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To: The Honorable Donavan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Monday, January 29, 2018
Time: 10:15 A.M.
Place: Conference Room 221, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2086, Relating to Use Tax

The Department of Taxation (Department) offers the following comments on S.B. 2086 for the Committee's consideration.

S.B. 2086 requires individual taxpayers to report and pay use tax on their individual income tax returns. The bill also requires individual taxpayers who are not required to file individual income tax to report and pay use tax on use tax return forms prescribed by the Department. The use tax return for individual taxpayers will be due on or before the twentieth day of the fourth month of the following calendar year. The bill is effective upon approval and it applies to taxable years beginning after December 31, 2018.

The use tax is meant to complement the general excise tax (GET) which is a gross receipts tax imposed for the privilege of doing business in Hawaii. When a purchase is made from an unlicensed seller (taxpayer not subject to GET) the purchaser is subject to use tax. Use tax is imposed in this manner so that there is the same tax imposition on a transaction regardless of whether the seller is subject to GET.

The use tax applies at the same rate as the GET. Purchases for use or consumption by the purchaser are subject to the retail rate of 4% (plus any applicable county surcharge) and purchases for resale are generally subject to the wholesale rate of 0.5%.

The Department notes that it is able to implement the measure with its current effective date as it applies to taxable years beginning after December 31, 2018.

Thank you for the opportunity to provide comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: USE, INCOME, Require individuals to report use tax on individual return

BILL NUMBER: SB 2086

INTRODUCED BY: K. RHOADS, Kidani

EXECUTIVE SUMMARY: Requires individuals who have not otherwise reported use tax to report it and pay it on their individual income tax return. This device is used in many other states with a use tax, with varying degrees of success. A proper cost-benefit analysis should be undertaken before adopting it here, because the administrative costs are likely to be considerable. The Committee should also consider a safe harbor provision because individuals may not be keeping the records required to establish the amount of liability.

SYNOPSIS: Amends section 238-5, Hawaii Revised Statutes, to require an individual taxpayer to report Use Tax annually on the individual income tax return instead of on a periodic or annual use tax return.

EFFECTIVE DATE: December 31, 2018

STAFF COMMENTS: States with a general sales tax have also enacted complementary use taxes, as has Hawaii. In general, a use tax is due on a transaction in which the sales tax (or, in Hawaii, the GET) is not paid and the good or service is imported into or used in the jurisdiction imposing the tax. The use tax equals the state tax rate plus the county surcharge, if any.

The Use Tax is designed to level the playing field between merchants by taxing sales made into the State by out-of-state merchants at the same rate as the General Excise Tax paid by in-State merchants. In other words, the Use Tax ensures that if the seller does not pay a 4% tax, the buyer will pay it. This tax is measured at 4% or ½% of the value of the property or service.

The Use Tax *is not* restricted to property or services used or consumed by a business. It also applies to personal use property. In theory, it applies to all tangible personal property purchased outside of the State and brought into the State, including personal clothing and souvenirs. The Department of Taxation, however, has no systematic program for enforcing and collecting the tax on small purchases by nonbusiness taxpayers. The Department *does* make an effort to collect Use Tax on large purchases, such as automobiles, even when the purchases are made for personal use. *See* Tax Information Release (TIR) 93-3.

The recitations in the bill mention an April 2015 policy brief of the Research Department of the Minnesota House of Representatives. That brief is attached for the Committee's information. The policy brief also contains a table, based on 2012 data, indicating that the average amount of use tax reported per return reporting use tax ranges from $39 to $154, except for Connecticut with $876 (possibly due to special circumstances described in a footnote in the report). The administrative burden is likely to be considerable, and a proper cost-benefit analysis should be done before adopting the recommendation in this bill.

Given that many taxpayers do not keep records sufficient to establish a use tax liability amount, we would urge the Committee to enact a safe harbor such as a certain percentage of taxable income.

Digested 1/26/2018