

SB 972



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February 27, 2009

The Honorable Donna Mercado Kim, Chair
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, Hawaii 96813

LATE

RE: S.B. 972, S.D.1, Relating to Tax Administration

HEARING DATE: Monday, March 2, 2009 at 9:30 a.m.

Aloha Chair Kim and Members of the Committee on Ways and Means

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance of the Government Affairs Committee of the Hawai'i Association of REALTORS® ("HAR"), here to testify on behalf of the HAR and its 9,600 members in Hawai'i. HAR submits the following **comments** and concerns with respect to Section 2 of S.B. 972, S.D.1, Relating to Tax Administration, which reads as follows:

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

"§231- Coordination policies concerning compliance with general excise tax payments. (a) The department shall coordinate with federal agencies to require a general excise tax clearance certificate for all construction projects in Hawaii. Notwithstanding any law to the contrary, the appropriate state agency shall have the authority to stop the construction project if any periodic general excise tax returns with payment are not timely or accurately filed, as appropriate, or if the federal procurement officers do not reasonably assist the department in ensuring that each construction project pays general excise tax in a timely and accurate manner.

(b) The department shall coordinate with unions and federal agencies, such as the United States Immigration and Customs Enforcement Agency, on database and intelligence sharing, along with cooperative auditing of construction work sites for compliance with the general excise tax reporting and income tax withholding requirements. Notwithstanding any law to the contrary, the appropriate state agency shall have the authority to stop the construction project if an owner, developer, employer, or similar entity is not paying income, withholding, general excise, or employment taxes to the State in a timely and accurate manner.

(c) The department shall coordinate with department of commerce and consumer affairs to require a general excise tax clearance certificate prior to license issuance or renewals for regulated industries licensed under chapters 436 through 471, such as those regulated under chapters 439 (beauty culture), 444 (contractors), and 467 (real estate brokers and salespersons)."



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Proposed HRS §231- (a) appears to apply only to federal construction projects.

However, proposed HRS §231- (b) appears to apply to all construction projects. It is unclear to HAR how a homeowner is to avoid risking a work stoppage on a major home construction or renovation project without requiring regular tax clearance certificates for income, withholding, general excise, and employment taxes from the contractor and each subcontractor. It is also unclear whether the contractor will want to obtain regular tax clearance certificates for income, withholding, general excise, and employment taxes from the owner; and whether each subcontractor will want to obtain regular tax clearance certificates for income, withholding, general excise, and employment taxes from the contractor.

With respect to proposed HRS §231- (c), HAR believes that a Tax Clearance certificate may be obtainable from the State Department of Taxation if a licensee owes taxes but is current on an approved payment plan. HAR would note that if this is not the case, it may be very difficult for an applicant or licensee to pay his or her back taxes if he or she cannot obtain or renew his or her license and earn a living.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

LATE



KURT KAWAFUCHI
DIRECTOR OF TAXATION

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**SENATE COMMITTEE ON WAYS & MEANS
TESTIMONY REGARDING SB 972 SD 1
RELATING TO TAX ADMINISTRATION**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: MARCH 2, 2009

TIME: 9:30AM

ROOM: 211

As amended, this measure seeks to ensure that taxpayers pay their fair share of tax by directing the Department of Taxation to identify "Tax Gap" taxpayers by cooperating and coordinating with other government agencies, information-sharing, and requiring tax clearances from all businesses regulated by the Department of Commerce & Consumer Affairs.

The Department of Taxation (Department) has **strong concerns** with this measure and **recommends that its original contents be reinserted** with the current contents eliminated.

I. THE TAX GAP

In all tax systems, the government is continually working to reduce tax noncompliance known as the "tax gap." Hawaii's tax gap is estimated to be about \$2,000,000,000 in unreported and unpaid taxes every year with approximately \$1,000,000,000 attributed to the cash economy. Focusing resources on shoring up compliance in this area should be a priority to ensure that everyone pays their fair share of taxes.

II. CASH TRANSACTIONS AND THE NEED FOR ENFORCEMENT TO ENSURE EVERYONE PAYS THEIR FAIR SHARE

Cash-based transactions are a fundamental part of any economy. Cash is inherently private, efficient, and predictable for both purchaser and seller. However, cash transactions are also the simplest means of underreporting or non-reporting for tax purposes because no bank, no means of electronic oversight, and no intermediary maintains records of the movement of funds from one pocket to another. By focusing resources on the cash economy, the Department can ensure fairness in the tax system for those that comply without raising taxes or otherwise substantially burdening Hawaii's economy as a whole.

III. COMMENTS ON CURRENT VERSION

THE DEPARTMENT CURRENTLY PARTICIPATES IN INTER-GOVERNMENTAL COORDINATION

As a general matter, the Department supports efforts to work with other government agencies—federal, state, and local—to ensure that taxpayers maintain maximum compliance. The Department routinely coordinates with other tax agencies on tax compliance and remains active with tax associations to keep up-to-date on the state-of-the-art when it comes to tax enforcement.

FOCUS ON THE CONSTRUCTION INDUSTRY IS SHORT-SIGHTED

As amended, this measure appears to focus greatly on the construction industry. While the Department does not dispute that the cash-based construction industry has its share of tax noncompliance, the Department believes that the statutory focus on the construction industry needs to be revisited. Almost every industry in Hawaii could potentially have Tax Gap implications and are not immune from tax cheats. The Department prefers the original contents of this measure because it focused on every industry where cash was a substantial part of its economy in order to shore up confidence in the tax system.

TAX CLEARANCE REQUIREMENT WILL BE UNDULY BURDENSOME AND IS ANTI-BUSINESS FOR THOSE THAT COMPLY

The Department has strong concerns with the amendments that require every business regulated by the Department of Commerce & Consumer Affairs to obtain a tax clearance. The focus on the original contents of this measure was to ensure the business community that those taxpayers that are compliant with their tax obligations will not be burdened by the cash economy Special Enforcement Section. This measure, as amended, effectively punishes all regulated businesses for the bad acts of a few. The Department intentionally drafted the original version of this measure to avoid burdening all businesses for the cheating of a few.

The tax clearance requirement, though valuable, has limitations because it is a clearance only that the taxpayer has paid what they say they owe. It is not an upfront "audit." Nonetheless, the tax clearance system is effective in ensuring that taxpayers are paid-up. The Department supports the intent of requiring tax clearances for these industries, but without sufficient resources, this requirement will unduly burden both the Department and taxpayers. Tax clearances can be a lengthy process because each taxpayer has to be cleared for all taxes. Additional resources will be necessary to accomplish the intent of this measure within a reasonable time—more resources than were requested in the original measure.

If the Committee deems it necessary to continue the tax clearance requirements, the Department suggests that the bill be amended to provide that the taxpayers will be cleared for income and general excise taxes, "and any other tax deemed relevant by the Department." Currently, only income and general excise taxes are available electronically for expedient processing. Having

to clear a person who is a beautician for liquor taxes or transient accommodations taxes is required under current law; though is likely ultimately irrelevant. Providing the Department with the discretion to clear the "other" taxes will greatly assist with efficiencies.

IV. PREFERENCE FOR THE ORIGINAL CONTENTS

The Department strongly recommends that the current SD 1 be eliminated in favor of its original contents. The original cash economy measure struck the right balance between enforcing taxpayer behavior that erodes confidence in the self reporting tax system; yet also not burdening those that comply.

The purpose of the original contents of this legislation is to provide the Department with the necessary resources and tools to target high-risk, cash-based transactions to shore up confidence in Hawaii's tax system. In this regard, this measure ensures that all sectors of Hawaii's economy, including those prone to substantial underreporting, are paying their fair share of taxes.

FOCUS ON CIVIL ENFORCEMENT THROUGH A SPECIAL UNIT

Importantly, the original is intended to focus on the civil collection and enforcement nature of Hawaii's tax laws—not criminal. Civil enforcement is accomplished by forming the Special Enforcement Section, a group of tax officials charged with handling sensitive and high-risk civil tax cases. The Special Enforcement Section members will be elite investigators trained in the area of tax law who will focus on the subject businesses. They will have many powers, including the ability to obtain and serve writs of entry with the assistance of police officers. These persons will not be police officers and will not have the authority to carry a firearm. Six FTE investigators are requested.

The Section will be given specific authority with regard to inspecting books and records. Currently, the Department already has authority to review books and records and subpoena documents. The Section will be authorized to inspect operations and premises during normal business hours as a matter of course. Moreover, where the Section suspects unlawful activity in a business' tax compliance, the Section may apply to the Circuit Court for a writ of entry (a civil search warrant) based upon probable cause, at which time the Section members may serve and search any premises with the assistance of armed police to carry out the duties of the Section.

CASH ECONOMY CASES AS THE SPECIAL ENFORCEMENT SECTION'S FOCUS

Due to the highly sensitive nature of cash based businesses and that many of the targeted businesses will be high-risk, the Special Enforcement Section will be the unit charged with auditing and enforcing the tax laws in this sector of the economy. Cash businesses are inherently secretive and therefore the auditing of these businesses is labor intensive. Because of the resources necessary to focus on cash cases, having one unit handle these matters is appropriate.

It is anticipated that much of the investigators' work will be undercover or surveillance work, observing the activities of businesses that operate in cash.

CITATIONS AND OFFENSES FOR BUSINESSES OPERATING IN CASH

Currently, the Department lacks the authority to fine or assess penalties against taxpayers for many activities that are likely to give rise to tax evasion or avoidance. Though cash is an acceptable form of payment, it can easily lead to tax revenue leakage, underreporting, and other evasive behavior because it is unreported. The Department seeks to regulate certain cash activities for businesses by proposing civil fines and citations enforceable by the Special Enforcement Section. These fines include—

FAILURE TO PROVIDE LICENSE UPON DEMAND—Much like the requirement that a driver produce his or her license upon demand by the police, this infraction requires a business to produce the required GET license number upon demand. Every business is required to post their GET license for public display.

FAILURE TO KEEP ADEQUATE BOOKS AND RECORDS—Every business is required by law to keep records of income, expense, deduction, and credit. There is no excuse for failing to keep adequate records, though some businesses operate with none.

FAILURE TO RECORD A TRANSACTION—There are two infractions for failing to record a transaction in cash, either in a receipt or register. Where there are records of a transaction in cash, there is less room for evasion. This bill proposes an infraction for failing to issue a receipt or ring the register when the means exist to do so more than 10 times per day. To issue such an infraction, investigators will have to observe a business failing to record cash transactions.

PRICE FIXING FOR TAX AVOIDANCE PURPOSES—It is not uncommon for cash based businesses to offer two prices—one for credit and one for cash, purely for tax evasion purposes. An infraction for price fixing for tax avoidance purposes is proposed where the Department can prove that the lower price was offered for cash.

The infractions vary in range from \$500 to \$3,000. The penalties are greater if the person penalized is a cash-based business, as defined. Cash-based business is defined so that businesses can delineate whether they fall into that category. A business will be considered cash-based where it operates in cash, as well as having a past history of tax issues or other noncompliance.

FUNDING OF THE SPECIAL ENFORCEMENT SECTION THROUGH EXISTING MEANS

Due to budget constraints, it was necessary for the Special Enforcement Section to be funded out of the Department's current Tax Administration Special Fund. The Section will also be self-funded. It will be entitled to retain a certain amount of collected tax and all penalties, not to exceed \$500,000.

V. REVENUE IMPACT

The original contents of this measure resulted in the following revenue gains:

FY 2010--\$11.9 million
FY 2011--\$35.6 million
FY 2012 and thereafter \$47.4

In its current form, it is indeterminate how much revenue gain this measure will produce. In order to properly carry out the intent of this measure, the Department would need adequate resources to staff the tax clearance undertaking presented in this bill. Assuming sufficient resources are provided, it is possible that this measure will produce considerable revenue gains.

LATE

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**THE SENATE
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009**

COMMITTEE ON WAYS AND MEANS

**Hearing date: March 2, 2009
Testimony on S.B. 972 S.D. 1
(Relating to Tax Administration)**

Chair Kim, Vice-Chair Tsutsui, members of the Committee, I am testifying as a citizen in support of S.B. 972 S.D. 1.

Senate Draft 1 ensures that Hawaii businesses and residents are paying their fair share of taxes by directing the Department of Taxation to coordinate with federal agencies, unions, and other state agencies, as applicable, on enforcement and auditing, and database and intelligence sharing to identify tax gap taxpayers.

Coordinating with federal agencies, unions and other state agencies is an efficient use of the Department's resources.

Thank you for the opportunity to testify.

Very truly yours,

/S/
Peter L. Fritz



DRAFT

February 27, 2009

The Honorable Donna Mercado Kim, Chair
Senate Committee on Ways and Means
State Capitol, Room 211
Honolulu, Hawaii 96813

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Mahalo for the opportunity to testify.

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LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

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TO THE SENATE COMMITTEE ON WAYS AND MEANS

TWENTY-FIFTH LEGISLATURE
Regular Session of 2009

Monday, March 2, 2009
9:30 a.m.

WRITTEN COMMENTS ON SENATE BILL NO. 972, S.D. 1, RELATING TO TAX ADMINISTRATION.

TO THE HONORABLE DONNA MERCADO KIM, CHAIR,
AND MEMBERS OF THE COMMITTEE:

The Professional and Vocational Licensing Division of the Department of Commerce and Consumers Affairs ("PVLD/DCCA") appreciates the opportunity to submit comments on S.B. 972, S.D. 1, Relating to Tax Administration. Our comments are limited to section 2 of the bill, subsection (c) (page 4, lines 9-14). PVLD/DCCA's purpose in submitting comments is to ensure there is an understanding of the impacts of subsection (c).

As subsection (c) sets forth, the Department of Taxation ("DoTax") shall coordinate with DCCA to require tax clearance certificates prior to licensure or renewals for industries licensed pursuant to specified chapter numbers referenced in the bill. For PVLD/DCCA, this amounts to 63 different licensed professionals. Provided there is an

understanding that while DoTax may coordinate with respective licensing boards and programs in DCCA on the matter of requiring a tax clearance for licensure, the decision to actually require this should be made only after full and open discussion with all stakeholders, and all negative impacts addressed. Moreover, any new licensing requirement should be established in the licensing authorities' respective licensing chapters.

While PVLD/DCCA's licensing boards and programs are open to discussing the merits of a tax clearance requirement with DoTax, we feel it necessary to set forth the following concerns that will be immediately raised in discussions on this issue with the licensing authorities:

- Of the 63 licensed professionals in the PVLD/DCCA group, we have no knowledge to confirm that any or all these licensees operate on a cash basis. We are, however, aware that such licensees are primarily persons employed by a business. Thus, we do not know why such professionals are singled out to be in the cash basis "tax gap taxpayers" group covered by the S.D. 1;
- With licensing, a requirement such as a tax clearance would be applied to all in the given profession. No distinction is made in licensing laws on the person's source of income;
- Tax clearances, as currently used for licensing purposes by PVLD/DCCA licensing authorities, are required to license a business where financial integrity is among the qualifications to be licensed. Not all business license types have a financial integrity component. Also, of the 63 licensed professionals in the PVLD/DCCA group, the vast majority are individuals who

are licensed based on their competency to practice. Competency is demonstrated through satisfying such requirements as education, experience, and passing a licensing exam. A tax clearance for such individuals would not appear to have a nexus to their competency to practice and if there is no nexus to competency, it would appear inappropriate to impose this requirement for licensing purposes;

- Requiring a tax clearance of licensed professionals would create a burden on applicants for licensure and licensees. Of the 63 licensed professionals in the PVLD/DCCA group, shortages of many of the practitioners exist and adding a requirement for a tax clearance would disincentivize licensing and practicing in Hawaii. In addition, if there is no nexus to, or reason they need to obtain, a tax clearance to demonstrate their competency to practice, this could be regarded as a deterrent to licensing which would be contrary to all efforts by the PVLD/DCCA licensing authorities to make the licensing process free of restrictive requirements;
- Applicants for licensure and current licensees include practitioners who reside out-of-state, who may or may not actually work in Hawaii. Such licensees do not appear to be the "tax gap taxpayers" targeted by this bill but nevertheless would be subject to the tax clearance if imposed for licensure. *With licensing, distinction is not made if a person is or is not in-State. The person is allowed to apply for and retain a license irrespective of residency.* The ability for such

out-of-state applicants and licensees to obtain a tax clearance, or minimally obtain a meaningful tax clearance, is questionable;

- PVLD/DCCA expects that with imposition of a tax clearance, processing of applications and renewals will be delayed. Each additional document to be reviewed for compliance in the licensing and renewal process contributes to delays. Given the magnitude of 63 licensed professionals to be potentially impacted with a tax clearance requirement, there will be significant impact to our timely processing. Our timeliness affects a newly licensed and renewed licensee's ability to practice in Hawaii – and thus to make a living – as soon as possible;
- Should PVLD/DCCA determine that there will be added costs with the necessity for additional full time employees to manage the additional strain on processing applications and renewals due to the inclusion of the tax clearance requirement, such costs will be passed onto the licensees. Increased fees for such purposes will be opposed;
- Many of the 63 licensed professionals in the PVLD/DCCA group are provided the ability to renew online. If a tax clearance requirement is imposed for renewal, it will depend on whether DoTax can provide the support to furnish tax clearances through our online system as to whether online renewal will remain possible. Currently we work with DoTax for Contractors and Pest Control Operators renewals because both professions require a tax clearance. While DoTax does support their end to clear the tax clearance

requirement as part of our online process, it has put a strain on their resources. Again, given the magnitude of 63 licensing professionals to be added to DoTax's workload, we would have concerns for DoTax's ability to provide the needed support to make our online renewal system efficient. If the efficiency or effectiveness of our online system is to be negatively affected, PVLD/DCCA may have to reconsider whether online renewal is a workable option for the impacted professionals;

- It is interesting to note that in subsection (c), three specific professions are named: cosmetology, contractors, and real estate brokers and salespersons. As indicated above, a contractor's license requires a tax clearance (both with initial licensing and with biennial renewal). Licensees under the cosmetology and real estate licensing law do not require a tax clearance, but we also have no confirmation that any or all operate on a cash basis; and
- If this bill is attempting to target licensed professionals that operate on a cash basis, there might be a better understanding of achieving the specific goals of the bill if we knew what professionals these were. However, until that is known, the impacts above would appear to outweigh any consideration of imposing a tax clearance requirement for all 63 licensed professionals in the PVLD/DCCA group.

Thank you for allowing us to provide our perspective as you deliberate on the S.D. 1, specifically section 2 of the bill, subsection (c).

LATE

Department of Taxation

Position Summary

Senate Committee on Ways & Means/March 2, 2009

Bill Number	Bill Title "Relating to..."	Position	Comments	Revenue Impact	Methodology
SB 972 SD 1	TAX ADMINISTRATION	Strong concerns; prefer original version	*The Department strongly prefers the enforcement efforts set forth in the original measure because they are effective and comprehensive to target the Cash Economy. * Tax clearances as provided in this measure will be both time consuming and costly for the Department and taxpayers. The Department would need additional resources to accomplish this measure beyond what the original measure provided.	Potentially substantial, assuming sufficient resources.	Pending



LATE

March 1, 2009

To: The Honorable Donna Mercado Kim, Chair - Committee on Ways and Means
The Honorable Shan S. Tsutsui, Vice Chair - Committee on Ways and Means
Members of the Senate Committee on Ways and Means

Re: S.B. 972 – Relating to Tax Administration

We are opposed to passage of S.B. 972

I am Greg Ravelo, President of the Hawaii Association of Mortgage Brokers. The Hawaii Association of Mortgage Brokers (HAMB), a 200+ member organization, actively works to improve the mortgage broker industry since its charter in 1992.

The stated purpose of the bill is to focus state resources on tax compliance regarding cash based activity as it impacts General Excise Taxes (GET). The bill if enacted would apply to Mortgage Brokers and Mortgage Solicitors covered under Chap 454. More broadly this would apply to all PVL licensed persons and companies licensed under Chapters 436 through 471.

We would make the following argument: There is virtually no unreported income or GET tax money to be collected from the Chap 454 licensees.

- Hawaii law classifies mortgage brokers as “mortgage loan companies” specifically exempting them from GET. Tax law applies the Hawaii franchise tax to its income. Please reference Hawaii Tax Information Release No. 99-4.
- Hawaii Mortgage Solicitors (Loan Originators / Loan officers) are generally employees and employees do not need GET licenses.
- The mortgage industry is **not** a “cash business” in any form. Formal escrows administered by licensed companies are used to meet federally mandated standards for accounting of all funds. Federal law is also very explicit as to how fees can be split in a mortgage transaction.

Licensing delays due to processing tax clearances could jeopardize business viability. Many national lending sources are routinely terminating business relationships if licensing renewal is not available “on line” at the DCCA web site

In summary it is un-productive to apply this measure to all PVL licensed companies and individuals.

Sincerely,
Greg Ravelo, President 808 748-8896