**HAWAII – TAX** by Dan Chun Nov.4, 2023

Discussion: In lieu of sales tax, Hawaii levies GROSS EXCISE TAX or GET on gross income of a business.

* Only the state can levy GET and no county/city sales taxes are allowed. Counties can only levy real property taxes and county hotel tax.
* Tourism is biggest industry, so it is assumed tourists pay large % of GET. GET is state’s largest source of income. Hotel room rates are subject to GET; plus state Transient Accommodation Tax at 10.25% and county room tax; a total of almost 18% - among the highest hotel tax in USA .
* However, the state does pay to construct / operate all public school buildings for a single public school district; with equity between rich and poor communities. This has been practice from 1830s when Hawaii was a Monarchy.
* GET is not sales tax because a business owes GET. However, it is common practice to pass GET on to customers. Hawaii considers GET (typically 4%) collected from customers as “gross income” so businesses typically charge customers 4.712%.
* Honolulu residents must temporarily pay extra 0.5% to fund rail transit construction; but subject to legislative approval. State charges Honolulu handsome % to manage this tax.
* GET typically “pyramids” meaning business-to-business transactions are subject to GET. GET dates back to late 1930s when Big Five most politically powerful companies had “vertical monopolies” that could avoid ”pyramiding.” Some critics claim GET is equivalent of 13% sales tax.
* But Contracting services, including architectural services, are allowed to subtract $ paid to subcontractors/engineer consultants and pay GET only on net income. Because gross income is greatly reduced by payments for subcontracting. General / prime is still liable if sub fails to pay. We don’t know what other states charge, but it has been said that no jurisdiction wants to tax construction at any high rate. (We understand FL sales tax building materials, but exempts labor?)
* The state pays GET even on its own construction. Populists frequently campaign for food and medicine exemption from GET. Local political wisdom is to avoid granting too many exemptions / differing rates because this would cause each session to be consumed by warring special interests. AIA has testified that GET on single family houses rivals the plumbing cost, but legislature does nothing
* When serious recessions occur, construction and design industry successfully lobby for GET exemption for certain improvements like hotel renovations and home renovations. Last recession, hotels loaned a mid-level executive to gather $ data on planned / possible investment for hotel renovations. Construction industry coalition used data to help pass GET exemption.
* Being taxed as “contracting service” rather than “professional service” has made stronger bonds with larger part of Hawaii’s construction industry.
* GET has been used to close down plan stamping. Most egregious offender (he was witnessed stamping plans at rock concert on hood of his car while in darkness) in Hawaii County was investigated by state tax based on complaint. DOTAX audited Hawaii County permit applications and multiplied each sheet with his stamp / signature X “going rate per sheet.” Maybe $100 per sheet from what local taxi driver casually told me after inquiring what I did for a living. Then DOTAX checked his GET return and found significant under-reporting of income. “Where there is smoke there is fire!” He is now in federal prison for same under-reporting.

 **§237-6  "Contractor", "contracting", "federal cost-plus contractor", defined.**  "Contracting" means the business activities of a contractor.

     "Contractor" includes, for purposes of this chapter:

     (1)  Every person engaging in the business of contracting to erect, construct, repair, or improve buildings or structures, of any kind or description, including any portion thereof, or to make any installation therein, or to make, construct, repair, or improve any highway, road, street, sidewalk, ditch, excavation, fill, bridge, shaft, well, culvert, sewer, water system, drainage system, dredging or harbor improvement project, electric or steam rail, lighting or power system, transmission line, tower, dock, wharf, or other improvements;

     (2)  Every person engaging in the practice of architecture, professional engineering, land surveying, and landscape architecture, as defined in section 464-1; and

     (3)  Every person engaged in the practice of pest control or fumigation as a pest control operator as defined in section 460J-1.

     "Federal cost-plus contractor" means a contractor having a contract with the United States or an instrumentality thereof, excluding national banks, where, by the terms of the contract, the United States or such instrumentality, excluding national banks, agrees to reimburse the contractor for the cost of material, plant, or equipment used in the performance of the contract and for taxes which the contractor may be required to pay with respect to such material, plant, or equipment, whether the contractor's profit is computed in the form of a fixed fee or on a percentage basis; and also means a subcontractor under such a contract, who also operates on a cost-plus basis.

**Discussion on Exemption for Exported Services;**

1. It took several years to pass GET exemption to “level the playing field” for Hawaii-based design professionals when designing out-of-state projects.
2. At House ECON Committee hearing, chairperson asked AIA how many design contracts we expect this to be a factor? I said “Representative, selling architecture is like going fishing.” The committee erupted into laughter; one of only two times in 30 years that I have made a comment with humorous intent. They agreed, but the bill still did not pass that first session. Problems arose due to other services like financial where electronic data readily flies among various states. There was a larger problem because leg did not want to single out design professionals for special treatment.
3. One session AIA leadership hired powerful plaintiff attorney lobbyist to advocate for the exemption. He still failed and it caused friction with rest of construction industry. Taking back the lobbying, AIA convinced the leg that our service is “consumed“ in process of unique design for site and usage.
4. If we import “contracting service” like Mainland consulting engineering, we typically pay GET on imported service so that out-of-state business need not register as Hawaii business. For design-build that can include out-of-state consulting, it seems simpler for prime design-builder to pay GET on behalf of entire DB team.
5. But it took until last week of session when Senate refused to ratify popular AG nominee. Public uproar ensued and Senate searched for bills friendly to small business. They called it from committee and passed it with slightly flawed language. “Glitch bill” needed following session. A veteran lobbyist advised us always to have some desirable bill hanging around.
6. AIA need to further research tax situation for federal contracts. Pearl Harbor is headquarters for US Indo-Pacific Fleet and issues design contracts for Pacific Rim sites and naval facilities down to Antarctica and Indian Ocean. NAVFAC is important client for design professional services.

 **§237-29.53  Exemption for contracting or services exported out of State.**  (a)  There shall be exempted from, and excluded from the measure of, taxes imposed by this chapter, all of the value or gross income derived from contracting (as defined under section 237-6) or services performed by a person engaged in a service business or calling in the State for use outside the State where:

     (1)  The contracting or services are for resale, consumption, or use outside the State; and

     (2)  The value or gross income derived from the contracting or services performed would otherwise be subject to the tax imposed under this chapter on contracting or services at the highest rate.

For the purposes of this subsection, the seller or person rendering the contracting or services exported and resold, consumed, or used outside the State shall take from the customer, a certificate or an equivalent, in a form the department prescribes, certifying that the contracting or service purchased is to be otherwise resold, consumed, or used outside the State.  Any customer who furnishes this certificate or an equivalent shall be obligated to pay the seller or person rendering the contracting or services, upon demand, if the contracting or service purchased is not resold or otherwise consumed or used outside the State, the amount of the additional tax which by reason thereof is imposed upon the seller or person rendering the ntracting or service.

     (b)  There shall be exempted from, and excluded from the measure of, taxes imposed by this chapter, all of the value or gross income derived from contracting (as defined in section 237-6) or services performed by a person engaged in a service business or calling in the State for a purchaser who resells all of the contracting or services for resale, consumption, or use outside the State pursuant to subsection (a).  For the purposes of this subsection, the seller or person rendering the contracting or services for a purchaser who resells the contracting or services for resale, consumption, or use outside the State shall take from the purchaser, a certificate or an equivalent, in a form that the department prescribes, certifying that the contracting or services purchased is to be for resale, consumption, or use outside the State pursuant to subsection (a).  Any purchaser who furnishes this certificate or an equivalent shall be obligated to pay the seller or person rendering the contracting or services, upon demand, if the contracting or services purchased is not resold in its entirety to a customer of the purchaser who has complied with subsection (a), the amount of the additional tax which by reason thereof is imposed upon the seller or the person rendering the contracting or service.

**USE TAX is intended to replace GET income lost from exempting exported services**

1. USE TAX is levied @ 4% on gross value and is self-reported obligation on part of importer. See following Q&A #24 from state tax website.
2. AIA has no firm information, but we have suspicion that Use Tax is often overlooked by clients for luxury homes because clients lack state GET license.
3. State says it is difficult to enforce Use Tax, but we hope it is being paid by clients such as big box retailers. Otherwise clients are enjoying 4% cost advantage over Hawaii-based architects. Larger number of Hawaii architect licensees do not live in Hawaii. And Hawaii is not geographically contiguous with any other states like US Mainland; where practice is frequently multi-state basis. Some wild speculation in that our CES requirement is only 8 hours per year; reputed to be lowest requirement among all NCARB jurisdictions. If you fulfill CES for one NCARB jurisdiction, you are considered to fulfill CES for all jurisdictions in which you hold license.
4. One consideration is to link Use Tax to building permit issuance because the permit system already requires state tax clearance from construction contractors. The applicant would simply need to add GET license number that covers GET or USE TAX on design service. AIA has requested this in testimony for bills relating to tax obligation of construction contractors listed on building permit application. No success yet, but those bills all fail to pass because bills require contractor to submit state tax clearance two successive times to county permitting agency. Actually AIA has opposed these bills in concert with home builders.

**Contracting**

**24. I am a Hawaii homeowner. I hired an architect, located outside Hawaii, who is not licensed for GET, to draw plans to build an extension on my Hawaii home. The architect did not perform any work in Hawaii. Do I need to pay use tax?**

Generally, for contracting, if the project situs is in Hawaii, then the architect should be licensed for GET and the homeowner would not be subject to use tax. However, if the architect does not have a GET license, then the homeowner would be subject to use tax on the value of contracting imported into Hawaii at the rate of 4% (4.5% if applicable to the county surcharge).