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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, March 14, 2013
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 948 S.D.1 Proposed H.D.1, Relating to Taxation

The Department **appreciates the intent** of S.B. 948 S.D.1 Proposed H.D.1 and provides the following information and comments for your consideration.

The Department notes that the General Excise Tax is applied to all persons engaging in business in the State. The present definition of "engaging in business" in Section 237-2, Hawaii Revised Statutes, is exceptionally broad and is designed to cover all business activities in the State. There has been significant litigation and specific guidance from the United States and Hawaii Supreme Courts regarding when the General Excise Tax is applicable to sums resulting from business with out-of-state sellers. In short, the General Excise Tax as it is currently codified is applicable to all sums that are not specifically exempt from the General Excise Tax, or that the State is not allowed to tax under the United States Constitution.

Section 2 of S.B. 948 S.D.1 Proposed H.D.1 makes significant changes to Section 237-13, Hawaii Revised Statutes, which imposes the General Excise Tax. These changes would create a presumption, under various circumstances, that a seller was engaged in business within the State if certain conditions are met. The General Excise Tax, however, *actually* applies to all the sums discussed in the proposed amendments to Section 237-13 – no presumption is involved. Because these changes, though, create a statutory presumption, they could also generate a *negative* presumption. Since these presumptions are fact-based, they are open to interpretation and could likely be exploited by taxpayers attempting to lessen their tax liability.

Specifically, page 8, line 14 states that a seller is "engaging or continuing within this State in business" if the seller, regularly or intermittently, owns any property, maintains any place of business, or used any representative in the State, irrespective of the whether the person has qualified to do business in the State. This definition could have the inadvertent effect of exempting certain activities that are currently subject to General Excise Tax.

The Department also notes that there may be Constitutional issues regarding sections 4 and 5 of this bill. Section 5 deals specifically with the mandatory collection of the Use Tax by sellers. While the Department defers to the Department of the Attorney General on the Constitutionality of the proposed changes, we note that the holding in Quill Corp. v. North Dakota, 504 US 298 (1992) requires that a corporation have a physical presence in the taxing jurisdiction in order for the state to impose a duty to collect Use Tax on that corporation. The Department additionally notes that if a taxpayer has nexus, that taxpayer bears the burden of General Excise Tax. Thus, a taxpayer who has nexus is not collecting the Use Tax, it is passing on the General Excise Tax to the consumer.

Thank you for the opportunity to provide comments.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, USE, Taxability of out-of-state sellers

BILL NUMBER: SB 948, Proposed HD-1

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Amends HRS section 237-13 to provide that a seller of tangible personal property shall be considered "engaging or continuing within this state in business" if the seller owns any property, maintains any place of business, or uses a representative in the state, regardless of whether the person has qualified to do business in the state.

A seller shall be presumed to be "engaging or continuing within this state in business" if a person or an affiliated person has substantial nexus in the state (excluding a person acting as a common carrier) and: (1) sells a similar line of products as the seller under the business name; (2) maintains an office, distribution facility, warehouse, storage place, or similar place of business in the state to facilitate the delivery of property or services sold by the seller to the seller's customers; (3) uses trademarks, service marks, or trade names in the state that are the same as those used by the seller; (4) delivers, installs, assembles, or performs maintenance services for the seller's customers within the state; (5) facilitates the seller's delivery of property to customers in the state by allowing the seller's customers to pick up property sold by the seller at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in the state; or (6) conducts any other activities in the state that are significantly associated with the seller's ability to establish and maintain a market in the state. This presumption that a seller is "engaging or continuing in business within this state" may be rebutted by demonstrating that the activities of the person or affiliated person in the state are not significantly associated with the seller's ability to establish or maintain a market in this state for the seller's sales.

A seller shall be presumed to be "engaging or continuing in business within this state" if the seller enters into an agreement with residents of this state for a commission or other consideration and refers potential customers, by a link on a website, telemarketing, an in-person oral presentation to the seller, if the cumulative gross receipts from sales by the seller to customers in the state is in excess of $10,000 during the preceding twelve months. This provision shall take effect 90 days after the effective date of this act and shall be applicable to sales made, uses occurring, and services rendered on or after the effective date of this act regardless of the date the seller and the resident entered into the agreement. This presumption that a seller is "engaging or continuing in business within this state" may be rebutted by submitting proof that the residents with whom the seller has an agreement did not engage in any activity within the state that was significantly associated with the seller's ability to establish or maintain the seller's market in this state during the preceding twelve months. Such proof may consist of sworn written statements from all of the residents with whom the seller has an agreement stating that they did not engage in any solicitation in this state on behalf of the seller during the preceding year provided that such statements were provided and obtained in good faith.

Requires any person that sells or leases tangible personal property or services to the state, a state department, a state agency, or an agent thereof, that person and any affiliated person, as a prerequisite for any such sale or lease, is to register with the department of taxation as a seller and be required to collect and remit general excise taxes and comply with all legal requirements imposed on such sellers.

Defines "affiliated person" as any person that is a member of the same "controlled group of corporations" as defined in section 1563(a) of the Internal Revenue Code (IRC) as the seller or any other entity that, notwithstanding its form of organization, bears the same ownership relationship to the seller as a corporation that is a member of the same "controlled group of corporations" as defined in section 1563(a) of the IRC.

Amends HRS section 237-1 to amend the definition of "representative" to mean any salesperson, commission agent, manufacturer's representative, broker or other person who is authorized or employed by an unlicensed seller to conduct activities in this state that are significantly associated with the seller's ability to establish or maintain a market in this state for the seller's sales, including selling property for use in the state, procuring orders for sales, and making collections or deliveries, it being immaterial whether such activities are regular or intermittent. Any unlicensed seller who in person carries on any such activity in the state shall also be classed as a representative.

Amends HRS section 238-6 to provide that a seller shall be presumed to be "engaged in business in the state" if: (1) a person (excluding a person acting as a common carrier), that has substantial nexus in this state: (a) sells a similar line of products as the seller under the same business name; (b) maintains an office, distribution facility, warehouse, storage place, or similar place of business in the state to facilitate the delivery of property or services to the seller's customers; (c) uses trademarks, service marks, or trade names in the state that are the same or substantially similar to those used by the seller; (d) delivers, installs, assembles, or performs maintenance services for the seller's customers within the state; (e) facilitates the seller's delivery of property to customers in the state by allowing the seller's customers to pick up property sold by the seller at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in the state; or (f) conducts any other activities in the state that are significantly associated with the seller's ability to establish and maintain a market in the state for the seller's sales; or (2) an affiliated person has substantial nexus in the state. The presumption that a seller is "engaged in business in the state" may be rebutted by demonstrating that the activities of the person or affiliated person in the state are not significantly associated with the seller's ability to establish or maintain a market in this state for the seller's sales.

For the purposes of this section, "engaged in business in the state" is also presumed to include every seller that has entered into an agreement with residents of this state under which the resident, for a commission or other consideration, refers potential customers, whether by a link on a website, telemarketing, or an in-person oral presentation to the seller, if the cumulative gross receipts from sales by the seller to customers in the state is in excess of $10,000 during the preceding twelve months. This provision shall take effect 90 days after the effective date of this act and be applicable to sales made, uses occurring, and services rendered on or after the effective date of this act. The presumption that a seller is "engaged in business in the state" may be rebutted by submitting proof that the residents with whom the seller has an agreement did not engage in any activity within the state that was significantly associated with the seller's ability to establish or maintain the seller's market in this state during the preceding twelve months. Such proof may consist of sworn written statements from all of the residents

with whom the seller has an agreement stating that they did not engage in any solicitation in this state on behalf of the seller during the preceding year provided that such statements were provided and obtained in good faith.

Requires any person that sells or leases tangible personal property or services to the state, a state department, a state agency, or an agent thereof, that person and any affiliated person, as a prerequisite for any such sale or lease, is to register with the department of taxation as a seller and be required to collect and remit use taxes and comply with all legal requirements imposed on such sellers.

Defines "affiliated person" as any person that is a member of the same "controlled group of corporations" as defined in section 1563(a) of the IRC as the seller or any other entity that, notwithstanding its form of organization, bears the same ownership relationship to the seller as a corporation that is a member of the same "controlled group of corporations" as defined in section 1563(a) of the IRC.

Amends HRS section 238-1 to amend the definition of "representative" to mean a seller being present in the state; and a seller having in the state a salesperson, commission agent, manufacturer's representative, broker, or other person who is authorized or employed by the seller to conduct activities in this state that are significantly associated with the seller's ability to establish or maintain a market in this state for the seller's sales, including assisting the seller in selling property, services, or contracting for use or consumption in the state, procuring orders for the sales, and making collections or deliveries.

EFFECTIVE DATE: July 1, 2030

STAFF COMMENTS: This measure establishes presumptions under the general excise and use tax law whereby an out-of-state seller will be subject to taxation by amending the definitions of "engaging in or continuing in business" under the general excise tax or "engaging in business" under the use tax.

Under the proposed measure a person shall be considered "engaging or continuing within this state in business" if a person or an affiliated person has substantial nexus in the state if such person: (1) sells a similar line of products as the seller under the business name; (2) maintains an office, distribution facility, warehouse, storage place, or similar place of business in the state to facilitate the delivery of property or services sold by the seller to the seller's customers; (3) uses trademarks, service marks, or trade names in the state that are the same as those used by the seller; (4) delivers, installs, assembles, or performs maintenance services for the seller's customers within the state; (5) facilitates the seller's delivery of property to customers in the state by allowing the seller's customers to pick up property sold by the seller at an office, distribution facility, warehouse, storage place, or similar place of business maintained by the person in the state; or (6) conducts any other activities in the state that are significantly associated with the seller's ability to establish and maintain a market in the state. A seller shall also be presumed to be "engaging or continuing in business within this state" if the seller enters into an agreement with residents of this state for a commission and refers potential customers, by a link on a website, telemarketing, or an in-person oral presentation to the seller, if the cumulative gross receipts from sales by the seller to customers in the state is in excess of $10,000 during the preceding twelve-month period.

This approach to collecting the general excise or use tax on out-of-state purchases deserves serious consideration as an alternative to the proposed "streamlined sales tax" project that places the onus of the burden on the seller to collect the tax from the consumer. This approach is a work in progress and serious consideration should be given to refining the provisions of this proposal. However, it is far superior to the approach of the "streamlined sales tax" in that it continues to maintain the structure and philosophy of the general excise tax rather than attempting to change Hawaii's tax into a "sales tax."

It should be noted that "nexus" has been the defining standard as to whether a company must collect and remit sales and/or use taxes. **Quill Corp. v. North Dakota, 504 U.S. 298 (1992)** is a Supreme Court ruling concerning use tax. Quill Corporation is an office supply retailer that had no physical presence in North Dakota, but it had a licensed computer software program that some of its North Dakota customers used for checking Quill's current inventories and placing orders directly. North Dakota attempted to impose a use tax on Quill, which was struck down by the Supreme Court that ruled that a business must have a physical presence in a state for that state to require its sales tax to be collected. If Congress overturns the Quill decision by enacting legislation that would not require such a standard, all companies would have to begin collecting and remitting the appropriate sales tax on sales in interstate commerce.

This bill mirrors many others that have been adopted by other states in recent years. Leading the way has been New York which adopted a similar measure more than four years ago and has been collecting its sales tax on such cross-border sales from vendors who have no physical presence in that state. California reached an agreement with Amazon.com recently and is currently collecting its sales taxes on purchases made by its residents.

The proposed measure further strengthens the identification of an out-of-state vendor gaining "physical presence" in the state which again was the turning point in the case of ***Baker & Taylor v. State of Hawaii (2004)*** where the Hawaii Supreme court affirmed that the vendor had gained physical presence in the state and, therefore, was subject to the general excise tax even though they had no goods or inventory in the state as the title to those goods had passed outside the state. This latter point was the basis for the Court's recognition that the taxpayer, while subject to the general excise, was not necessarily subject to the use tax as it did not cause the goods to be imported into the state.

A recent study of the issue entitled "Collecting Hawaii's General Excise Tax on E-commerce" was issued by this office and provides a status report based on the end of the 2011 as to where other states are in requiring the collection of their state sales taxes by out-of-state vendors. The study also noted that the adoption of a similar measure proposed in 2012 would not have resulted in a tax increase, but a mechanism by which taxes already due under the general excise/use tax can be collected. More importantly, the study underscores the fact that Hawaii does not have a retail sales tax structure like the forty some other retail sales tax states and that adoption of this approach to the collection of taxes from out-of-state vendors preserves the integrity of Hawaii's unique general excise tax, something that the Streamlined Sales Tax Project tends to ignore.

Digested 3/13/13

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March 14, 2013

The Honorable Sylvia Luke, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: S.B. 948, S.D.1, Proposed H.D. 1, Relating to Taxation

HEARING: Thursday, March 14, 2013, at 2:00 p.m.

Aloha Chair Luke, Vice Chair Nishimoto, Vice Chair Johanson, and Members of the Committee:

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,000 members in Hawai'i. HAR **supports the intent** of S.B. 948, Proposed H.D.1, which: (a) expands application of the General Excise Tax ("GET") to business activities in the State of Hawai'i that are significantly associated with a seller's ability to establish or maintain a market in the State; (b) creates a presumption under the GET law for sellers of tangible personal property where the seller's activities in the State demonstrate a significant business nexus with the State; and (c) creates a presumption under the Use Tax law that a seller is engaged in business in the State if the seller's activities in the State demonstrate a significant business nexus with the State.

Currently, many states and municipalities are encountering unprecedented budget deficits. In order to meet their obligations, many public agencies must either cut jobs and services or raise revenue from increasing sales taxes, property taxes or other business fees. Proposed federal legislation may give the states the power to collect revenue they are owed and help offset current budget shortfalls – all without costing the federal government a dime.

Every day, brick-and-mortar retailers of all sizes collect and remit sales taxes, putting them at a significant competitive disadvantage to online and catalogue retailers who continue to reap the benefits from an antiquated and biased system. Proposed federal legislation may provide a fairer and more transparent market for community based retailers and it will help keep our downtowns vibrant by protecting much needed local jobs, promoting community investment and maintaining access to essential goods and services in our neighborhoods.

HAR therefore supports the intent of S.B. 948, Proposed H.D.1, to the extent that it may become consistent with any proposed federal legislation.

Mahalo for the opportunity to testify.

Representative Sylvia Luke, Chair
Representative Scott Nishihara, Vice Chair
Representative Aaron Ling Johanson, Vice Chair
Committee on Finance

HEARING Thursday, March 14, 2013
2:00 pm
Conference Room 308
State Capitol, Honolulu, Hawaii 96813

RE: SB948, SD1, Proposed HD1, Relating to Taxation

Chair Luke, Vice Chairs Nishihara and Johanson, and Members of the Committee:

Retail Merchants of Hawaii (RMH) is a not-for-profit trade organization representing 200 members and over 2,000 storefronts, and is committed to support the retail industry and business in general in Hawaii. The retail industry is one of the largest employers in the state, employing 25% of the labor force.

RMH strongly supports the Proposed HD1 to SB948, SD1, which expands application of the general excise tax to business activities in the State that are significantly associated with a seller's ability to establish or maintain a market in the State; creates a presumption under the general excise tax law for sellers of tangible personal property where the seller's activities in the State demonstrate a significant business nexus with the State and creates a presumption under the use tax law that a seller is engaged in business in the State if the seller's activities in the State demonstrate a significant business nexus with the State.

We are in an era of omnichannel retailing, with brick and mortar retailers leveraging innovative digital technologies to improve the consumer experience. But unlike our omnichannel counterparts, brick and mortar retailers must comply with 7,600 different state and local sales tax systems.

As electronic commerce continues its dramatic increase, traditional brick and mortar retailers are experiencing continued erosion of their sales base to remote sellers, which, under most circumstances, are not subject to tax mandates. SB948, SD1, HD1 will level the playing field. The unfair disadvantage our Hawaii retailers are experiencing results in unrealized sales, lower tax revenue to the state, and minimized revenue and resources to expand their operations and create jobs.

Twelve states enacted e-fairness and/or consumer use laws since 2008: New York, Rhode Island, North Carolina, Colorado, Oklahoma, Illinois, South Dakota, Arkansas, Connecticut, Vermont, California and Texas. Ten other states have legislation pending: Arizona, Florida, Georgia, Michigan, Minnesota, Missouri, New Jersey, Virginia, Utah and now Hawaii.

The reality is that the State of Hawaii has considerable liabilities and unfunded mandates that cannot be satisfied without additional revenue or cutting essential services. It is more than reasonable to collect a tax that's already due before instituting new taxes on everyone. Tax revenue generated from online sales can be used to pay down deficits and get Hawaii back on track toward fiscal solvency.

We urge you to pass SB948, SD1, HD1. Thank you for your consideration and for the opportunity to comment on this measure.

Carol Pregill

Carol Pregill, President

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Testimony of
Gary M. Slovin / Mihoko E. Ito
on behalf of
Walgreens

DATE: March 13, 2013

TO: Representative Sylvia Luke
Chair, Committee on Finance
Submitted Via FINTestimony@capitol.hawaii.gov

RE: **S.B. 948 S.D.1 – Relating to Taxation**
Hearing Date: Thursday, March 14, 2013 at 2:00 pm
Conference Room: 308

Dear Chair Luke and Members of the Committee on Finance:

We submit this testimony on behalf of Walgreen Co. ("Walgreens").

Walgreens operates more than 8,200 locations in all 50 states, the District of Columbia and Puerto Rico. In Hawai`i, Walgreens now has 11 stores on the islands of Oahu, Maui and Hawai`i.

Walgreens **supports** the proposed H.D.1 for S.B. 948, S.D. 1, which: 1) expands application of the general excise tax to business activities in the State that are significantly associated with a seller's ability to establish or maintain a market in the State, 2) creates a presumption under the general excise tax law for sellers of tangible personal property where the seller's activities in the State demonstrate a significant business nexus with the State, and 3) creates a presumption under the use tax law that a seller is engaged in business in the State if the seller's activities in the State demonstrate a significant business nexus with the State.

Walgreens supports this measure because it seeks to level the playing field so that local "brick-and-mortar" stores operate under the same rules and online sellers. To date, 24 states have implemented the Streamlined Sales & Use Tax Agreement, and 15 states have passed legislation to require online retailers to pay sales taxes when they have an affiliate or "nexus" presence in the state.

Gary M. Slovin
Mihoko E. Ito
Tiffany N. Yajima
Nicole A. Velasco

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Walgreens believes that both community and online retailers should conduct business in a fair, competitive environment. With the changes in the marketplace, e-commerce has become a critical marketplace for both retailers to sell and consumers to buy products 24 hours a day, regardless of geography. However, tax collection laws, including those in Hawaii, have not changed to address the marketplace changes. Walgreens therefore supports legislation which would enable the collection of taxes from internet retail sellers.

Thank you very much for the opportunity to testify.