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To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Isaac W. Choy, Director
Department of Taxation

Date: Thursday, February 24, 2022
Time: 10:00 A.M.
Place: Via Video Conference, State Capitol

Re: S.B. 2475, S.D. 1, Relating to Taxation

The Department of Taxation (Department) has concerns about S.B. 2475, S.D.1, and offers the following comments for your consideration.

S.B. 2475, S.D.1, amends the general excise tax (GET) exemption for certain activities related to shipping. Specifically, the bill adds "stevedoring services," as defined in Hawaii Revised Statutes (HRS) section 382-1, to the exemption for loading or unloading cargo from ships at HRS section 237-24.3(3). S.B. 2475, S.D. 1, also adds wharfage and demurrage imposed under HRS chapter 266 to the exemption. The bill has a defective effective date of July 1, 2050.

First, the Department notes that although this measure's stated purpose is a clarification of law, the bill does not clarify the existing exemption. The existing exemption at HRS section 237-24.3(3) exempts from GET all gross income from the "loading and unloading of cargo from ships, barges, vessels, or aircraft…." S.B. 2475, S.D. 1, simply adds "including stevedoring services as defined in section 382-1" to the existing exemption. "Stevedoring services" is defined as "services for the loading and unloading of cargo transported or to be transported on vessels and other craft…." As currently written, the Department fails to see a clarification.

Second, if the Legislature has identified the need to clarify the exemption, the Department suggests specifying that the income received in exchange for the transportation and/or storage of the cargo does not qualify for the exemption. In order to accomplish this, the Department suggests amending HRS section 237-24.3(3)(a) to read as follows:

> The loading or unloading of cargo from ships, barges, vessels, or aircraft, but not including receipts for transportation or storage of cargo, whether or not the

ships, barges, vessels, or aircraft travel between the State and other states or countries or between the islands of the State;

Third, the Department notes that the added exemption of wharfage and demurrage is unclear. As currently written, the exemption would cover amounts paid by shipping companies to the Department of Transportation rather than amounts received by shipping companies. As such, the allowance of wharfage and demurrage appears to be an attempt at allowing a deduction for certain companies' costs. The Department points out that the GET is based on *gross* receipts with very few deductions. Because GET is a tax based on *gross* receipts, the Department generally opposes the allowance of any deductions. The Department strongly suggests amending this provision so that it is exempting specific income, rather than payments.

Finally, if this measure is moved forward, the Department requests the effective date of any changes be made effective on January 1, 2023. Thank you for the opportunity to provide testimony on this measure.

DAVID Y. IGE
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CRAIG K. HIRAI
DIRECTOR

GLORIA CHANG
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

LATE

WRITTEN ONLY

TESTIMONY BY CRAIG K. HIRAI
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
TO THE SENATE COMMITTEE ON WAYS AND MEANS
ON
SENATE BILL NO. 2475, S.D. 1

February 24, 2022
10:00 a.m.
Room 211 and Videoconference

RELATING TO TAXATION

The Department of Budget and Finance (B&F) offers comments on this bill.

Senate Bill No. 2475, S.D. 1, amends Section 237-24.3, HRS, to clarify that the amounts received or accrued for stevedoring services, as defined in Section 382-1, HRS, and wharfage and demurrage imposed under Chapter 266, HRS, are exempt from State general excise tax law.

B&F notes that the federal American Rescue Plan (ARP) Act restricts states from using ARP Coronavirus State Fiscal Recovery Funds (CSFRF) to directly or indirectly offset a reduction in net tax revenue resulting from a change in law, regulation, or administrative interpretation beginning on March 3, 2021, through the last day of the fiscal year in which the CSFRF have been spent. If a state cuts taxes during this period, it must demonstrate how it paid for the tax cuts from sources other than the CSFRF, such as:

- By enacting policies to raise other sources of revenue;
- By cutting spending; or
- Through higher revenue due to economic growth.

If the CSFRF provided have been used to offset tax cuts, the amount used for this purpose must be repaid to the U.S. Treasury.

The U.S. Department of Treasury has issued rules governing how this restriction is to be administered. B&F will be working with the money committees of the Legislature to ensure that the State of Hawai‘i complies with this ARP restriction.

Thank you for your consideration of our comments.

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 305 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GET, Exemptions; Shipping Activities; Stevedoring; Wharfage; Demurrage

BILL NUMBER: SB 2475 SD1

INTRODUCED BY: Senate Committee on Transportation

EXECUTIVE SUMMARY: Clarifies that amounts received or accrued for stevedoring services and related services, wharfage, and demurrage are exempt under the general excise tax law.

SYNOPSIS: Amends section 237-24.3(3), HRS, to state explicitly that stevedoring services and related services defined in section 382-1, HRS, are eligible for the GET exemption for the loading or unloading of cargo from ships, barges, vessels, or aircraft.

Also states that wharfage and demurrage imposed under chapter 266, HRS, that is paid to the Department of Transportation would be eligible for the same GET exemption.

EFFECTIVE DATE: July 1, 2022.

STAFF COMMENTS: GET is now applied on transportation industries in an uneven way.

First, we can't tax air transportation. There are federal laws prohibiting us from applying a gross receipts tax (like our General Excise Tax) to transportation charges. Back in the late 70's and early 80's, we tried to tax air carriers by imposing our Public Service Company Tax, which applies to public utilities in lieu of GET. We were very creative. The Hawaii Supreme Court held, and our state told the U.S. Supreme Court, that our tax was actually a tax on real and personal property (which was allowed), but because it was so difficult to value the kinds of property that utilities had, like airspace rights, rights-of-way for power and cable lines, or easements for water pipes, the tax used the gross income of an airline as a proxy for valuing its property.

The U.S. Supreme Court didn't buy the argument. "It's still a tax measured by gross receipts, which is a gross receipts tax under federal law, and we get to interpret that federal law," they said, in effect, in a unanimous 8-0 decision in 1983.

Despite this ruling, zealous tax auditors still tried to go after helicopter tour companies and those companies pushed back, leading the Department of Taxation to rule, in Tax Information Release 89-10, that those gross receipts were immune both from the Public Service Company Tax and the GET.

There are also federal restrictions on taxing transportation by water. Federal law prohibits anyone other than the federal government to tax a vessel, its passengers, or its crew while the vessel is operating on navigable waters. In 2010, our Intermediate Court of Appeals ruled that the GET as applied to charges for chartering a sport fishing boat was valid because it was a tax on the business and not on the vessel, passengers, or crew. The court reasoned that the federal

law was meant to prohibit fees and taxes on a vessel simply because the vessel sails through a given jurisdiction and didn't mean to affect whether sales or income taxes can apply in general. The Hawaii Supreme Court declined to review the case, as did the U.S. Supreme Court. So, GET can be applied to transportation by water, at least for now.

In the meantime, fine distinctions are already being made. In cases involving UPS and Lynden Air Freight, the Hawaii Supreme Court held that when a shipper pays for a shipment to go from your office to your counterpart on the Mainland, GET can apply only to the transportation by ground between your office and the airport.

In short, the landscape here is filled with complexity and disparities between transportation industries. Are there good reasons why, as a matter of tax policy, we should tax water and ground transportation when air transportation can't be taxed? (Other than, "Because we can.") We're an island state. One of the reasons often given to explain our astronomical cost of living is that goods and people need to be shipped in and out, and that isn't done for free. If the tax is lessened or eliminated, the transportation industries would compete on a more level playing field, residents would feel some relief in the cost of living department (or at least sellers wouldn't be able to use the tax as an excuse), and the government revenues might not go down because fewer costs may lead to more buying, and thus more total revenue subject to GET taxation.

We welcome efforts to lessen the tax burden on transportation or provide clarity to the area.

As a technical matter, we note that the Senate Committee on Transportation deleted reference to "related services" in the bill as introduced because the Committee thought the term was vague and undefined. It turns out that "related services" is defined in section 382-1, so a reference in the exemption to "stevedoring services and related services, as those terms are defined in section 382-1," would not be inappropriate.

Digested: 2/8/2022

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LATE

Testimony of The Pasha Group
in Support of SB2475
Before the Committee on Ways and Means
February 24, 2022

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee on Ways and Means,

The Pasha Group ("Pasha") supports SB2475, which clarifies existing law and tax treatment for (1) stevedoring and related services; and (2) wharfage and dockage.

SB2475 does not provide new exemptions, but is consistent with the long-standing policy of the Department of Taxation and the Legislature as derived from and supported by, among other things, (A) the Department of Taxation's longstanding position that stevedoring and related services are exempt from the general excise tax, as set forth in Tax information Release ("TIR") 56-78; (B) the legislative intent in 1979 at the adoption of provision that would ultimately become Haw. Rev. Stat. § 237-24.3(3); (C) the legislative intent in 1987 when the more specific stevedoring and related services exemption was added to the subsection that would ultimately become Haw. Rev. Stat. § 237-24.3(3); and (D) the Legislature's express acknowledgment in Act 105 in 2011 that the general excise tax exemption in Haw. Rev. Stat. § 237-24.3(3) applies to amounts received for "stevedoring services" and "related activities", as defined in Haw. Rev. Stat. § 382-1. Independently, each of these evidences that amounts received from stevedoring and related services are exempt from the general excise tax. Collectively, and particularly after Act 105, there can be no doubt that amounts received from stevedoring and related services are exempt from the general excise tax are exempt pursuant to Haw. Rev. Stat. § 237-24.3(3).

A. TIR 56-78

In TIR 58-78 the Department of Taxation recognized that, "**Stevedoring and other interstate commerce activities and the proceeds derived therefrom have historically enjoyed exemption from State taxation and the exemption will continue for an indefinite period**." (Emphases added.) This exemption of amounts received from stevedoring and related services was soon codified.

B. 1979 Act 74

In 1979, by way of Act 74 the Hawaii State Legislature amended Haw. Rev. Stat. § 237-24 to add the provision that would ultimately become Haw. Rev. Stat § 237-24.3(3), which was specifically intended to exempt stevedoring and related services, thereby codifying the historical exemption:

> (21) Any provision of law to the contrary notwithstanding, exemptions or exclusions from tax under this chapter allowed on or before April 1, 1978 for amounts received by any person or common carrier engaged in interstate or foreign commerce, or both, whether ocean-going or air, shall continue undiminished and be available thereafter to the extent and under the conditions such exemptions or exclusions have theretofore been previously allowed in the State under the provisions of the Constitution of the United States or an act of the Congress of the United States."

The Legislature was very clear about why this provision was being added. As explained in the House Committee Reports:

> Your Committee finds that **the practical effect of this bill would be to exclude from general excise and use taxation stevedoring and other interstate commerce activities. Such activities and the proceeds derived from them have historically enjoyed exemption from state taxation due** to judicial interpretation of the interstate commerce clause of the U.S. Constitution.
>
> In April of 1978, however; the U. S. Supreme Court handed down a ruling which determined that states may directly tax the privilege of conducting interstate business where such taxes are fair and a relationship between the business activities being taxed and the state is established, Several months after the Court's ruling, the state department of taxation set guidelines for the taxation of stevedoring and other interstate commerce activities, Expressing concern for the economic impact of the implementation of the taxation guidelines, the governor later suspended assessment of the taxes. **This bill would codify this exemption of stevedoring and related activities from taxation, notwithstanding the recent U.S. Supreme Court ruling.**
>
> **Your Committee believes that the imposition of the tax on interstate commerce proceeds and activities would have a substantial impact on the state's economy as nearly all consumer goods must be imported**. Due to Hawaii's remote geographic location, Hawaii residents already face high prices as a result of shipping costs. Any increase in these shipping costs will ultimately be borne by the consumers, leading to further escalation of the state's cost of living.

1979 House Committee Reports - SCRep. 513 (emphases added). See also 1979 House Committee Reports - SCRep. 637 (same).

The Senate Committee Reports affirmed the intention to codify the exemption from general excise tax for amounts received for stevedoring and related services:

> The purpose of this bill is to continue the exemption and exclusion from Hawaii general excise and use taxes for activities in and income derived from the conduct of interstate and foreign business, to the extent such activities and income were treated as exempt by the State of Hawaii on April 1, 1978. This bill would continue the tax status of interstate business as it existed prior to the decisions of the United States Supreme Court in Department of Revenue of Washington v. Association of Washington Stevedoring Companies, 55 L.Ed.2d. 682 (1978); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); and Michelin Tire Corporation v. Wages, 423 U.S. 276 (1976).
>
> **Among the activities for which an exclusion from taxation is continued by the bill are those listed in Tax Information Release Number 56-78**, issued June 15, 1978 by the State of Hawaii, Department of Taxation, and those treated as exempt or excluded in opinions of the Attorney General of Hawaii. See, e.g., Hawaii Attorney General Opinion No. 1720, August 22, 1939, Hawaii Attorney General Opinion No, 2253, June 3, 1943.

1979 Senate Committee Reports – SCRep. 719 (emphasis added) and SCRep. 810.

C. 1987 Act 292

In 1987, Act 292 amended Haw. Rev. Stat. § 237-24(21) to read substantially the same as Haw. Rev. Stat. § 237-24.3(3) does in its current form by adding the following language:

> Amounts received or accrued from:
>
> (A) The loading or unloading of cargo from ships, barges, vessels, or aircraft, whether or not the ships, barges, vessels, or aircraft travel between the State and other states or countries or between the islands of the State;
>
> (B) Tugboat services including pilotage fees where such services are performed within the State, and the towage of ships, barges, or vessels in and out of state harbors, or from one pier to another; and

> (C) The transportation of pilots or governmental officials to ships, barges, or vessels offshore; rigging gear; checking freight and similar services; standby charges; and use of moorings and running mooring lines;

1987 Act 292.

Accordingly, the Legislature explained, with respect to the bill that would later become Act 292, that the additional language was intended "to clarify the activities related to interstate or foreign commerce which are exempt from Hawaii's general excise and use taxes. **More specifically, these activities are the stevedoring business of loading and unloading cargo, freight forwarding [[1]] activities, tugboat services, and harbor transportation activity**." 1987 House Committee Reports SCRep. 883 (emphasis added) and SCRep 1076.

D. 2011 Act 105

The Legislative history makes very clear that amounts received from stevedoring and related activities are not subject to the general excise tax. However, in 2011, in Act 105, the actual statute explicitly acknowledged that Haw. Rev. Stat. § 237-24.3(3) exempts amounts received for stevedoring services and related activities. In Act 105, the Legislature temporarily suspended several general excise tax exemptions, including Haw. Rev. Stat. § 237-24.3(3). However, **the Act 105 suspension did not apply to "gross proceeds from stevedoring services and related services, as defined in section 382-1, furnished to a company by its wholly owned subsidiary**." Haw. Rev. Stat. § 382-1 provides the following relevant definitions:

- "Stevedoring industry" means the business of furnishing services for the loading and unloading of cargo transported or to be transported on vessels and other craft, at any ports within the State, and also means the business of furnishing related services, as herein defined.

- "Related services" means and includes all services, other than stevedoring services, ordinarily or necessarily performed in regard to cargo, goods, wares, and merchandise of every kind arriving at a terminal facility for shipment by or discharge from vessels and other craft; and "related facilities" means and includes all facilities in connection therewith.

- "Stevedoring services" means services for the loading and unloading of cargo transported or to be transported on vessels and other craft and the handling of lines of vessels and other craft, at any ports within the State.

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[1] The bill was amended to remove the exemption for freight forwarding activities. 1987 House Committee Reports SCRep. 883.

In Act 105, the Legislature has made it indisputably clear that with respect to stevedoring Haw. Rev. Stat. § 237-24.3(3) exempts: (1) the loading and unloading of cargo transported or to be transported on vessels and other craft and the handling of lines of vessels and other craft; and (2) all services ordinarily or necessarily performed in regard to cargo, goods, wares, and merchandise of every kind arriving at a terminal facility for shipment by or discharge from vessels and other craft.

SB2475 also provides for a specific exemption for wharfage and dockage paid to the Department of Transportation by the shipping company to clarify that these fees that are imposed on third-parties, collected by the shipping company, and paid to the Department of Transportation are exempt from general excise tax, similar to other such fees that the Department of Taxation recognizes as being exempt from general excise tax as set forth in Department of Taxation Announcement No. 2008-05 (relating to Rental Motor Vehicle Customer Facility Charges and Invasive Species Fees on Freight).

Similarly, for wharfage, Hawaii Administrative Rules ("HAR") § 19-44-61(a) provides that "**[T]he charge for wharfage is due to be paid by the owners of the cargo** but the collection of the wharfage shall be guaranteed by the vessel, its master, operator, charterer, agents, or owners." (Emphasis added.) Thus, the owners of the cargo, not the vessel operator, charterer, agent or owner, are assessed the wharfage charges. The vessel operator, charterer, agent or owner serves only as a conduit or collection agent of the Department of Transportation. Thus, amounts collected for wharfage do not represent gross income or gross proceeds subject to Hawaii income or general excise tax.

Thank you for providing Pasha with the opportunity to provide testimony in support and your consideration of our comments.

LATE

Testimony of Matson Navigation Company, Inc.
Comments on SB2475, SD1
Before the Committee on Ways and Means
February 24, 2022

Dear Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee,

Matson Navigation Company, Inc. (Matson) requests technical, nonsubstantive amendments to SB2475, SD1. Specifically, we request that page 1, lines 1 to 10 be amended to read "The legislature finds that the State's shipping industry is critical to the people of Hawaii. It is the means by which most goods come to the islands to support our lives thousands of miles away. The legislature further finds that because of our remote location, nearly all of our goods are shipped and imported here and then transported intrastate between our islands. As such, Hawaii is sensitive to fees and taxes that are associated with shipping."

Thank you for providing Matson the opportunity to provide comments.