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June 23, 2011

DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2011-10

RE: Grandfathering Guidelines for Act 105, Session Laws of Hawaii 2011, Relating to Taxation

On June 9, 2011, Governor Neil Abercrombie signed into law Senate Bill 754 SD1, HD1, CD1 as Act 105, Session Laws of Hawaii 2011.

This Act suspends temporarily the exemptions for certain persons and certain amounts of gross income or proceeds from the general excise and use tax, and requires the payment of both taxes at a four per cent rate. One of the exemptions temporarily suspended is the subcontractor's deduction described in section 237-13(3)(B). In general, section 237-13(3)(B) allowed a general contractor to deduct payments to subcontractors as long as all of the provisions of section 237-13(3)(B) had been met.

Grandfathering Guidelines

However, Act 105 specifically states that gross income from "binding written contracts entered into prior to July 1, 2011, that do not permit the passing on of increased rates of taxes" will be exempt from GE tax even if the amounts would be made taxable by the suspension of an exemption. In order to be saved from paying tax by this grandfathering clause, a taxpayer must keep several things in mind. First, the contract must not permit the increase in the tax to be passed on to the consumer. Second, the contract must be in writing. Third, the contract must be binding prior to July 1, 2011.

Change Orders, Task Orders, and Subcontracts by Subcontractors

If these three conditions are met, any change orders relating to the original contract will be treated as entered into before July 1, 2011, as provided in Tax Announcement 2011-09. In addition, task orders will be treated like change orders. Like change orders and task orders, subcontracts by subcontractors of the general/prime contractor that are entered into after June 30, 2011, where the general/prime contract fulfills the three conditions discussed above, will also be treated as entered into before July 1, 2011.

For example, a general contractor enters into a binding written contract with a developer on June 29, 2011, to build a building that does not permit the increase in the general excise tax to be passed on to the developer. On July 5, 2011, the general contractor enters into a subcontract with Subcontractor A to install the glass windows in the building and on July 12, 2011, Subcontractor A enters into a subcontract with Subcontractor B to install a portion of the windows. Because the contract between the general contractor and the developer meets all three conditions specified above, the general contractor would still be eligible for the subcontractor's deduction as described in section 237-13(3)(B) for payments made to Subcontractor A, even though the contract between the general contractor and Subcontractor A was entered into after July 1, 2011. The contract between Subcontract A and Subcontractor B will be treated like a change order. Therefore,

Subcontractor A will be able to deduct the amounts paid to Subcontractor B, provided the requirements of section 237-13(3)(B) are met, because the contract between the general contractor and the developer was a binding written contract entered into prior to July 1, 2011, that did not permit the passing on of an increased rate of tax.

Contract Prohibition of Passing On of the Tax Increase

To be eligible for grandfathering under these guidelines, the contact must "… not permit the passing on of increased rates of taxes." In general, this means that the contract does not permit or allow the seller to impose the increased rate of tax on the buyer. For example, if the contract provides that the price is $X, including tax, and the rest of the contract is silent as to whether an increase in tax can be passed on, then the contract does not permit the passing on of the increase in tax and Act 105 does not apply. In contrast, if the contract provides that the price is $X, plus tax, without specifying the amount of tax, and the rest of the contract is silent as to whether an increase in tax can be passed on, then the contract does permit the passing on of the increase in tax and the contract is subject to the temporary suspension of any general excise tax exemption provided in Act 105.

Use Tax Grandfathering Guidelines

The same grandfathering language also applies to contracts that previously qualified for a use tax exemption, however, the use tax, unlike the general excise tax, generally is not passed on. Therefore, for purposes of the use tax grandfathering provision, the Department will not require that the contract not permit the passing on of increased rates of tax.

Grandfathering Guidelines for Government Contracts

Only for purposes of the temporary suspension of the exemptions in Chapter 237, including but not limited to the subcontractor's deduction, provided in Act 105, the Department will consider the following to be a "binding written contract" if: (1) done prior to July 1, 2011: (a) a bid is submitted in response to an invitation for bids issued by a local, state, or federal government; or (b) an award for a contract is made in response to a bid or proposal prepared for the local, state, or federal government; and (2) the accepted bid or award results in a fully executed written contract.

For example, if a contractor submits a bid to the State on June 1, 2011 in response to an invitation to bid by a local, state or federal government, the bid is accepted or awarded on July 15, 2011, and the award results in a fully executed contract on December 15, 2011, Act 105 does not apply because the bid was done prior to July 1, 2011.

Act 105 takes effect July 1, 2011 and is repealed June 30, 2013.

For more information on this Act, please contact the Rules Office at 808-587-1577.



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