claim. The Department denied the claim on the basis that the claim was untimely. The Department has no record of receiving the tax return Taxpayers alleged they submitted until after the deadline for making the claim. Trial is scheduled for February 11, 2008.

In the Matter of the Tax Appeal of Kulakane Rental, Inc., T.A. No. 07-0077, Tax Appeal Court, State of Hawaii; and In the Matter of the Tax Appeal of Polynesian Shores Rental Association, T.A. No. 07-0078, Tax Appeal Court, State of Hawaii.

In these two cases, Taxpayers have not served the Director nor have they served the Department of the Attorney General. This office obtained copies of the Notices of Appeal from Tax Court, but because of their vagueness, it is unclear what the Taxpayers' claims are.

Make-up Arts Cosmetics Inc. v. Director of Taxation, State of Hawaii, T.A. No. 03-0259, Tax Appeal Court, State of Hawaii.

The Department assessed Taxpayer the general excise tax as follows: 0.5 percent for the wholesale of make-up products sold, four percent on services provided at its counters in the stores, and 4.5 percent on the import and sale of furniture and fixtures. The case is currently in discovery to determine the validity of Taxpayer's claims that the assessments are incorrect for the following reasons: it did not sell nor did it import any products in Hawaii and that it had sharing agreements with the stores concerning the employees at the counters. The Court granted partial summary judgment for the taxpayer and the parties have reached a tentative settlement on the remaining issues.

Richard A. Meyer v. Kurt Kawafuchi, T.A. No. 07-0071, Tax Appeal Court, State of Hawaii.

Plaintiff filed a complaint for refund from taxes paid under protest. The amount in controversy is \$4,506.74. Plaintiff believed that his automatic extension to file his 2005 net income tax return and to pay the attendant liabilities was October 2006. However, Plaintiff did not file a Form N-101B specifying reasonable cause as to why he should be allowed the additional two months to file his return. The Department assessed Plaintiff additional taxes and penalties that he is currently disputing. Plaintiff agreed to dismiss the case by stipulation and to pay all additional taxes. Trial is currently scheduled for December 31, 2007.

In the Matter of the Appeal of Moana Pa'akai, Inc., T.A. No. 06-0094, Tax Appeal Court, State of Hawaii.

Taxpayer, a.k.a. Hawaiian Tug & Barge, filed a notice of appeal and complaint appealing general excise tax assessments for tax years 2001, 2002, 2003, and 2004. Taxpayer argues that the Department failed to apply exemptions or lower tax rates under §§ 237-4, 237-13, 237-13.3, and 237-24.3, HRS. Trial is currently scheduled for August 18, 2008.

In the Matter of the Tax Appeal of Navatek, Ltd., T.A. No. 07-0070, Tax Appeal Court, State of Hawaii.

Taxpayer filed an appeal under a new law allowing taxpayers to file a Notice of Appeal to Tax Appeal Court if a refund claim is not answered in 180 days. Taxpayer filed a

refund claim for research credits under § 235-110.91, HRS, and the Department did not respond within 180 days.

In the Matter of the Tax Appeal of Nordstrom, Inc., T.A. No. 06-0079, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for the tax period from February 1, 2001, through January 31, 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

In the Matter of the Tax Appeal of Ohana Foundation for Technical Development, T.A. No. 07-0009, Tax Appeal Court, State of Hawaii.

Taxpayer filed a refund claim for research credits under § 235-110.91, HRS, that the Department denied. A trial date has not been set for this case.

In the Matter of the Tax Appeal of Pihana Pacific, Inc., n.k.a. Equinix Pacific Inc., f.k.a. Pacific Internet Exchange, Inc., T.A. No. 07-0017, Tax Appeal Court, State of Hawaii.

Taxpayer filed a Notice of Appeal from the Board of Review's decision in favor of the Department that the research activities tax credits and capital good credits for tax years 2000 and 2001 was incorrect. Taxpayer argues that it conducted qualified research in Hawaii and purchased qualified property to be able to claim the respective credits. Trial is currently scheduled for April 14, 2008.

Reel Hooker Sportfishing, Inc. v. Department of Taxation, State of Hawaii, Case No. 07-0072, Tax Appeal Court, State of Hawaii.

Taxpayer filed a complaint for a refund of a tax payment made under protest for tax year 2004 claiming that it is exempt from the general excise tax pursuant to the Supremacy and Tonnage Clauses of the U.S. Constitution. Taxpayer filed its self-assessed general excise tax return and paid the amount as reported under protest. A motion to dismiss was filed on the basis that there is no dispute between the Taxpayer and Department. The motion is scheduled to be heard on August 20, 2007.

In the Matter of the Tax Appeal of Safeway, Inc., T.A. No. 07-0042, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for the tax period from 2002 through 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

In the Matter of the Tax Appeal of Snorkel Bob Brand, Inc., T.A. No. 06-0081, Tax Appeal Court, State of Hawaii.

Taxpayer failed to report certain items of income listed on its net income return on its general excise tax return and was assessed the difference in corresponding general excise taxes. Taxpayer failed to provide any documentation to support its claims that the unreported income was not taxable.

In the Matter of the Appeal of Spirent Holdings Corp. & Subsidiaries, T.A. No. 06-0100, Tax Appeal Court, State of Hawaii.

Taxpayer filed a Notice of Appeal challenging the Department's assessment denying its request for additional research activities credits for tax year 2001. Taxpayer filed an original 2001 corporate income tax return on or about October 21, 2002 (originally due on April 21, 2002). Subsequently, on October 20, 2003, Taxpayer filed an amended return increasing the amount claimed for the research activities credit. The Department denied Taxpayer's amended return because it was not filed within the twelve months after the close of the 2001 tax year.

In the Matter of the Tax Appeal of the Director of Taxation, State of Hawaii v. Sunamerica Securities, Inc., T.A. No. 05-0075, Tax Appeal Court, State of Hawaii.

Taxpayer is a mainland securities dealer with local independent contractors providing sales services to its Hawaii customers. Taxpayer buys securities from underwriters and facilitates sales to Hawaii consumers through its independent contractors located here. The Department assessed general excise taxes on Taxpayer's gross receipts based on its commissions received from the underwriters.

In the Matter of the Tax Appeal of Takeno Group, LLC, T.A. No. 05-0069, Tax Appeal Court, State of Hawaii.

Taxpayer filed its notice of appeal challenging general excise taxes for tax years 2002–2004 and a withholding tax assessment for tax year 2005. In the Notice of Appeal, Taxpayer claims: (a) the assessments overstate Taxpayer's liability by making assumptions; (b) Taxpayer did not pay employees in 2004 and therefore did not owe any withholding tax; and (c) Taxpayer operates in the Enterprise Zone. Trial is currently scheduled for June 16, 2008.

In the Matter of the Tax Appeal of Territorial Mutual Holding Company and Subsidiaries, T.A. Nos. 06-0096 and 07-0079, Tax Appeal Court, State of Hawaii.

Taxpayer appealed from assessments of franchise taxes resulting from the disallowance of a deduction for dividends it received from a wholly owned REIT. Taxpayer claimed that because IRC § 857(c) (which is operative in Hawaii and denies the deduction for dividends paid by a REIT) refers to IRC § 243 (which is inoperative), it was entitled to take a deduction for \$89 million in dividends it received from a REIT. The parties are waiting to see how the Tax Appeal Court responds to the motion for reconsideration in the Central Pacific Bank cases.

In the Matter of the Tax Appeal of WV Sub, LLC, and Campbell Hawaii Investor LLC, T.A. No. 05-0078, Tax Appeal Court, State of Hawaii.

Taxpayers/Plaintiffs filed a complaint for refund of a notice of appeal from conveyance taxes paid under protest. The amount in controversy is \$339,407.40. Act 156, SLH 2005, increased the applicable conveyance tax rate from 0.1 percent to 0.3 percent for properties with a value of \$1 million or greater unless it is a condominium or a single-family residence. Act 156 is effective as of July 1, 2005. The parties in this case allegedly entered into a Disposition Agreement dated November 29, 2004, for the sale of

a shopping mall on Maui. The actual sale of the property, however, took place on November 1, 2005. Taxpayers/Plaintiffs argue that the old rate applies. Trial is currently scheduled for November 5, 2007.

In the Matter of the Tax Appeal of Robert and Anita Wintner, T.A. No. 06-0082, Tax Appeal Court, State of Hawaii.

Taxpayers are the owners of Snorkel Bob Brand, Inc., a company assessed with additional general excise taxes. As a result of adjustments to income made by the auditor to Snorkel Bob Brand Inc.'s net income return, Taxpayers were assessed additional net income taxes.

In the Matter of the Tax Appeal of Zale Delaware, Inc., T.A. No. 06-0080, Tax Appeal Court, State of Hawaii.

The Department denied Taxpayer's refund request on the use taxes paid on Taxpayer's business income derived from the importation of products for resale to the general public for the tax period from August 1, 2001, through July 31, 2004, inclusive. Taxpayer claims that the assessments are incorrect pursuant to Baker and Taylor, 103 Haw. 359 (2004).

CRIMINAL CASES

During FY 2007, the Criminal Justice section of the Department of the Attorney General filed complaints or indictments against 43 taxpayers¹ for violating Hawaii state tax laws as set out in HRS §§ 231-34, 231-35, and 231-36. The complaints and indictments filed against the 43 taxpayers accounted for over \$2,466,054 in unpaid taxes (excluding civil assessments, penalties, and interest). To date, the courts have imposed criminal fines of \$235,000.²

During FY 2007, the Criminal Unit collected \$2,047,157 in unpaid taxes, penalties, and interest in all its criminal tax cases. This was the first time in the unit's history that over \$2 million was collected in consecutive years.

Nine of the 43 taxpayers were real estate agents who were not filing their general excise tax returns despite earning substantial commission income as a result of the booming real estate market. One agent had over \$926,200 in unreported commission income over five years. The majority of the real estate agents plead to misdemeanor, failure to file charges; however, one of the nine agents plead guilty to felony and false statements charges for underreporting commission income on her annual general excise tax returns.

¹ Note: During the FY 2006, there were 39 complaints/indictments.

² Criminal fines are imposed at sentencing; to date, 21 taxpayers have yet to be sentenced.

Other Cases Of Note

During the year, four companies were indicted for theft violations, which stemmed from not paying over their employee withholding taxes. The responsible parties and the companies pled guilty and the Court ordered restitution of over \$470,000.

A corporate executive was sentenced to a prison term of 30 days in connection with two counts of filing false tax returns for the years 2003 and 2004. The taxpayer had been under investigation prior to 2003 for filing false returns, but the investigation was discontinued because the taxpayer claimed he had received incorrect tax advice. Subsequent to the investigation being closed, the taxpayer again filed false returns for 2003 and 2004.

Six City and County of Honolulu employees were indicted for attempting to evade their State of Hawaii income taxes and failing to file their State of Hawaii individual income tax returns. Oahu Transportation Service employed four of the six taxpayers; the taxpayers claimed an exempt status for payroll withholding purposes and subsequently did not file their tax returns

Despite the number of complaints and indictments this fiscal year, the Criminal Unit still receives numerous referrals and reports of potential cases. The Unit is a critical part of the Department's Compliance Division and will continue with its efforts of deterrence through successful prosecution of tax offenders along with steady media exposure.

LEGISLATION

The Twenty-Fourth Legislature enacted the following major tax-related measures during the 2007 Regular and Special Sessions:

REGULAR SESSION 2007

<u>Act</u>	<u>Brief Description</u>
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- | | |
|------------|--|
| 045 | Emergency Appropriation for Department of Taxation County Surcharge Implementation Costs. Appropriates \$5,041,691 to the Department of Taxation for unbudgeted costs incurred implementing and administering the county surcharge on the general excise tax for the City and County of Honolulu. <i>Effective April 27, 2007.</i> |
| 084 | Conformity of the Hawaii Income Tax Law to the Internal Revenue Code. Amends Hawaii's income tax law to conform with changes to the Internal Revenue Code, with exceptions. <i>Effective May 22, 2007, and applies to taxable years beginning after December 31, 2006; provided that retroactive and prospective effective dates contained in the congressional acts relating to the Internal Revenue Code and enacted during 2006 shall be operative.</i> |
| 102 | Cigarette Tax. Clarifies the disposition of revenues collected under Chapter 245, HRS, relating to cigarette taxes. Makes clarifying amendments to provide for deposit of cigarette tax revenues to various special funds on a per-cigarette basis. Allows for interest earned on deposits to the Hawaii Cancer Research Special Fund to be deposited into the special fund. <i>Effective May 28, 2007.</i> |
| 103 | Energy. Adds a new definition to Chapter 243, HRS, of the term, "Power-generating Facility." Defines power-generating facility as any electricity-generating facility requiring a permit under the Federal Clean Air Act (42 USC § 7401, <i>et. seq.</i>), the Hawaii Air Pollution Control law, or both. Specifically provides for the taxation of naphtha fuel under Chapter 243, HRS. Assesses the tax for naphtha fuel sold for use in a power-generating facility at 1 cent per gallon. <i>Effective May 29, 2007; provided that the amendments adding the definition of "Power-generating Facility" and the 1 cent rate for naphtha fuel are to be repealed on December 31, 2009, and §243-4, HRS, is to read in the manner it read prior to enactment; provided further that the 1 cent per gallon tax on naphtha fuel is effective retroactively for naphtha fuel sold for use in power-generating facilities.</i> |
| 128 | Ethanol Production Facility Tax Credit. Extends the date by which an ethanol production facility must be in production to qualify for the ethanol production facility tax credit by five years to January 1, 2017. <i>Effective July 1, 2007.</i> |

- 151 Income Taxation.** Eliminates references to the term, "resident," and requires that all renewable energy technology systems be installed in the State for purposes of the renewable energy technologies income tax credit. Clarifies the income tax credit allocation provision for S corporations. *Effective June 7, 2007, and applies to taxable years beginning after December 31, 2006.*
- 154 Perfection of Appeals to the Tax Appeal Court.** Requires as a condition for jurisdiction to be conferred upon the Tax Appeal Court, service of a notice of appeal on the Director of Taxation and, in the instance of an appeal from a decision involving a county, service upon the real property assessment division of the county involved. *Effective June 8, 2007, and applies to any notice of appeal filed after this date.*
- 166 Leasehold Conversion.** Excludes from income tax 100% of the gain realized by a fee simple owner from the sale of a leased fee interest in a condominium project, cooperative project, or planned unit development, to the association of apartment owners or the residential cooperative corporation. Defines "fee simple owner", "legal and equitable owner", "leased fee interest", "condominium project", and "cooperative project" by reference to other law. *Effective June 8, 2007, and applies to taxable years beginning after December 31, 2007, and ending prior to January 1, 2013; provided that on January 1, 2013, this Act is repealed and §235-7(a), HRS, is reenacted in the form in which it read prior to enactment.*
- 173 General Excise Tax.** Exempts from the general excise tax amounts received by the operator of the Hawaii Convention Center for reimbursement of costs or advances made pursuant to a contract with the Hawaii Tourism Authority under §201B-7, HRS. *Effective June 13, 2007, and applies to gross income or gross proceeds received after this date.*
- 206 High Technology Business Investment Tax Credit.** Requires a qualified high technology business (QHTB) that accepts an investment for which the high technology business investment tax credit may be claimed to annually complete and file an information survey with the Department of Taxation. Requires the Department of Taxation to aggregate the survey information and to annually report the summarized information to the Legislature. Requires the Department of Taxation to study the effectiveness of the high technology business investment tax credit and to annually report the study results to the Legislature. Requires the Department of Taxation to aggregate the information reported on Forms N-317 for all previous years, and to report the summarized information to the Legislature by October 31, 2007. Amends §235-110.9, HRS, to provide that, by accepting an investment for which the high technology business investment tax credit may be claimed, a QHTB consents to the public disclosure of its name and its status as a beneficiary of this credit. Amends §235-20.5, HRS, to allow expenditures from the tax administration fund for administering the high technology business investment tax credit. *Effective July 1, 2007, and applies to investments received after June 30, 2007; provided that on January 1, 2011, this Act is repealed and §235-20.5, HRS, and §235-110.9(b), HRS, are reenacted in the form in which they read prior to enactment.*

- 209 Transportation.** Exempts gross income or gross proceeds from the sale of alcohol fuel from the general excise tax, and requires the producer, wholesaler, or retailer of alcohol fuel to pass on any savings realized. Increases the fuel tax on the sale or use of various fuels by 1 cent per gallon. *Effective July 1, 2007, provided that the exemption for sales of alcohol fuels from the general excise tax is repealed on June 30, 2009.*
- 210 General Income Tax Credit.** Provides a one-time refundable income tax credit for qualifying resident individual taxpayers to satisfy the requirements of Article VII, section 6, of the Constitution of the State of Hawaii. The amount of credit is based on the taxpayers' federal adjusted gross income and filing status, and is phased out for taxpayers whose federal adjusted gross income is \$30,000 or more if single or married filing a separate return, and \$60,000 or more for all other taxpayers. *Effective June 26, 2007, and applies to the taxable year beginning after December 31, 2006.*
- 211 Refundable Food/Excise Tax Credit.** Changes the name of the low-income refundable tax credit to the refundable food/excise tax credit. The allowable credit per qualified exemption was changed from a \$10 to \$35 credit per qualified exemption for taxpayers with Hawaii adjusted gross income of \$20,000 or less, to a \$25 to \$85 credit per qualified exemption for taxpayers with federal adjusted gross income less than \$50,000. *Effective June 26, 2007, and applies to taxable years beginning after December 31, 2007.*
- 222 Conveyance Tax.** With respect to taxation, this Act clarifies the disposition of conveyance tax collections and extends the temporary increase in the percentage of conveyance tax collections deposited into the rental housing trust fund to June 30, 2008. *Effective July 1, 2007, provided that the extension of the temporary increase in the percentage of conveyance tax collections deposited into the rental housing trust fund is effective June 30, 2007.*
- 225 Professional Employment Organizations.** Exempts from the general excise tax amounts received by a professional employment organization from a client company equal to amounts disbursed by the professional employment organization for employee wages, salaries, payroll taxes, insurance premiums, and benefits to employees assigned to the client company. Defines "professional employment organization," "client company," and "assigned employee" in a new chapter of the HRS. *Effective July 1, 2007, provided that the general excise tax exemption applies to gross income or gross proceeds received after June 30, 2007.*
- 239 General Excise Tax.** Exempts from the general excise tax amounts received by submanagers of an association of apartment owners or nonprofit homeowners or community association in reimbursement for common expenses. Also exempts from the general excise tax amounts received by hotel operators from timeshare associations and amounts received by suboperators of hotels from hotel owners, timeshare associations, or hotel operators equal to amounts disbursed for employee wages, salaries, payroll taxes, insurance premiums, and benefits. *Effective January 1, 2008; provided that this Act is repealed on December 31, 2009, and §237-24.3, HRS, and §237-24.7, HRS, reenacted in the form in which they read on December 31, 2007.*

- 240 Dishonored Payments.** Increases the service charge for dishonored payments to \$25 and precludes the Department of Taxation from assessing interest on the \$25 dishonored payment service charge. *Effective July 2, 2007.*
- 258 Rental Motor Vehicle Surcharge Tax.** Extends the temporary rental motor vehicle surcharge tax increase from \$2 to \$3 per day for one year to August 31, 2008. *Effective July 5, 2007.*
- 272 State Funds.** Requires the disclosure on a single website of entities receiving "state awards," as defined, of not less than \$25,000 in a single transaction. Information on tax-related state awards authorized under Title 14, HRS, other than aggregated information, are entitled to confidentiality protection in accordance with Title 14, HRS. The website shall be established and implemented by the Department of Budget and Finance by January 1, 2009. *Effective July 1, 2007.*

SPECIAL SESSION 2007

<u>Act</u>	<u>Brief Description</u>
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- | | |
|------------|---|
| 008 | Comprehensive Offender Reentry System. Requires the Department of Taxation to assist the Department of Public Safety to develop and propose for legislative consideration tax incentives for employers who hire individuals who were formerly incarcerated. <i>Effective July 1, 2007.</i> |
|------------|---|

INCOME ASSESSMENT AND AUDIT

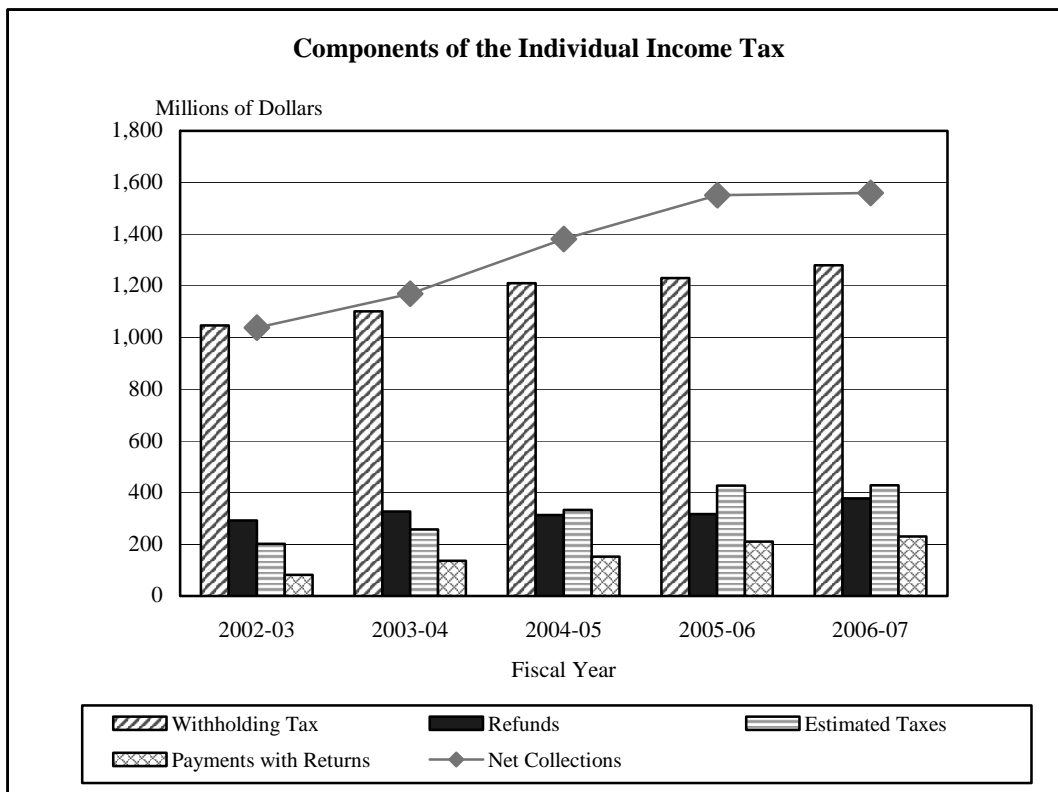
INDIVIDUAL INCOME TAX

Increased amounts of estimated taxes, payments with returns, and withheld taxes over last year contributed to a \$70.9 million growth in individual income taxes; however, increased refunds reduced this sum by \$61.2 million. Overall, net individual income tax increased by 0.6% or \$9.7 million for FY 2007.

TAXES PAID BY INDIVIDUALS (In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 428,754	\$ 426,864	\$ 1,890	0.4
Payment with Return	229,964	210,629	19,335	9.2
Withholding Tax on Wages	1,279,649	1,230,018	49,631	4.0
Subtotal	\$ 1,938,367	\$ 1,867,511	\$ 70,856	3.8
Refunds	378,081	316,915	61,166	19.3
NET	\$ 1,560,286	\$ 1,550,596	\$ 9,690	0.6

NOTE: Due to rounding, details may not add to totals.



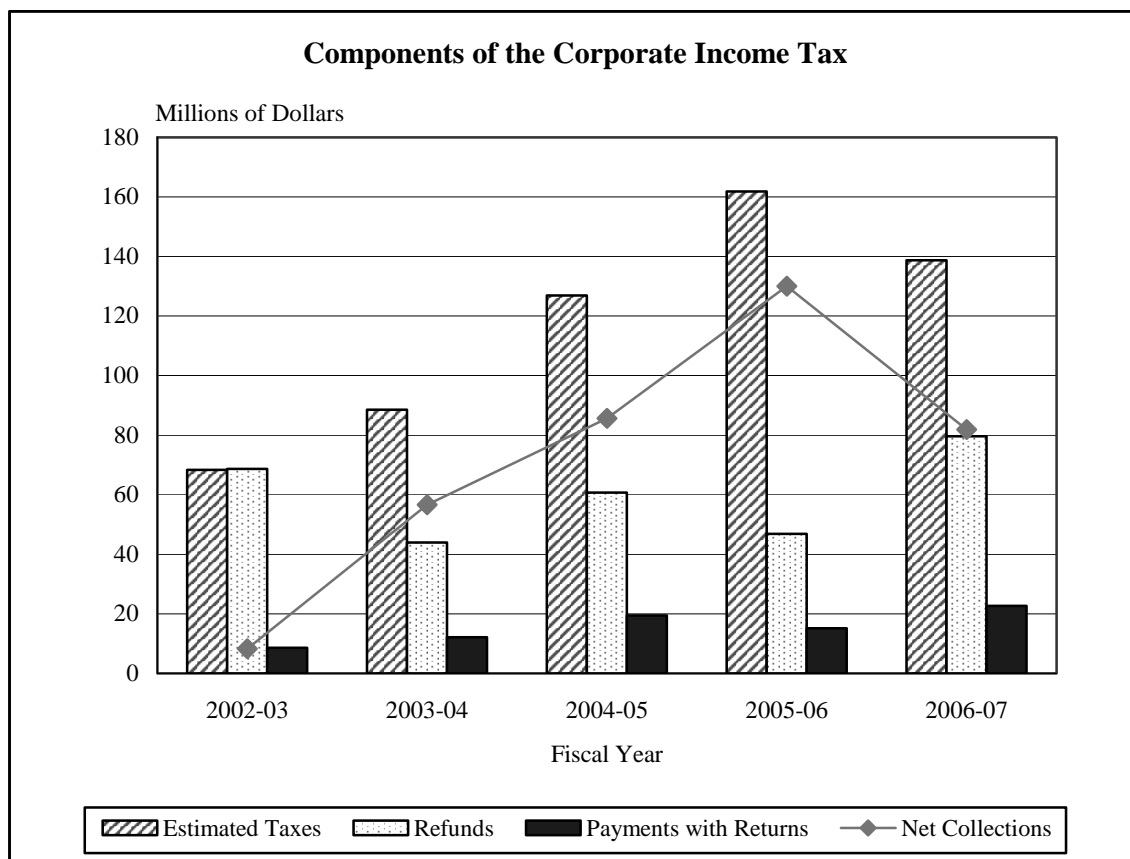
CORPORATE INCOME TAX

Net corporate income tax collections totaled \$81.8 million for FY 2007, decreasing by a sizable \$48.2 million over the previous year's total of \$130.0 million. The decrease was mainly due to a large, one-time estimated tax payment received last fiscal year.

TAXES PAID BY CORPORATIONS (In Thousands of Dollars)

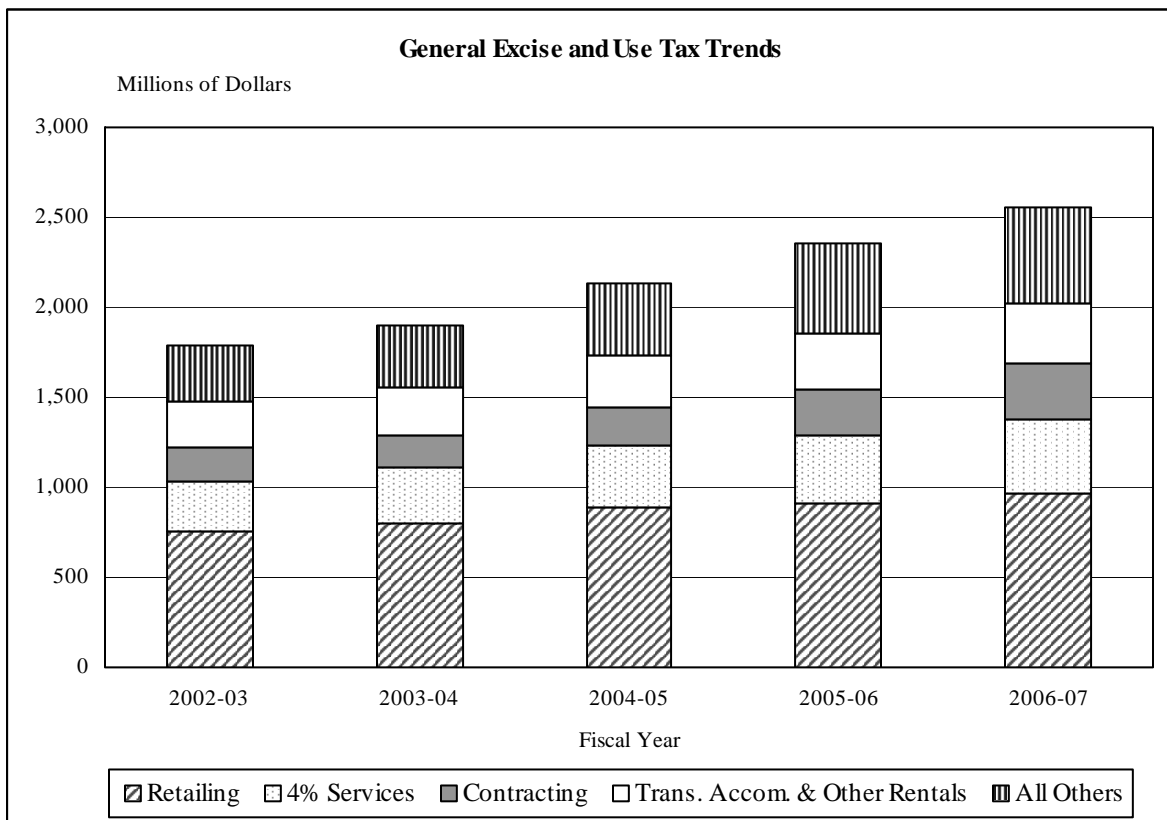
	FY 2007	FY 2006	Difference	
			Amount	%
Declaration of Estimated Taxes	\$ 138,769	\$ 161,795	\$ (23,026)	(14.2)
Payment with Return	22,653	15,118	7,535	49.8
Subtotal	\$ 161,422	\$ 176,913	\$ (15,491)	(8.8)
Refunds	79,588	46,904	32,684	69.7
NET	\$ 81,834	\$ 130,009	\$ (48,175)	(37.1)

NOTE: Due to rounding, details may not add to totals.



GENERAL EXCISE AND USE TAXES

General excise and use taxes made up 48.1% of total tax collections. The total \$2.6 billion collected represents an 8.5% growth over the prior fiscal year. Major components of the general excise taxes showed healthy increases over the last fiscal year—contracting rose 23.2%, services 9.3%, transient accommodation rentals 9.7%, all other rentals 6.4%, and retailing 5.9%.



GENERAL EXCISE AND USE TAX BASE AND TAXES
FOR FISCAL YEARS ENDING JUNE 30, 2007 AND 2006
(In Thousands of Dollars)

SOURCE OF REVENUE	Rate	FY 2007	FY 2006	Difference	
				Amount	%Change
<u>TAX BASE</u>					
Retailing		\$ 24,244,573	\$ 22,892,951	\$ 1,351,622	5.9
Services		10,355,378	9,456,656	878,722	9.3
Contracting		7,595,150	6,165,875	1,429,275	23.2
Trans. Accom. Rentals		3,139,956	2,861,311	278,645	9.7
All Other Rentals		5,196,368	4,882,268	314,099	6.4
All Others (4%)		5,148,240	4,693,711	454,528	9.7
Subtotal		<u>\$ 55,659,664</u>	<u>\$ 50,952,773</u>	<u>\$ 4,706,891</u>	<u>9.2</u>
Wholesaling		\$ 12,835,433	\$ 11,978,457	\$ 856,976	7.2
Manufacturing		690,097	662,981	27,115	4.1
Producing		435,040	528,430	(93,391)	(17.7)
Wholesale Services		560,351	520,771	39,580	7.6
Use (1/2%)		7,588,627	6,571,106	1,017,521	15.5
Insurance Commissions		522,035	454,715	67,321	14.8
Subtotal		<u>\$ 22,631,583</u>	<u>\$ 20,716,460</u>	<u>\$ 1,915,122</u>	<u>9.2</u>
TOTAL – ALL ACTIVITIES		<u>\$ 78,291,247</u>	<u>\$ 71,669,233</u>	<u>\$ 6,622,014</u>	<u>9.2</u>
<u>TAX</u>					
Retailing	4.00%	\$ 969,783	\$ 915,718	\$ 54,065	5.9
Services	4.00%	413,415	378,266	35,149	9.3
Contracting	4.00%	303,806	246,635	57,171	23.2
Trans. Accom. Rentals	4.00%	125,598	114,452	11,146	9.7
All Other Rentals	4.00%	207,855	195,291	12,564	6.4
All Others (4%)	4.00%	205,930	187,748	18,181	9.7
Subtotal		<u>\$ 2,226,387</u>	<u>\$ 2,038,111</u>	<u>\$ 188,276</u>	<u>9.2</u>
Wholesaling	0.50%	\$ 64,177	\$ 59,892	\$ 4,285	7.2
Manufacturing	0.50%	3,450	3,315	136	4.1
Producing	0.50%	2,175	2,642	(467)	(17.7)
Wholesale Services	0.50%	2,802	2,604	198	7.6
Use (1/2%)	0.50%	37,943	32,856	5,088	15.5
Insurance Commissions	0.15%	783	682	101	14.8
Subtotal		<u>\$ 111,331</u>	<u>\$ 101,991</u>	<u>\$ 9,340</u>	<u>9.2</u>
Unallocated*		\$ 218,044	\$ 215,214	\$ 2,830	1.3
TOTAL – ALL ACTIVITIES		<u>\$ 2,555,762</u>	<u>\$ 2,355,316</u>	<u>\$ 200,446</u>	<u>8.5</u>

*Included are collections from penalty and interest, assessments and corrections, delinquent collections, refunds, protested payments, settlements, etc.

NOTE: Due to rounding, details may not add to totals.

TRANSIENT ACCOMMODATIONS TAX

Transient accommodations tax collections were \$224.9 million for FY 2007, an increase of 3.7% over last year. All transient accommodations tax funds are distributed as follows: approximately 44.8% to the counties; 17.3% to the Convention Center Fund, provided that the revenues in excess of \$33.0 million in any calendar year are deposited into the General Fund; 32.6% to the Tourism Special Fund, provided that if the revenue projections are below \$63,292,000 in any fiscal year, monies will be transferred from the Transient Accommodations Tax Trust Fund to make up the difference; and 5.3% to the Transient Accommodations Tax Trust Fund, provided that amounts not transferred to the Tourism Special Fund are transferred to the General Fund. After these allocations, \$17.1 million remained in the General Fund for FY 2007.

TRANSIENT ACCOMMODATIONS TAX (In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
Transient Accommodations Tax	\$ 219,831	\$ 213,226	\$ 6,604	3.1
Time Share Occupancy Tax	5,101	3,770	1,331	35.3
Trans. Accom./Time Share Occ. Fees	11	12	(1)	(8.3)
TOTAL	\$ 224,942	\$ 217,008	\$ 7,934	3.7
Counties' Share	\$ 100,769	\$ 97,214	\$ 3,555	3.7
Convention Center Fund	33,758	32,663	1,095	3.4
Tourism Special Fund	73,328	70,741	2,587	3.7
General Fund	17,087	16,390	697	4.3
TOTAL	\$ 224,942	\$ 217,008	\$ 7,934	3.7

NOTE: Due to rounding, details may not add to totals.

FUEL AND MOTOR VEHICLE TAXES

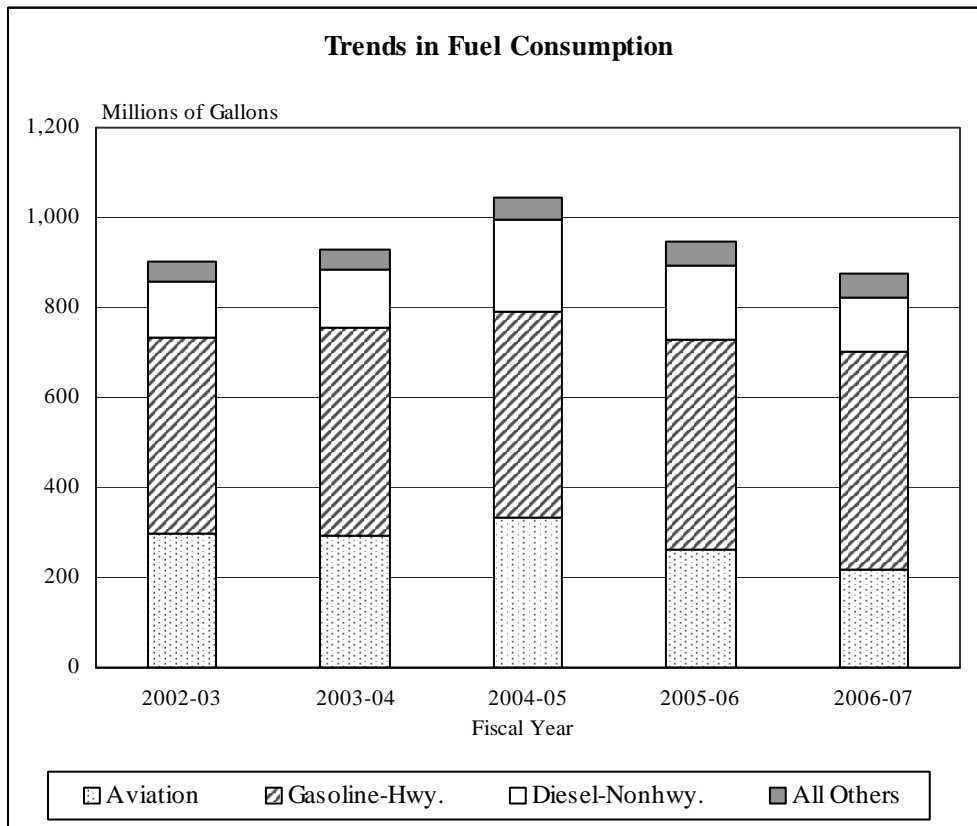
Taxable fuel consumption decreased 7.3% to 875.5 million gallons in FY 2007. As seen in the table below, the decline was attributable primarily to a drop of 46.6 million gallons in the aviation fuel consumption and a drop of 42.6 million gallons in the off-highway diesel oil consumption. On the other hand, gasoline consumption increased by 3.6%, or 16.7 million gallons. An environmental response tax of five cents is imposed on each barrel of petroleum product sold by a distributor to any retail dealer or end user. A total of 34.8 million barrels of petroleum was subject to the environmental response tax in FY 2007, a decline of 3.7% from last year.

GALLONS OF FUEL CONSUMED
(In Thousands of Gallons)

	FY 2007	FY 2006	Difference	
			Amount	%
Gasoline	483,229	466,524	16,705	3.6
Diesel Oil – Non-highway	120,378	162,939	(42,561)	(26.1)
Diesel Oil – Highway	51,507	48,464	3,043	6.3
Liq. Pet. Gas – Off Highway	1	607	(606)	(99.9)
Liq. Pet. Gas – Highway	118	235	(117)	(49.6)
Small Boats – Gasoline	45	18	27	153.5
Small Boats – Diesel Oil	33	45	(12)	(27.0)
Aviation Fuel	217,399	264,048	(46,649)	(17.7)
Other Fuel*	2,821	1,715	1,106	64.5
TOTAL GALLONS	875,530	944,594	(69,064)	(7.3)
Environmental Tax (Barrel)	34,826	36,158	(1,332)	(3.7)

*Includes ethanol, methanol, biodiesel.

NOTE: Due to rounding, details may not add to totals.



The revenues from fuel taxes are distributed to several special funds. The State Boating Fund receives 1% of the State and county fuel taxes exclusive of aviation fuel taxes. The State Airport Fund receives all of the tax revenues from aviation fuel. Monies from the environmental

response tax are deposited into the Environmental Response Revolving Fund, which is administered by the Department of Health for oil spill prevention and remediation programs. The remaining State fuel tax revenues are deposited into the State Highway Fund, while the remaining county fuel tax revenues are deposited into the County Highway Fund. The State Highway Fund also receives monies from the motor vehicle weight taxes and registration fees, which are administered and collected by the counties, and rental motor vehicle and tour vehicle surcharge taxes.

ALLOCATION OF FUEL TAXES
(In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
STATE HIGHWAY FUND:				
Gasoline	\$ 76,415	\$ 73,726	\$ 2,689	3.6
Diesel Oil – Non-highway	1,192	1,614	(421)	(26.1)
Diesel Oil – Highway	8,159	7,677	482	6.3
Liq. Pet. Gas – Off Highway	0	6	(6)	(99.9)
Liq. Pet. Gas – Highway	6	12	(6)	(49.6)
Other Fuel	97	68	29	42.5
Subtotal	\$ 85,868	\$ 83,102	\$ 2,766	3.3
Motor Vehicle	62,932	59,435	3,497	5.9
Rental Vehicle	49,480	48,092	1,388	2.9
TOTAL	\$ 198,280	\$ 190,629	\$ 7,651	4.0
COUNTY HIGHWAY FUND:				
City & County of Honolulu	\$ 52,221	\$ 52,385	\$ (164)	(0.3)
County of Maui	11,837	12,659	(822)	(6.5)
County of Hawaii	8,240	8,118	122	1.5
County of Kauai	5,973	3,809	2,164	56.8
TOTAL	\$ 78,270	\$ 76,970	\$ 1,300	1.7
BOATING SPECIAL FUND:	\$ 1,658	\$ 1,617	\$ 41	2.5
STATE AIRPORT FUND:				
Aviation Fuel	\$ 2,174	\$ 2,640	\$ (466)	(17.7)
ENVIRONMENTAL TAX FUND:	\$ 1,741	\$ 1,808	\$ (67)	(3.7)

NOTE: Due to rounding, details may not add to totals.

The State legislature sets the State fuel tax rates, while the county councils set the county rates. The effective rates for FY 2007 are shown below:

FUEL TAX RATES PER GALLON*

GASOLINE AND DIESEL OIL (HIGHWAY USE)**	State	County	Total
City & County of Honolulu	16.0¢	16.5¢	32.5¢
County of Maui	16.0¢	16.0¢	32.0¢
County of Hawaii	16.0¢	8.8¢	24.8¢
County of Kauai	16.0¢	13.0¢	29.0¢
LIQUID PETROLEUM GAS (HIGHWAY USE):			
City & County of Honolulu	5.2¢	5.4¢	10.6¢
County of Maui	5.2¢	4.3¢	9.5¢
County of Hawaii	5.2¢	2.9¢	8.1¢
County of Kauai	5.2¢	4.3¢	9.5¢
ETHANOL:			
City & County of Honolulu	2.4¢	2.4¢	4.8¢
County of Maui	2.4¢	3.8¢	6.2¢
County of Hawaii	2.4¢	1.3¢	3.7¢
County of Kauai	2.4¢	1.9¢	4.3¢
METHANOL:			
City & County of Honolulu	1.9¢	1.8¢	3.7¢
County of Maui	1.9¢	2.9¢	4.8¢
County of Hawaii	1.9¢	1.0¢	2.9¢
County of Kauai	1.9¢	1.4¢	3.3¢
BIODIESEL:			
City & County of Honolulu	4.0¢	8.3¢	12.3¢
County of Maui	4.0¢	0.0¢	4.0¢
County of Hawaii	4.0¢	2.2¢	6.2¢
County of Kauai	4.0¢	0.0¢	4.0¢
ENVIRONMENTAL RESPONSE TAX (PER BARREL):			
All Counties	5.0¢	0.0¢	5.0¢

* Gasoline used for agricultural equipment off highways, aviation fuel, and diesel oil used off highways are taxed by the State at 1¢ per gallon.

** Includes 1¢ State license tax on diesel oil.

PUBLIC SERVICE COMPANY TAXES

Public utilities paid public service company taxes totaling \$124.0 million, including penalty and interest.

PUBLIC SERVICE COMPANY TAXES (In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
Public Service Company Taxes	\$ 123,788	\$ 116,460	\$ 7,328	6.3
Penalty & Interest	<u>229</u>	<u>4,219</u>	<u>(3,990)</u>	<u>(94.6)</u>
TOTAL	\$ 124,017	\$ 120,679	\$ 3,338	2.8

NOTE: Due to rounding, details may not add to totals.

ESTATE AND TRANSFER TAXES

During FY 2007, a total of 803 estates were settled, of which 40 were taxable. Estate tax collections totaled \$0.6 million, compared to \$4.0 million the year before.

The decline in estate and transfer taxes was due to the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which gradually phases out the estate and transfer taxes and replaces the federal credit for state death taxes with a deduction. Hawaii's tax was effectively eliminated for decedents dying after December 31, 2004, when the federal credit was replaced with a deduction.

ESTATE AND TRANSFER TAXES (In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
Estate Tax	\$ 595	\$ 3,894	\$ (3,299)	(84.7)
Penalty & Interest	<u>0</u>	<u>123</u>	<u>(123)</u>	<u>(100.0)</u>
TOTAL	\$ 595	\$ 4,017	\$ (3,422)	(85.2)

NOTE: Due to rounding, details may not add to totals.

OTHER TAXES

Total revenues from other miscellaneous taxes amounted to \$487.0 million, \$37.4 million more than the previous year. Employment security contributions decreased \$14.8 million in FY 2007. Insurance premium tax collections exceeded last year's total by \$4.1 million, while tobacco tax collections rose \$6.1 million. Contributing to the increase in tobacco tax collections was Act 316,

SLH 2006, which increased the excise tax per cigarette by one cent per year over a six-year period beginning on September 30, 2006. Act 316, SLH 2006, allocated portions of the tobacco tax collections to the following special funds: the Hawaii Cancer Research Special Fund, the Trauma System Special Fund, the Emergency Medical Services Special Fund, and the Community Health Centers Special Fund. On September 30, 2006, an initial allocation to the Hawaii Cancer Research Special Fund of one cent per cigarette began, with the remaining allocations beginning on September 30, 2007.

Conveyance taxes collected by the Bureau of Conveyances under the Department of Land and Natural Resources decreased by \$12.3 million, a decline of 20.8% from the previous year. Act 100, SLH 2006, increased the amount of conveyance tax deposited into the Rental Housing Trust Fund to 50% from 30% for one fiscal year, effective July 1, 2006. As a result, the amount of conveyance tax revenues paid into the General Fund decreased from 35% to 15%. The amount of conveyance tax allocated to the Natural Area Reserve Fund and the Land Conservation Fund remained at 25% and 10%, respectively.

Liquor tax collections rose 0.2% to \$46.0 million. Franchise taxes collected from banks and other financial corporations increased 1.5 % to \$18.6 million.

Act 247, SLH 2005, granted counties the authority to impose a county surcharge of no more than 0.5% to the State's 4% general excise tax. The county surcharge tax could be levied no earlier than January 1, 2007, to fund county public transportation systems, and would be repealed on December 31, 2022. The Department of Taxation is required to levy, assess, collect, and administer the county surcharge tax for the counties. The City and County of Honolulu was the only county that adopted an ordinance to levy a county surcharge tax of 0.5%. The Honolulu county surcharge tax took effect on January 1, 2007, and \$53.8 million collected during the last six months of the fiscal year.

MISCELLANEOUS TAXES*
(In Thousands of Dollars)

	FY 2007	FY 2006	Difference	
			Amount	%
Banks & Other Financial Corporations	\$ 18,599	\$ 18,324	\$ 275	1.5
Conveyance	46,887	59,201	(12,314)	(20.8)
Employment Security Contributions	134,612	149,388	(14,776)	(9.9)
Insurance Premiums	92,196	88,068	4,128	4.7
Liquor & Permits	46,034	45,955	79	0.2
Tobacco & Licenses	94,387	88,261	6,126	6.9
General Excise Licenses & Fees	484	405	79	19.5
Honolulu County Surcharge	53,805	-	53,805	n/m
TOTAL	\$ 487,004	\$ 449,602	\$ 37,402	8.3

* Before allocation to special or other funds.

NOTE: Due to rounding, details may not add to totals.

n/m = not meaningful.

COLLECTION AND ACCOUNTING OF TAXES

TAX COLLECTIONS

Total tax collections in FY 2007 amounted to \$5.3 billion, 4.2% more than the \$5.1 billion collected in the previous year. While the Department of Taxation collected the majority of taxes, the counties collected \$62.9 million in State motor vehicle weight taxes and registration fees, the Department of Commerce and Consumer Affairs collected \$92.2 million in insurance premium taxes, and the Department of Land and Natural Resources collected \$46.9 million in conveyance taxes.

TAX COLLECTIONS (In Thousands of Dollars)

SOURCE OF REVENUE	FY 2007		FY 2006	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corporations	\$ 18,599	0.35	\$ 18,324	0.36
Conveyance	46,887	0.88	59,201	1.16
Employment Security Contributions	134,612	2.53	149,388	2.93
Fuel	169,712	3.19	166,138	3.26
General Excise & Use Tax	2,555,762	48.07	2,355,316	46.17
Honolulu County Surcharge	53,805	1.01	-	-
Income – Corporations	81,834	1.54	130,010	2.55
Income – Individuals	1,560,286	29.35	1,550,596	30.40
Inheritance and Estate	595	0.01	4,017	0.08
Insurance Premiums	92,196	1.73	88,068	1.73
Liquor & Permits	46,034	0.87	45,955	0.90
Motor Vehicle Tax*	112,412	2.11	107,527	2.11
Public Service Companies	124,017	2.33	120,679	2.37
Tobacco & Licenses	94,387	1.78	88,261	1.73
Transient Accommodations Fees	11	0.00	12	0.00
Transient Accommodations Tax	224,931	4.23	216,996	4.25
All Others**	514	0.01	522	0.01
TOTAL	\$ 5,316,593	100.00	\$ 5,101,011	100.00

* Includes motor vehicle weight tax, registration fees, commercial driver's license, periodic motor vehicle inspection fees, rental motor vehicle and tour vehicle registration fees, and rental motor vehicle and tour vehicle surcharge tax.

** Includes fuel retail dealer permits, fuel penalty and interest, and general excise fees.

NOTE: Due to rounding, details may not add to totals.

DISTRIBUTION OF TAXES

Of the total \$5.3 billion in tax revenues collected, \$4.6 billion (86.3%) was deposited into the General Fund. The four counties received \$179.0 million (3.4%), which came from the county fuel taxes and 44.8% of the transient accommodations tax collections. In addition, \$53.8 million was collected and credited to the City and County of Honolulu county surcharge tax. The remaining \$497.2 million of tax revenue was distributed among several State special funds. The State Highway Fund received the largest portion, \$198.3 million. All \$134.6 million of the employment security contributions went into the Unemployment Trust Fund for unemployment benefits. Portions of the transient accommodations tax went to the next two largest special funds: \$73.3 million to the Tourism Special Fund and \$33.8 million to the Convention Center Fund.

Effective July 1, 2006, the amount of conveyance tax revenue allocated to the Rental Housing Trust Fund increased to 50% from 30% (Act 100, SLH 2006). Due to the reallocation of the conveyance tax revenue, the amount deposited into the General Fund decreased from 35% to 15%.

In FY 2007, a new special fund was created pursuant to Act 316, SLH 2006. Beginning on September 30, 2006, a portion of the tobacco tax revenues, one cent per cigarette, was to be deposited into the Hawaii Cancer Research Special Fund. Distribution of the tax collected is shown in the following table.

DISTRIBUTION OF COLLECTIONS
(In Thousands of Dollars)

	FY 2007		FY 2006	
	Amount Collected	% of Total	Amount Collected	% of Total
<u>STATE FUNDS</u>				
State General Fund	\$ 4,586,504	86.27	\$ 4,434,993	86.94
State Highway Fund	198,280	3.73	190,629	3.74
State Airport Fund	2,174	0.04	2,640	0.05
Boating Special Fund	1,658	0.03	1,617	0.03
Environmental Fund	1,741	0.03	1,808	0.04
Cigarette Stamp Admin/Enforcement Fund	1,422	0.03	1,434	0.03
Compliance Resolution Fund	2,000	0.04	2,000	0.04
Unemployment Trust Fund	134,612	2.53	149,388	2.93
Election Campaign Fund	220	0.00	186	0.00
Tourism Special Fund	73,328	1.38	70,741	1.39
Rental Housing Fund	23,443	0.44	17,760	0.35
Natural Area Reserve Fund	11,722	0.22	14,800	0.29
Convention Center Fund	33,758	0.63	32,663	0.64
Public Libraries Fund	88	0.00	60	0.00
School Repair & Maintenance Fund	106	0.00	74	0.00
Land Conservation Fund	4,689	0.09	5,920	0.12
Domestic Violence/Child Abuse Fund	182	0.00	111	0.00
Cancer Research Fund	7,823	0.15	-	-
Subtotal – State	<u>\$ 5,083,749</u>	<u>95.62</u>	<u>\$ 4,926,826</u>	<u>96.59</u>
<u>HONOLULU COUNTY SURCHARGE</u>	\$ 53,805	1.01	-	-
<u>REVENUES TRANSFERRED TO COUNTIES</u>				
Other County Revenues				
Fuel	\$ 78,270	1.47	\$ 76,970	1.51
Transient Accommodations Tax	100,769	1.90	97,214	1.91
Subtotal – Counties	<u>\$ 179,040</u>	<u>3.37</u>	<u>\$ 174,185</u>	<u>3.41</u>
TOTAL	\$ 5,316,593	100.00	\$ 5,101,011	100.00

NOTE: Due to rounding, details may not add to totals.

BRIEF SUMMARY OF HAWAII'S TAX SYSTEM

Hawaii has 17 separate tax laws, of which 14 are administered by the State. The counties administer the remaining three—the real property tax, motor vehicle weight tax, and public utility franchise tax—although the revenue from the motor vehicle weight taxes accrues to both the State and county highway funds. The number of taxes administered by the State is indicative of the highly centralized nature of the State's governmental structure.

The State's primary revenue source is the general excise tax. Unlike more common sales taxes, the general excise tax is levied on the business receiving the income, rather than the customer, for the privilege of doing business in the State. Despite its relatively low tax rate, substantial revenue is generated in large part due to the broad tax base on which this tax, as well as its complementary use tax, is levied. Gross income from most business activities, including most sales, services, contracting, and rental activities, are subject to the general excise tax. In general, the general excise tax law levies the tax on all business activities at a 4% retail rate, while allowing a lower rate on some transactions, including many business-to-business transactions, and exempting some other transactions because those transactions are subject to other taxes or because the legislature wished to grant a preference to that economic activity.

Although not a State tax realization, the Department of Taxation is required to administer the county surcharge on the State's general excise tax for the counties. Act 247, SLH 2005, authorized the counties to establish by ordinance a surcharge of up to 0.5% to fund public transportation systems; only the City and County of Honolulu adopted a surcharge. Beginning January 1, 2007, the county surcharge tax adopted pursuant to City and County of Honolulu Ordinance No. 05-027 has been levied at the rate of 0.5% on transactions that are subjected to the State general excise or use tax at the 4% rate and that are attributable to business conducted in the City and County of Honolulu. Act 247, SLH 2005, and Ordinance No. 05-027 will both be automatically repealed on December 31, 2022.

Second in revenue generation is the State's income tax, the majority of which is from the income tax levied on individual taxpayers. Hawaii resident individuals are taxed on worldwide income, whereas nonresidents of the State are taxed on income from Hawaii sources only. A large number of credits against the income tax levied are available to qualified resident and nonresident individuals. Two refundable income tax credits target low-income resident individuals, including those with no gross income. The low-income refundable tax credit is allowed in amounts ranging from \$35 per qualified exemption for resident individuals with adjusted gross incomes under \$10,000, to \$10 per qualified exemption for resident individuals with adjusted gross incomes of \$20,000 or less. The credit for low-income household renters is \$50 per qualified exemption for resident individuals with less than \$30,000 of adjusted gross income. The most commonly claimed business tax credit is the capital goods excise tax credit.

Revenues from 11 of the State-administered taxes go into the General Fund and are used to provide government services. Although the fuel tax is administered by the State, it is a source of revenue for both the State and county highway funds. Employment security tax collections are deposited into the Unemployment Trust Fund and used exclusively to provide benefits to

unemployed workers. Rental motor vehicle and tour vehicle surcharge taxes are deposited into the State Highway Fund.

STATE GENERAL FUND*
(In Thousands of Dollars)

SOURCE OF REVENUE	FY 2007		FY 2006	
	Amount Collected	% of Total	Amount Collected	% of Total
Banks – Financial Corporations	\$ 16,599	0.36	\$ 16,324	0.37
Conveyance	7,033	0.15	20,720	0.47
General Excise & Use Tax	2,555,762	55.72	2,355,316	53.11
Income – Corporations	81,834	1.78	130,010	2.93
Income – Individuals	1,559,690	34.01	1,550,164	34.95
Inheritance and Estate	595	0.01	4,017	0.09
Insurance Premiums	92,196	2.01	88,068	1.99
Liquor & Permits	46,034	1.00	45,955	1.04
Public Service Companies	124,017	2.70	120,679	2.72
Tobacco & Licenses	85,143	1.86	86,827	1.96
Transient Accommodations Tax	17,076	0.37	16,378	0.37
All Others**	525	0.01	534	0.01
TOTAL	\$ 4,586,504	100.00	\$ 4,434,993	100.00

* Net of transfers to special funds.

** Includes fuel retail dealer permits, fuel penalty and interest, general excise fees, and transient accommodations fees.

NOTE: Due to rounding, details may not add to totals.

OUTLINE OF THE HAWAII TAX SYSTEM AS OF JULY 1, 2007

Issued by the Department of Taxation

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(1) Net Income Chapter 235 — Section 235-1 to 235-130	For taxable years beginning after December 31, 2001, the tax rates for individuals as well as estates and trusts range from 1.4% to 8.25% of taxable income. For taxable years beginning after December 31, 2006: (1) the individual income tax brackets are expanded, and (2) the standard deduction amounts are increased as follows: married filing joint return or surviving spouse with dependent child is \$4,000; single or married filing separately is \$2,000; and head of household is \$2,920. Tax rates for corporations are 4.4% up to \$25,000, 5.4% over \$25,000 but not over \$100,000, and 6.4% over \$100,000 of taxable income.	Returns due 20th day of 4th month following the close of taxable year. Withholding returns due monthly on or before the 15th day of the following calendar month. When the total tax liability is less than \$5,000 for the calendar year, returns may be filed quarterly on or before the 15th day of the month after the close of each quarter. An annual employer's return and reconciliation of Hawaii income tax withheld, Form HW-3, must be filed together with a duplicate copy of each employee's tax statement, Form HW-2, on or before the last day of February following the close of the calendar year. Estimates of income of individuals not subject to withholding, estates, trusts, and corporations, April 20th.	In general, at time of filing returns. Estimates of individuals, estates, trusts, and corporations, one-quarter, April 20th; June 20th; September 20th; and January 20th. See Booklet A, Employer's Tax Guide, for the withholding requirements for employers who are required to pay the taxes withheld by electronic funds transfer (EFT).
(2) Estate and Transfer (for decedents dying after 6/30/83 and before 1/1/05) Chapter 236D — Section 236D-1 to 236D-18	Every resident decedent is taxed on transfer of taxable estate equal to federal credit for estate death taxes allowed by IRC section 2011. Credit is allowed for death tax imposed by another state not qualified by reciprocal provision. For non-resident decedent, tax is based on transfer of taxable estate located in Hawaii by use of ratio. Exemption afforded resident estate equally applicable to nonresident, with certain exceptions. Note: For estates of decedents dying after December 31, 2004, there will be no estate and transfer tax since the federal credit for state death taxes was repealed effective January 1, 2005.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.
(3) General Excise (Gross Income) Chapter 237 — Section 237-1 to 237-49	This is a business privilege tax measured by gross proceeds of sales or gross income. The tax rate is 0.5% on wholesaling and wholesale services, producing, sugar processing and pineapple canning; all other activities (retailing business and professional services, contracting, theatre, amusement, radio, interest, commissions, rentals) are taxed at 4%, except insurance commissions received by general agents, subagents and solicitors who are taxed at 0.15%. The licensing fee for general excise tax licensees and nonprofit organizations is a one-time fee of \$20. Effective January 1, 2007, a county surcharge of 0.5% will be added to the State's 4% general excise tax for business conducted in the City and County of Honolulu.		

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(4) Transient Accommodations Tax Chapter 237D — Section 237D-1 to 237D-16	This is a tax levied on the furnishing of a room, apartment, suite, or the like which is customarily occupied by the transient for less than 180 consecutive days for each letting by a hotel, apartment, motel, horizontal property regime or cooperative apartment, rooming house, or other place in which lodgings are regularly furnished to transients for consideration. The tax is imposed at the rate of 7.25%. The registration fee for transient accommodations operators is a one-time fee of \$5 for each registration consisting of 1 to 5 units and \$15 for 6 or more units. Effective January 1, 1999, plan managers are liable for and pay to the State the transient accommodations tax of 7.25% that is imposed on the fair market rental value of time share vacation units.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.
(5) Use Chapter 238 — Section 238-1 to 238-16	This is an excise tax levied on tangible personal property which is imported or purchased from an unlicensed seller for use in the State. The tax is based upon the purchase price or value of the tangible personal property purchased or imported, whichever is applicable. Rates: 0.5% if for resale at retail, 4%, if for use or consumption. For exceptions, see sections 238-3 and 238-4. The use tax is imposed on the value of services or contracting that are performed by an unlicensed seller at a point outside the State and imported or purchased for use in the State, effective for use taxes accruing after December 31, 1999. Effective January 1, 2007, a county surcharge of 0.5% will be added to the State's 4% use tax for the importation or purchase of tangible personal property or services for use in the City and County of Honolulu.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year. These returns have been consolidated with the general excise (gross income) tax returns and are filed simultaneously.	At time of filing returns.
(6) Public Service Company Chapter 239 — Section 239-1 to 239-25	Nature of Tax—Public utility business in lieu of general excise tax. (a) Measurement of assessment—general rule: Gross income from public utility business of public utilities for preceding calendar year. For exception, see section 239-9. (b) Rates: (i) Gross income from passenger fares for transportation between points on a scheduled route by a carrier of passengers, 5.35%. (ii) Sale of its products or services to another public utility which resells such products or services, 0.5%. (iii) Sale of telecommunications services by a public utility to an interstate or foreign telecommunications services provider that is subject to the general excise tax and that resells the services to retail customers, 0.5%. (iv) All other revenues: 4% of gross income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th, and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.
(7) Banks, Building and Loan, Financial Services Loan Companies and Certain Other Financial Corporations Chapter 241 — Section 241-1 to 241-7	(1)(a) Assessment Date: January 1. (b) Nature of Tax: a franchise tax (in lieu of net income and general excise taxes) on banks, building and loan associations, development companies, financial corporations, financial services loan companies, trust companies, mortgage loan companies, financial holding companies, small business investment companies, or subsidiaries not subject to the tax imposed by chapter 235. (2) Measure of Assessment: Net income for the preceding year from all sources as defined by chapter 235 (Income Tax Law) with modifications. (3) Rate: 7.92% of taxable income.	Returns filed on or before the 20th day of the 4th month following the close of the taxable year, based upon operations of the preceding taxable year.	First installment at the time of filing return, or, on or before the 20th day of the 4th month. Other installments due on the 20th day of the 2nd, 5th and 8th month thereafter. If the total tax liability for the taxable year exceeds \$100,000, 1st installment on or before the 10th day of the 1st month. Remaining installments due on or before the 10th day of each calendar month thereafter.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(8) Fuel Chapter 243 — Section 243-1 to 243-16	Distributors, as defined, are required to pay: 2¢ per gallon on aviation fuel, an initial 2¢ per gallon on diesel oil, 1¢ per gallon of naphtha fuel sold for use in a power-generating facility, as defined, .25¢ per gallon on alternative fuels for operation of an internal combustion engine and at the rates specified below per gallon on alternative fuels, and from 25.8¢ to 33.5¢ per gallon on liquid fuels other than the foregoing; also, pay additional taxes from 23.8¢ to 31.5¢ per gallon on diesel oil used to operate motor vehicles upon the public highways; however, they are not required to pay the additional tax on diesel oil and the tax on alternative fuels if purchasers furnish Exemption Certificates. Form M-38. Refunds of liquid fuel used for agricultural equipment not operated upon the public highways, diesel oil used for motor vehicles not operated upon the public highways, and alternative fuels used for motor vehicles and internal combustion engines not operated upon the public highways may be claimed on Form M-36. Distributors are required to register and be licensed. Licenses are valid until revoked. An Environmental Response Tax of 5¢ per barrel or a fractional part of a barrel of petroleum product sold by a distributor to a retail dealer or end user is also imposed. Effective July 1, 2004, the fuel tax is adjusted to reflect the energy content of alternative fuels as follows: ethanol- 0.145 times the rate for diesel; methanol- 0.11 times the rate for diesel; biodiesel- 0.25 times the rate for diesel; liquefied petroleum gas- 0.33 times the rate for diesel; and for other alternative fuels, the rate is based on the energy content of the fuels as compared to diesel fuel, using a lower heating value of 130,000 BTUs per gallon as a standard for diesel, so that the tax rate, on an energy content basis, is equal to one-quarter the rate for diesel fuel.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(9) Liquor Chapter 244D — Section 244D-1 to 244D-17	This is a gallonage tax imposed upon "dealers" as defined in the law and certain others who sell or use liquor. A \$2.50 liquor tax permit is required and must be renewed before July 1st of each year. See section 244D-4 for exemption from tax. The tax rates per wine gallon are \$5.98 on distilled spirits, \$2.12 on sparkling wine, \$1.38 on still wine, \$.85 on cooler beverages, \$.93 on beer other than draft beer, and \$.54 on draft beer.	Returns are due monthly on or before the last day of the following month.	At time of filing returns.
(10) Cigarette and Tobacco Chapter 245 — Section 245-1 to 245-63	"Wholesalers" and "dealers" as defined in the law must pay an excise tax on sale or use of tobacco products equal to 40% of the wholesale price and a fixed tax rate of 8¢ on each cigarette sold, used, or possessed on and after September 30, 2006. Section 245-3 increases the tax on cigarettes to 9¢ per cigarette sold on and after September 30, 2007. A \$2.50 tobacco tax license is required and must be renewed before July 1st of each year. Effective January 1, 2001, cigarette and tobacco wholesalers and dealers are required to affix stamps to individual cigarette packages as proof of payment of cigarette taxes. Beginning December 1, 2006, every retailer engaged in the retail sale of cigarettes and other tobacco products is required to obtain a \$20.00 retail tobacco permit that must be renewed before December 1st of each year.	Returns are due monthly on or before the last day of the following month.	At time of filing returns. Cigarette tax paid through the purchase of cigarette tax stamps by licensees.

KIND OF TAX & LEGAL REFERENCES (HAWAII REVISED STATUTES)	MEASURE AND RATE OF TAX	REPORTS	TAX PAYABLE
(11) Conveyance Chapter 247 — Section 247-1 to 247-13	This tax is imposed on all documents transferring ownership or interest in real property and is based on the actual and full consideration paid or to be paid. Minimum \$1 tax for each taxable transaction. Effective July 1, 2005, The conveyance tax is imposed as follows: (1) 10¢ per \$100 for properties with a value of less than \$600,000, (2) 20¢ per \$100 for properties with a value of at least \$600,000, but less than \$1,000,000, and (3) 30¢ per \$100 for properties with a value of \$1,000,000 or greater. For the sale of a condominium or single family residence for which the purchaser is ineligible for a county homeowner's exemption on property tax, the conveyance tax is imposed as follows: (1) 15¢ per \$100 for properties with a value of less than \$600,000, (2) 25¢ per \$100 for properties with a value of at least \$600,000, but less than \$1,000,000, and (3) 35¢ per \$100 for properties with a value of \$1,000,000 or greater. (Documents of certain conveyances are exempted.)	A certificate of conveyance must be filed with the document at the Bureau of Conveyances within 90 days after a taxable transaction; a claim for exemption from the conveyance tax must be filed for certain exempt conveyances.	At time of filing the certificate, but no later than 90 days after the taxable transaction.
(12) Rental Motor Vehicle and Tour Vehicle Surcharge Tax Chapter 251 — Section 251-1 to 251-15	There is a rental motor vehicle surcharge tax of \$3 a day or any portion of a day that a rental motor vehicle is rented or leased. The tax is levied on the lessor. There is also a tour vehicle surcharge tax of \$65 per month for each tour vehicle in the 25 passenger seat and over category and \$15 per month for each tour vehicle in the 8 to 25 passenger seat category. The tax is levied on the tour vehicle operator. There is a one-time \$20 registration fee. Effective September 1, 2008, Act 258, Session Laws of Hawaii 2007, decreases the rental motor vehicle surcharge tax to \$2 a day or any portion of a day that a rental motor vehicle is rented or leased.	Monthly returns are due on or before the last day of the following month. When the total tax liability does not exceed \$4,000 for the calendar or fiscal year, returns may be filed quarterly on or before the last day of the month after the close of each quarter. When the total tax liability does not exceed \$2,000 for the calendar or fiscal year, returns may be filed semiannually on or before the last day of the month after the close of each semiannual period. An annual summary and reconciliation return must be filed on or before the 20th day of the 4th month following the close of the taxable year.	At time of filing returns.
(13) Unemployment Insurance Chapter 383 — Section 383-1 to 383-176	This is a tax on wages paid by employing units with 1 or more employees with certain exemptions. The unemployment tax rate is determined according to a multi-contribution schedule system. Each year, 1 of 8 contribution schedules is applicable depending on the condition of the UI Trust Fund. An employer's contribution rate is not less than 0.00% or greater than 5.4%. There is also an additional employment and training (E & T) fund assessment on taxable wages paid to an employee. The percentage rate for this additional tax is 0.1%. The E & T assessment is applicable to all employing units with unemployment insurance contribution rates greater than 0.00% and less than 5.4%. There is a limitation of the tax on wages paid to an employee called the "tax base". The tax base represents 100% of the state's average annual wages reported by employers contributing to the unemployment trust fund. Note: The tax base for calendar year 2008, 2009, and 2010 has been set at \$13,000, so long as the balance of the unemployment trust fund does not fall below the adequate reserve fund as specified by section 383-63.	On a quarterly basis, employers submit Form UC-B6, "Quarterly Wage, Contribution and Employment and Training Assessment Report." The report must be filed on or before the last day of the month following the report quarter.	At time of filing returns.
(14) Insurance Premiums Chapter 431 — Section 431:7-201 to 431:7-209	Tax on insurance companies (Underwriters) based on premiums written in Hawaii. In lieu of all taxes except property tax and taxes on the purchase, use or ownership of tangible personal property. Tax Rates: Life Insurance, 2.75%; Surplus Lines, 4.68%; Ocean Marine, .8775% on gross underwriting profit; and Other Insurance, 4.265%. To insurers who qualify, there is a 1% tax credit to facilitate regulatory oversight. This law is administered and the tax collected by the Insurance Commissioner, who is required to report to the Director of Taxation all amounts of taxes collected under this chapter.	Quarterly tax statement is due on or before the last day of the calendar month following the quarter in which the tax accrued. Annual Tax Statement is due on or before March 1 with the Insurance Commissioner.	At time of filing statements.

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