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

Date: Wednesday, March 28, 2018
Time: 2:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2514, S.D. 1, Relating to Taxation

The Department of Taxation (Department) supports S.B. 2514, S.D. 1, and offers the following comments for the Committee's consideration.

S.B. 2514, S.D. 1, adds a new section in chapter 237 of the Hawaii Revised Statutes (HRS), which provides that a person is engaged in business in the State, whether or not the person has a physical presence in the State, if the person has gross income of \$100,000 or more in the State or 200 more transactions in the State in the current or preceding calendar year. The bill is effective upon approval and applies to tax years beginning after December 31, 2017.

The Department notes that this bill will clarify the circumstances under which a person will be considered to be engaged in business in the State and subject to the general excise tax.

The Department further notes that it will be able to administer the changes in this bill with the current effective date.

Thank you for the opportunity to provide testimony.



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-NINTH LEGISLATURE, 2018**

ON THE FOLLOWING MEASURE:

S.B. NO. 2514, S.D. 1, RELATING TO TAXATION.

BEFORE THE:

HOUSE COMMITTEE ON FINANCE

DATE: Wednesday, March 28, 2018 **TIME:** 2:00 p.m.

LOCATION: State Capitol, Room 308

TESTIFIER(S): Russell A. Suzuki, Acting Attorney General, or
Nathan S.C. Chee, Deputy Attorney General

Chair Luke 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 as introduced was to amend chapter 231, Hawaii Revised Statutes (HRS), by adding a new section that would make any person without a physical presence in the State that is selling tangible personal products or services to customers in this State subject to Title 14, HRS, specifically, the general excise tax if:

- (1) Gross proceeds of goods or services entering the State exceeds \$5,000; or
- (2) The total number of transactions involving goods or services entering the State is equal to or exceeds 200.

This bill has been amended to affect chapter 237, HRS, exclusively and raises the threshold amounts where persons without physical presence in the State will be subject to the general excise tax if gross proceeds of goods or services entering the State exceeds \$100,000. The threshold for the total number of transactions remains at 200.

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. It is unknown whether the tests under Quill will be applied to a general excise tax and whether the imposition of such a tax without a requirement of a physical presence in the state would ultimately be sustained under a Commerce Clause challenge. Furthermore, it may be important to note that the United States Supreme Court will be reevaluating the physical presence requirement under Quill when it reviews the arguments from South Dakota v. Wayfair Inc., 901 N.W.2d 754 (S.D. 2017), cert. granted, 2018 WL 386568 (U.S. Jan. 12, 2018) (No. 17-494), later this year.

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.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: GENERAL EXCISE, Sellers Without Physical Presence; Economic Nexus

BILL NUMBER: SB 2514 SD-1

INTRODUCED BY: Senate Committee on Ways & Means

EXECUTIVE SUMMARY: States that the seller with more than \$100,000 in in-state sales or 200 transactions into the state shall be deemed to be doing business in the state for purposes of the GET law.

SYNOPSIS: Adds a new section to chapter 231, HRS, providing that a person is engaging in business in the State, whether or not the person has a physical presence in the State, if in the current or immediately preceding calendar year: (1) the person's gross income or gross proceeds from the sale of tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State is \$100,000 or more; or (2) the person sold tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State in 200 or more separate transactions.

EFFECTIVE DATE: Applies to taxable years beginning after December 31, 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 exempted 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, “economic 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.

This bill adopts thresholds that are on par with those in other states, who in most cases have adopted thresholds for sales in the \$100,000 to \$250,000 range.

Digested 3/27/2018



**TESTIMONY OF TINA YAMAKI
PRESIDENT
RETAIL MERCHANTS OF HAWAII
March 28, 2018**

Re: SB 2514 SD1 Relating to Taxation

Good afternoon Chair Luke and members of the House Committee on Finance. I am Tina Yamaki, President of the Retail Merchants of Hawaii and I appreciate this opportunity to testify.

The Retail Merchants of Hawaii (RMH) is a statewide not-for-profit trade organization committed to supporting 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.

The Retail Merchants of Hawaii SUPPORTS SB 2514 SD1 Relating to Taxation. Our local brick and mortar stores are the economic backbones of our communities that provide employment and tax revenue to fund vital services throughout the State. Many of our retailers statewide are already operating on a thin margin, especially mom and pop stores. This measure would provide e-fairness by leveling the playing field for businesses in our community.

Currently under the existing state law, consumers are required to pay the General Excise Tax on the goods they purchase in the brick and mortar stores physically located in the state of Hawaii. However, if local consumers shop on line, sellers are not required to collect a tax in the same way our local businesses do. This puts our local retailers at a disadvantage as this effectively makes products purchased at brick-and-mortar stores more expensive than products purchased online.

Although news last year that Amazon will begin charging tax on Hawaii purchases was a step in the right direction, they are only charging a 1% tax and NOT the 4% on neighbor islands and 4.5% for Oahu customers that our local brick and mortar stores have to charge. Furthermore, third party sellers on Amazon do not charge the tax. There are so many more online retailers like QVC, Wayfair, Overstock, Ebay, Vista Print, Etsy and Shoe Dazzle to name a few that are also not collecting taxes. Because of this, Hawaii is missing out on millions of dollars on uncollected use tax from remote sales. And every year online sales has been increasing substantially.

We urge you to support SB 2514 SD1

Again mahalo for this opportunity to testify.