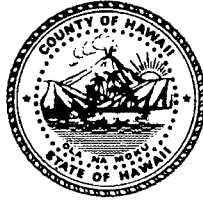


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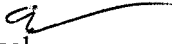
March 19, 2007

Sent via email; no hard copy will follow

Corporation Counsel Numbered Memorandum 2007-02

Memorandum

TO: OFFICE OF THE MAYOR
HAWAII COUNTY COUNCIL
OFFICE OF THE COUNTY CLERK
ALL COUNTY DEPARTMENTS AND AGENCIES
ALL COUNTY BOARDS AND COMMISSIONS

FROM: CRAIG T. MASUDA 
Deputy Corporation Counsel

RE: COUNTY SURCHARGE ON STATE EXCISE TAX

Act 247 of the 2005 State Legislature authorized the counties to collect a surcharge on the State Excise Tax. As of January 1, 2007, only the City and County of Honolulu has enacted an ordinance authorizing the collection of this additional tax at a rate of 0.5%.¹ Please note, however, that contracts entered into prior to June 30, 2006, which do not provide for passing on increases in taxes within the terms of the contract are not subject to the 0.5% surcharge.² Collection of this 0.5% surcharge is administered by the State Department of Taxation, and the State Department of Taxation developed Chapter 18-237-8.6 of the Hawai'i Administrative Rules (hereinafter "HAR") for the administration of this surcharge.

HAR Chapter 18-237-8 is premised on two primary factors:

1. Allotment of income to a tax district within or outside the Oahu Tax District.
2. Physical presence within or outside the Oahu Tax District.

¹ Ordinance 07-001, Revised Ordinances of the City and County of Honolulu. Sec. 6-60.1.

² Section 237-8.6(c), Hawai'i Revised Statutes.

Allotment of income is dependant upon whether the subject of the tax is a tangible item such as a good, personal property, or real property, or an intangible item such as a service. For intangible items such as a service and for real property, further analysis is required to determine where the service is used or consumed.³

Physical presence means the presence of one or more employees, representatives, property or closely-related subsidiaries within the tax district where the item is intended to be used or consumed.⁴

Purchase of Goods, Personal Property, and Tangible Items Other than Real Property

For the purchase of goods, personal property, and tangible items other than real property, consideration must first be made as to the relative tax districts of the seller and buyer. If the buyer is outside of the Oahu Tax District, then no surcharge is applicable. In the case of the County of Hawai'i acting as the buyer, this should be the norm. This includes cases where the County of Hawai'i is buying goods from any of the other counties. Therefore, in no case should a vendor be assessing the County of Hawai'i the surcharge of 0.5% to the State Excise Tax where the item is to be used or consumed in Hawai'i County.

Selling of Goods, Personal Property, and Tangible Items Other than Real Property

For the selling of goods, personal property, or other tangible items to a buyer in the Oahu Tax District, consideration must be made on whether the seller has substantial nexus or physical presence to the Oahu Tax District. Physical presence means the presence of one or more employees, representatives, property or closely-related subsidiaries.⁵ This substantial nexus would not likely include an employee briefly visiting the Oahu Tax District for a sale or delivery.⁶ In the case of the County of Hawai'i selling goods to an Oahu entity, unless there is a substantial nexus to the Oahu Tax District, there should be no instance where the surcharge of 0.5% would apply. Likewise, where the County of Hawai'i is selling goods to any other (non-Oahu) county, there should be no surcharge.

Purchase and Sale of Real Property

For the purchase and sale of real property, income is allocated solely based on the location of the real property. For the purchase of real property from the County of Hawai'i or the purchase of services to be performed in the County of Hawai'i, no surcharge should be assessed. Pursuant to HAR 18-237-8.6-06, allocation of income from the sale of real property is

³ HAR 18-237-8.6-03.

⁴ HAR 18-237-8.6-01 - Definitions.

⁵ HAR 18-237-8.6-01 - Definitions.

⁶ Based on examples provided by HAR 18-237-8.6, a substantial nexus appears to mean a permanent presence in the district, such as an office or permanent station of an employee or representative, for the tax year.

allocated to the tax district in which the sale occurs. Therefore, any sale of real property occurring within the County of Hawai'i to any person is not subject to the surcharge.

Purchase of Service

HAR 18-237-8.6-03 allocates income from the service provided to the tax district where the service is used or consumed, including but not limited to construction. Any service or work performed for the County of Hawai'i occurring within the County will have its income allocated to the Hawai'i Tax District. Therefore, contractors or other service providers should not assess the surcharge for services provided within Hawai'i County, regardless of where they are from. Where the County of Hawai'i contracts for services to be done on Maui or Kauai, no surcharge is applicable, since Maui, Kauai, and Hawai'i counties have not enacted surcharge ordinances. However, if any county contracts a service to be performed on Oahu, then income is allocated to Oahu and is therefore subject to the surcharge of 0.5%.

Conclusion

It should be noted that in the limited instances where the County of Hawai'i could rightfully be assessed the 0.5% surcharge, the County always has the option of negotiating with the vendor to not pass on this surcharge to the County. Further, as stated previously, contracts entered into prior to June 30, 2006, which do not provide for increases in taxes are not subject to Act 247⁷ or the 0.5% surcharge. There should be relatively few instances where the County of Hawai'i should be assessed the surcharge of 0.5%.

Should you have any questions or comments please contact me at your convenience.

CTM:mc

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⁷ Act 247 of the 2005 State Legislature.