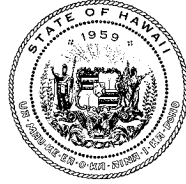


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July 7, 2011

TAX INFORMATION RELEASE NO. 2011-02

RE: General Excise Taxation of Sales of Tangible Personal Property to the Federal Government and the Grandfathering Rules Under Act 105, SLH 2011

The purpose of this Tax Information Release is to clarify the application of the general excise tax to sales of tangible personal property to the federal government due to the enactment of Act 105, Session Laws of Hawaii (SLH) 2011, and to clarify the grandfathering rules of Act 105 for requests for proposals issued by a local, state, or federal government.

Sales of Tangible Personal Property to the Federal Government and Credit Unions

Section 237-25(a)(3), Hawaii Revised Statutes (HRS), exempts from the imposition of the general excise tax all sales and the gross proceeds of all sales of tangible personal property sold by any person licensed under Chapter 237, HRS, to the United States (including any agency, instrumentality, or federal credit union thereof but not including national banks), and to any state-chartered credit union.

The exemption provided in 237-25(a)(3), HRS, has been temporarily suspended by Act 105 SLH 2011, for the period from July 1, 2011 through June 30, 2013.¹ The suspension means that the gross income derived from sales of tangible personal property to the federal government will no longer be exempt from the general excise tax and will be taxable at the 4% rate. However, amounts for which the general excise tax exemption is temporarily suspended will continue to be exempt from the county surcharge of 0.5%.

Section 2 of Act 105, SLH 2011, creates a new section under Chapter 237, HRS, that provides for the suspension of the exemption. Under this new section, subsection (b) provides that the previously exempt income is taxable at the rate of 4%. Therefore, gross income derived from sales of tangible personal property to the federal government is NOT taxable at the wholesale rate of 0.5% even though the federal government (e.g., commissary) may "resell" the tangible personal property.² See HRS section 237-4(a)(1). Whether the transaction could qualify

¹ The exemption for the sale of liquor and cigarettes to the federal government provided in HRS sections 237-25(a)(1) and (2) were also temporarily suspended and the analysis that applies to the suspension of HRS section 237-25(a)(3) also applies to the suspension of HRS sections 237-25(a)(1) and (2).

² Some taxpayers may have been erroneously treating sales to the federal government as a wholesale transaction and paying tax at the 0.5% rate. Because the federal government is an unlicensed seller and the resale transaction is not

as a wholesale transaction taxable at 0.5% is irrelevant in light of Act 105's provision imposing tax at the 4% rate.

Grandfathering Rules Applicable to Request for Proposals Issued by the Government

Act 105 provided 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 general excise tax even if the amounts would be made taxable by the suspension of an exemption. In Tax Announcement 2011-10, the Department provided special rules for government contracts executed in response to an invitation to bid so that a bid in response to an invitation to bid would be treated as a binding written contract for purposes of Act 105 if the bid or award was made prior to July 1, 2011, and the accepted bid or award ultimately resulted in a fully executed written contract.

Unlike bids in response to an invitation to bid, a proposal in response to a request for proposal issued by a local, state, or federal government will not be treated as a binding written contract. However, an award in response to a request for proposal will be treated as a binding written contract and will be grandfathered from the suspension of an exemption in Act 105, provided the award is made before July 1, 2011, and results in a fully executed written contract.

This TIR supplements TIR No. 2001-03, issued December 11, 2001, relating to the United States Government Credit Cards Issued Under the "GSA Smart Pay" Program, and TIR No. 2005-01, issued July 5, 2005, relating to the General Excise Tax Exemption for Sales of Tangible Personal Property to Credit Unions. This TIR does not supersede TIR Nos. 2001-03 and 2005-01 since the provisions of Act 105, SLH 2011, are temporary.

For more information, contact the Technical Section at (808) 587-1577 or by e-mail at Tax.Technical.Section@hawaii.gov.


for FREDERICK D. PABLO
Director of Taxation

HRS Sections Explained: Section 237-25
New Section under Chapter 237 created by Act 105, SLH 2011