

# SB620

Measure Title: RELATING TO TAXATION.

Report Title: General Excise Tax; Businesses Without Physical Presence in the State

Description: Amends the definition of "business" in the State's general excise tax law.

Companion: [HB345](#)

Package: None

Current Referral: CPH, WAM

Introducer(s): DELA CRUZ, KIDANI, Inouye, Nishihara, Wakai



**TESTIMONY OF  
THE DEPARTMENT OF THE ATTORNEY GENERAL  
TWENTY-NINTH LEGISLATURE, 2017**

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**ON THE FOLLOWING MEASURE:**

S.B. NO. 620, RELATING TO NONPROFIT CORPORATIONS

**BEFORE THE:**

SENATE COMMITTEE ON COMMERCE, CONSUMER PROTECTION, AND HEALTH

**DATE:** Tuesday, February 7, 2017                      **TIME:** 9:00 a.m.

**LOCATION:** State Capitol, Room 229

**TESTIFIER(S):** Douglas S. Chin, Attorney General, or  
Stacie M. Nakamura, Deputy Attorney General

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Chair Baker and Members of the Committee:

The Department of the Attorney General has concerns about this bill because it may be challenged as violating the Commerce Clause of the United States Constitution.

The purpose of this bill is to amend the definition of “business” in chapter 237, Hawaii Revised Statutes (HRS), relating to the general excise tax. Under the proposed amendment, a taxpayer would be engaging in “business,” and therefore subject to the general excise tax, regardless of whether it has a physical presence in Hawaii. The bill also includes four exceptions to the term “business”: (1) casual sales, (2) having a website as a third-party content provider on a computer located in Hawaii, (3) using a nonaffiliated third-party call center to accept and process orders that are primarily from non-Hawaii buyers and that are fulfilled outside of Hawaii, and (4) with regard to taxpayers without a physical presence in Hawaii, activities of a taxpayer and its affiliates when their gross receipts in Hawaii total less than \$100,000 in the prior calendar year.

The amendments proposed in this bill may withstand a challenge in the state court under the current Hawaii Supreme Court jurisprudence, but the amendments may still be subject to constitutional challenge.

The Commerce Clause of United States Constitution explicitly grants power to Congress to regulate interstate commerce, and in doing so, also implicitly restricts states from enacting laws that unduly burden interstate commerce. The United States Supreme Court stated that a state tax will survive a Commerce Clause challenge if the tax “is applied to an activity with a substantial nexus with the taxing State, is fairly

apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.” Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). Furthermore, the United States Supreme Court in Quill Corp. v. North Dakota, 504 U.S. 298 (1992), appeared to affirm the need for some type of physical presence, as originally established in National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967), in order to meet the substantial nexus requirement.

Today’s proliferation of online commerce reveals that the physical presence requirement affirmed by Quill 25 years ago may be inadequate in today’s market. For example, New York’s highest court recently said that “[t]he world has changed dramatically in the last two decades, and it may be that the physical presence test is outdated.” Overstock.com, Inc. v. New York Department of Taxation and Finance, 20 N.Y.3d 586, 595 (2013). Despite this statement, the New York court maintained that the taxpayer must have some type of physical presence in the state.

It may be important to note that many of the authoritative cases, including Quill, interpret the substantial nexus requirement to involve a state sales and use tax, not a general excise tax, which is at issue here in Hawaii. When describing the Hawaii general excise tax, the Hawaii Supreme Court stated “our case law does not support the contention that the taxpayer must have a physical presence in the state.” Travelocity.com, L.P. v. Director of Taxation, 135 Hawaii 88 (2015). It is unknown whether the tests under Quill will be applied to a general excise tax and whether the general excise tax that does not require a physical presence in the state would ultimately be sustained under a Commerce Clause challenge.

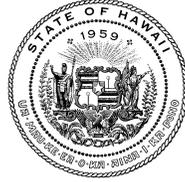
Because the main purpose of this bill is to apply the state general excise tax to the activity of certain taxpayers with no physical presence in Hawaii, if this bill becomes law, a taxpayer may cite to the United States Supreme Court decisions of Quill and Bellas Hess to challenge the State that the application of the general excise tax to a

taxpayer with no physical presence in Hawaii violates the Commerce Clause of the United States Constitution.

Thank you for the opportunity to provide comments.

DAVID Y. IGE  
GOVERNOR

SHAN TSUTSUI  
LT. GOVERNOR



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To: The Honorable Rosalyn H. Baker, Chair  
and Members of the Senate Committee on Commerce, Consumer Protection, and  
Health

Date: Tuesday, February 7, 2017  
Time: 9:00 A.M.  
Place: Conference Room 229, State Capitol

From: Maria E. Zielinski, Director  
Department of Taxation

Re: S.B. 620, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of S.B. 620 and provides the following comments for your consideration.

S.B. 620 amends the definition of business in the general excise tax (GET) to state that doing “business,” for purposes of the GET, does not require a physical presence as long as the taxpayer has \$100,000 or more of gross receipts attributable to Hawaii. The bill would also add two exceptions to the definition of “business.” The bill exempts taxpayers who only have a website hosted on a local and nonaffiliated server. The bill also exempts taxpayers who are only using a nonaffiliated call-center to process orders for primarily out of state customers. The bill becomes effective July 1, 2017.

The Department has the following concerns regarding this measure:

First, the Department notes that this measure addresses the State law issue of whether a seller without physical presence in Hawaii is engaged in business and therefore subject to GET. A bright line test like \$100,000 or more of Hawaii sales will clarify the State’s position. However, amending state law, as this bill proposes, would only remove the main challenge based on State law; this measure would not also prevent a Commerce Clause (nexus) challenge under the United States Constitution.

The Hawaii Supreme Court has applied the nexus test from *Tyler Pipe Indus., Inc. v. Washington Dept. of Revenue*, 483 U.S. 232 (1987) when determining whether application the GET statute violates the Commerce Clause. See *Tax Appeal of Baker & Taylor*, 82 P.3d 804 (2004). The *Tyler Pipe* test does not depend on physical presence, but instead turns on “whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in the state.” Thus, under current

Hawaii Supreme Court jurisprudence, the proposed \$100,000 sales threshold may withstand a Commerce Clause (nexus) challenge despite the explicit exclusion of a physical presence requirement.

However, any taxpayer challenging the statute would attempt to apply *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In this case, the United States Supreme Court held that a seller must have a physical presence in a State to be subject to that State's sales and use tax collection requirements. This requirement of physical presence is rooted in the Commerce Clause of the United States Constitution and will not be affected by the amendment to State law proposed by this bill. If the rule from *Quill* is applied, any application of the GET to a taxpayer without a physical presence in the State will be in violation of the Commerce Clause.

Thus, if passed and enforced, this measure will likely lead to litigation and may not lead to additional revenue for the State because affected taxpayers may still obtain relief under the Commerce Clause of the U.S. Constitution.

Second, the intent and scope of the exceptions to the no physical presence rule are not clear. The exceptions seem counter to the overall intent of the bill. This is because the exceptions seem to exempt from taxation taxpayers with more connection to the State rather than less connection to the State.

For example, a seller with no physical presence, but \$100,000 or more in would be subject to GET, whereas a similar seller, also with \$100,000 or more in sales, that is hosting its website on an unaffiliated local computer would not be subject to GET. Both taxpayers have \$100,000 or more in sales into Hawaii, but the one with more connection to Hawaii through the locally hosted website, is exempted.

Third, these exceptions, as written, could be interpreted to exempt even sellers that have a physical presence in the State. This is because these are written as exceptions to the overall definition of "business" for GET purposes. If this interpretation prevailed, a seller with a physical store in Hawaii would not be doing "business" if they could prove they had a website hosted on a nonaffiliated computer in the State.

If the intent of the legislature is to explicitly state that physical presence is not required for the State to impose GET on taxpayers whose sales are \$100,000 or more, then the Department recommends the bill be amended to read as follows:

"237-2 "Business", "engaging" in business, defined. (a) "Business" as used in this chapter, includes all activities (personal, professional, or corporate), engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, without regard to physical presence in the State, but does not include casual sales.

(b) A person with no physical presence in the State is engaged in "business" in this State if the person has gross receipts attributable to this State of \$100,000 or more."

This amendment would clarify the operation of the definition of "business" and make clear how the \$100,000 gross receipts threshold is intended to operate.

Thank you for the opportunity to provide comments.

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# TAX FOUNDATION OF HAWAII

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**SUBJECT:** GENERAL EXCISE, Define Doing Business Without Physical Presence

**BILL NUMBER:** HB 345; SB 620 (Identical)

**INTRODUCED BY:** HB by SOUKI, MCKELVEY; SB by DELA CRUZ, KIDANI, Inouye, Nishihara, Wakai

**EXECUTIVE SUMMARY:** This measure is an attempt to adopt a form of “factor presence nexus,” namely a statement that substantial sales in a state constitute a sufficient connection between the state and the seller to enable that state to impose sales tax or use tax collection obligations. While the measure may be subject to constitutional challenge, it is in line with other states’ measures increasing pressure on remote sellers to collect and remit sales and use taxes owed on purchases by customers in the state.

**BRIEF SUMMARY:** Amends the definition of “business” or “engaging” in business in HRS section 237-2 to provide that it is to be applied without regard to having a physical presence, including the presence of a representative acting on behalf of the person in this State.

Exceptions are provided for casual sales (existing law); having a website on a third-party content provider on a computer physically located in this State; using a nonaffiliated third-party call center in Hawaii to accept and process orders; and activity, together with the person’s affiliates, aggregate less than \$100,000 of gross receipts in the prior calendar year.

**EFFECTIVE DATE:** July 1, 2017.

**STAFF COMMENTS:** The United States Constitution has been interpreted as providing two limits on the states’ powers to tax. These limits come from at least two places: first, the Due Process Clause, requiring a person to have “minimum contacts” with a state before that state is allowed to exercise police powers, including the power to tax, against that person; and second, the Commerce Clause, where the Supreme Court held in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), that if the Congress does not otherwise define the threshold for taxability, state tax may not be imposed upon a person unless there is “substantial nexus” with that person. Substantial nexus is more than minimum contacts, and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), appears to stand for the proposition that some physical presence is needed to establish substantial nexus.

In Hawaii, section 237-22(a) HRS, states that there shall be excepted or deducted from the values, gross proceeds of sales, or gross income so much thereof as, under the Constitution and laws of the United States, the state is prohibited from taxing, but only so long as and only to the extent that the state is so prohibited. *In re Grayco Land Escrow, Ltd.*, 57 Haw. 436, 559 P.2d 264, *cert. denied*, 433 U.S. 910 (1977), established that Hawaii already extends its general excise and use taxes to reach the limit of the Constitution (“Thus, in plain and unmistakable language,

the statute evidences the intention of the legislature to tax every form of business, subject to the taxing jurisdiction, not specifically exempted from its provisions.”).

This bill is, of course, trying to solve the problem, faced by all states that have enacted sales and use taxes, about collecting sales and use taxes on remote sellers. A seller with no physical presence in a customer’s state might see no obligation to collect and remit tax in the customer’s state. The customer would be liable for use tax, but tax departments throughout the country have met with little success in motivating such customers, especially those with small purchases, to pay use tax.

Nothing the legislature enacts will change the U.S. Constitution, and the bill may face constitutional challenge if enacted. Even so, the Multistate Tax Commission has recommended, and many states have enacted, “factor presence nexus” standards saying that nexus should be found when a taxpayer has a significant dollar amount of sales activity in the state, and these standards have motivated some of the larger remote sellers to agree to collect and remit sales and use taxes on that activity.

Digested 1/27/2017