



HAWAII ASSOCIATION OF PUBLIC ACCOUNTANTS

Organized August 7, 1943
P.O. BOX 61043
HONOLULU, HAWAII 96839



March 3, 2015

Chairperson Nelson K. M. Lau and Members
State of Hawaii Board of Public Accountancy
P.O. Box 3469
Honolulu, Hawaii 96801-3469

Re: HAPA Study #2 – Individual CPA Temporary Permits to Practice and
Tax Compliance

Dear Chairperson Lau and Members:

The Hawaii Association of Public Accountants (HAPA) conducted a follow-up study to assess the continuing demand and process involved with the issuance of temporary individual CPA permits to out-of-state CPAs during the period January 2011 through and including November 2014 (hereafter known as Study #2). As with HAPA's earlier study covering the years 2007 and 2008 (Study #1), Study #2 was based upon redacted temporary permit application files provided to HAPA by the Department of Commerce and Consumer Affairs (DCCA) in response to our Office of Information Practices request.

A key finding of HAPA Study #1 was that over 70% of the out-of-state CPA firms, whose owners/partners or employees obtained a temporary individual permit to practice in Hawaii in the years 2007 and 2008, did not have an identifiable Hawaii General Excise Tax License number necessary for the firm to pay Hawaii General Excise taxes. As described below, Study #2 revealed a marked improvement in apparent tax compliance by out-of-state CPA firms whose owners/partners or employees obtained a temporary individual permit to practice.

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This turnaround in out-of-state CPA firms' tax compliance correlates with the combination of three changes in Hawaii's administration of CPA licenses and permits to practice.

- The Board of Public Accountancy finally implemented Hawaii's law requiring all CPA firms practicing in Hawaii to have a firm permit to practice.
- The New Board of Public Accountancy rules for firms required that firms provide Hawaii General Excise Tax License numbers, which was incorporated into the new application form for firm permits to practice.
- The newly revised application form for individual temporary permits to practice required each applicant to provide his or her firm's Hawaii CPA firm permit number.

This combination of newly required disclosures effectively gave notice to the individual CPA that a Hawaii firm permit is required, and the firm permit application requires a Hawaii General Excise Tax License number. The combined result was notice equals certain tax compliance.

The following pages present a statistical overview of HAPA Study #2 followed by its findings.

Statistical Overview Of HAPA Study #2:

Number of Approved Temporary Permits:	23
Number of Different Individuals Approved:	16
Number of CPA Firms Represented:	10

<u>Firm Name</u>	<u>Number of Temporary Permits</u>
Grant Thornton	5
PricewaterhouseCoopers LLP	5
KPMG LLP	3
Deloitte & Touche LLP	2
Ernst & Young LLP	<u>1</u>
Subtotal for TAC Members ¹	<u>16</u>
McGladrey & Pullen LLP	2
Tronconi Segarra & Associates LLP	2
Moss Adams LLP	1
Shearer Warner	1
Zielinski & Associates, P. C.	<u>1</u>
Subtotal for Small and Regional Firms	<u>7</u>
Combined Total	<u>23</u>

¹ The Accountants' Coalition (also known as TAC) consists of large national/international CPA firms.

Number of Mainland Licensing States: 10

<u>State</u>	<u>Number of Temporary Permits</u>
North Carolina	5
Colorado	4
California	3
New York	3
Minnesota	2
Oregon	2
Illinois	1
Massachusetts	1
Missouri	1
Virginia	<u>1</u>
Total Number of Temporary Permits	<u>23</u>

Findings Of HAPA Study #2:

Clear Shift Away From Temporary Permits To Hawaii Licenses: 23 applications for individual CPA temporary permits to practice were granted over the 47-month period studied, compared to 67 for a two-year period in Study #1. This is an average of 0.49 permits per month in Study #2 compared to 2.79 permits per month in Study #1, reflecting a substantial drop in demand for temporary individual permits to practice.

At first glance, this might suggest that out-of-state CPAs have gone underground and are ignoring Hawaii's CPA licensing laws, rules, and regulations. However, part of the decline in temporary permits may be because the rules regarding an applicant having "incidental practice" in Hawaii were followed after HAPA's Study #1 was distributed. In addition, when viewed together with the DCCA's annual *Geographic Reports*, an explanation other than the "going underground" theory surfaces. More out-of-state CPAs practicing on a continuing basis in Hawaii have obtained a regular Hawaii CPA license.

Significant Increase In Mainland And Foreign-Based CPAs Holding Hawaii CPA Licenses: While the number of temporary permits plummeted, the number of out-of-state CPAs obtaining regular individual CPA licenses jumped up 25.5% from 501 in 2007 to 629 in 2015 according to DCCA *Geographic Reports*. In 2007, 19% of all Hawaii individual CPA license holders were based on the mainland or overseas according to the DCCA's 2007 *Geographic Report*. In 2015, 22.5% of Hawaii CPAs were out-of-state CPAs according to the latest *Geographic Report*.

Part of the debate over adopting CPA Mobility in the State of Hawaii includes providing Hawaii's consumers with reasonable access to out-of-state CPA experts. There is no statistical benchmark for assessing how much access to out-of-state experts is enough. Furthermore, the proportion of out-of-state permit to practice holders versus total permit-to-practice holders would be a more relevant statistic to compare. Unfortunately, the annual DCCA *Geographic Reports* only report individual CPA license holders, not individual CPA permit to practice holders.

Nonetheless, with the percentage of Hawaii's total licensees now based either on the mainland or overseas growing to 22.5%, Hawaii's consumers currently appear to suffer no shortage of access to the expertise of CPAs based outside of Hawaii. In light of this large and growing market penetration by out-of-state based CPAs, perhaps today's debate should focus on what can be done to encourage more Hawaii residents to become CPAs rather than what can be done to facilitate more out-of-state CPAs entering the Hawaii market.

Out-Of-State CPA Firm Tax Compliance Soared From 2007/2008 To 2014: HAPA Study #1 reported that over 70% of the out-of-state CPA firms, whose employees or owners/partners obtained a temporary permit to practice in 2007 or 2008, did not have an identifiable Hawaii General Excise License as of December 2009, the time Study #1 was completed.

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Study #2 found only two of the ten firms did not have a General Excise License number as of February 2015. Those two anomalies involved temporary permits obtained in 2011 before:

- The Board of Public Accountancy finally implemented Hawaii's law requiring all CPA firms practicing in Hawaii to have a firm permit to practice.
- The new Board of Public Accountancy rules for firms required that firms provide Hawaii General Excise Tax License numbers, which was incorporated into the new application form for firm permits to practice.
- The newly revised application form for individual temporary permits to practice required each applicant to provide his or her firm's Hawaii CPA firm permit number.

This combination of newly required disclosures effectively informs individual CPA permit holders that a firm permit is required and that the CPA firm must disclose a Hawaii General Excise Tax License number if the firm intends to practice legally in Hawaii. As previously stated, notice equals certain tax compliance.

Business Registration Compliance Also Improved From 2007/2008 To 2014: With respect to compliance with Hawaii's business registration requirements, HAPA Study #1 only sampled those firms without GET numbers to see whether they also registered to do business in Hawaii. Of those sampled, 100% did not appear to be registered to do business in Hawaii as of the time Study #1 was conducted. In comparison, HAPA Study #2 noted only three out-of-state firms for which no Hawaii business registration could be identified on the Hawaii Business Registration Name Search website. Since Study #1 only sampled, rather than tested 100% of the population, it is impossible to draw precise statistical conclusions. Nonetheless, the Board of Public Accountancy's new application for a CPA firm permit to practice appears to have had a very positive impact on not only compliance with Hawaii's tax laws, but also with Hawaii's business registration laws.

Temporary Permits May Have Been Issued To Ineligible Foreigners:

Hawaii Revised Statutes section 436B-10 (6) states that an application for a professional or vocational license in the State of Hawaii shall provide: "Proof that the applicant is a United States citizen, a United States national, or an alien authorized to work in the United States;" None of the application files for individual temporary permits to practice provided to HAPA contained any documentation that would satisfy this eligibility requirement.

HAPA Study #2 identified three employees/partners of one national/international accounting firm (see attached) whose individual application packages contained information raising questions whether the applicants were eligible to receive a Hawaii temporary permit to practice pursuant to HRS §436B-10 (6). In two cases, the applicants were based in Canada, claimed to hold CPA licenses in Colorado, yet checked the box in their application forms indicating that they are not licensed to practice in the State of Colorado. The third individual was originally licensed in Ireland, next obtained a license in the State of California, and then obtained a CPA license in the State of New York.

HAPA wishes to note that some states routinely issue CPA licenses to foreigners (i.e., non-resident, non-U.S. citizens). Other states, such as Hawaii, do not. Holding a license in a mainland state does not mean the applicant is necessarily eligible to receive a license or permit in the State of Hawaii. Going forward, compliance with HRS §436B-10 (6) and its related rules should always be verified. Issuing a temporary permit to practice to an ineligible person could have adverse consequences to the citizens of Hawaii should the related client engagement later develop problems.

Foreign CPA Offices Citing U.S. Office General Excise Tax Numbers: HAPA wishes to raise awareness that just because the foreign office of an international CPA firm cites the General Excise Tax License number of a U.S. affiliate does not necessarily mean that the allocable portion of the gross and net income of the foreign office is being reported on the U.S. affiliate's general excise or income tax returns. HAPA believes that this is an area that the State of Hawaii Department of Taxation should explore.

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Records Have Noticeably Improved: The applicant files reviewed in Study #2 were better organized and more thorough than those files reviewed in Study #1. Applications generally appeared to be processed promptly. However, when flaws or gaps in the application materials were noted, the applications were held until the shortcomings were corrected. The following are two of many examples.

Example one: The application for an employee of a large regional firm was appropriately held up first because the regional firm's permit to practice in Hawaii had expired and then because that same firm no longer had a partner with a valid individual permit to practice in Hawaii. The requested temporary permit to practice was not issued until these requirements were addressed.

Example two: An individual applicant submitted his application without his firm having a permit to practice. The application was held up until his CPA firm obtained a firm permit to practice.

Suggested Area For Future Study:

Out-Of-State CPAs Compliance With Hawaii Income Tax Laws: For both HAPA studies #1 and #2, the redacted information provided does not include individual confidential tax information. For both studies, HAPA has applied the assumption that if an out-of-state CPA firm has a General Excise Tax License number, then the firm is filing both Hawaii general excise and income tax returns. That assumption may not be correct. Also, the State Department of Taxation should check to see whether the proper Forms W-2 were issued for work performed in Hawaii. HAPA practitioners have seen cases of Hawaii employees of out-of-state firms receiving Forms W-2 indicating all of their wages were earned in another state, not Hawaii.

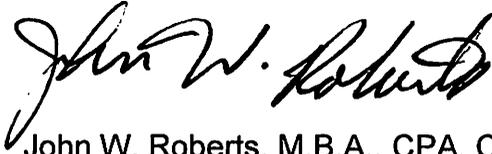
With respect to individual CPAs who receive temporary permits to practice, HAPA suspects widespread non-compliance with Hawaii income tax laws may exist. In order to assess how widespread non-compliance is with Hawaii's income tax laws for out-of-state CPAs, HAPA recommends that the Board of Public Accountancy periodically share application files for both temporary and regular CPA licenses/permits with the

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Department of Taxation so that the Department of Taxation can conduct a quick in-house study. Such a study could not only assess the degree of income tax compliance by out-of-state CPAs, but more importantly, provide valuable insight into the degree of tax compliance for the growing numbers of all professionals based outside of Hawaii who serve Hawaii clients.

Thank you for your consideration of the above.

Very truly yours,

A handwritten signature in black ink, appearing to read "John W. Roberts". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.

John W. Roberts, M.B.A., CPA, CGMA
Co-Chair of the HAPA Legislative Committee

cc: The Honorable Senator Rosalyn H. Baker
The Honorable Speaker of the House Joseph M. Souki
The Honorable Representative Angus L. K. McKelvey
The Honorable Representative Isaac W. Choy
Catherine P. Awakuni Colón, Hawaii Department of Commerce and Consumer
Affairs Director
Maria E. Zielinski, Hawaii Department of Taxation Director
Daria A. Loy-Goto, Complaints and Enforcement Officer, RICO