

STAND. COM. REP. NO.

210

Honolulu, Hawaii

FEB 19 2009

RE: S.B. No. 1678
S.D. 1

Honorable Colleen Hanabusa
President of the Senate
Twenty-Fifth State Legislature
Regular Session of 2009
State of Hawaii

Madam:

Your Committee on Economic Development and Technology, to which was referred S.B. No. 1678 entitled:

"A BILL FOR AN ACT RELATING TO TAXATION,"

begs leave to report as follows:

The purpose of this measure is to adopt changes to Hawaii's tax law that will allow Hawaii to participate in the Streamlined Sales and Use Tax Agreement.

Testimony in support of this measure was submitted by Hawaii Government Employees Association, Hawaii Association of Realtors, Retail Merchants of Hawaii, and the Democratic Party of Hawaii. Comments on this measure were submitted by the Department of Taxation. Written testimony presented to your Committee is available for review on the Legislature's website.

Your Committee finds that for Hawaii to participate in the Streamlined Sales and Use Tax Agreement, it is necessary for Hawaii to amend its tax law to be in conformance with the tax laws of the Streamlined Sales and Use Tax Agreement. The purpose of the Streamlined Sales and Use Tax project is to establish a streamlined sales and use tax collection system that is seamless for sellers in a global economy, while respecting the sovereignty of state borders. Hawaii's participation in the national Streamlined Sales and Use Tax Agreement will level the playing field between local, "bricks and mortar" retailers who pay their state general excise taxes and out-of-state retailers (primarily mail order and e-commerce merchants) who have not, up to this

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point, had to collect and remit the existing use tax on purchases by Hawaii residents.

Between 1967 and 1992, two Supreme Court cases (National Bella Hess case, 1967; and the Quill decision, 1992) prohibited states from requiring out-of-state sellers to collect sales taxes on purchases made by state residents, primarily because of the burdens on retailers of complying with forty-six different sales tax systems, and the monetary cost for retailers. However, in 2000, state officials, along with private sector/retail representatives, began developing a simpler, uniform, and fair system of sales and use taxation to accomplish four purposes:

- (1) Removing the burden on retailers;
- (2) Preserving state sovereignty;
- (3) Leveling the playing field for all retailers; and
- (4) Enhancing the ability of United States companies to compete in the global economy.

The urgency of state participation in the Streamlined Sales and Use Tax project has been heightened with the shift to a service-based economy, erosion of sales tax revenues due to e-commerce, and the current economic conditions. For example, an updated 2004 study entitled Sales and Local Tax Revenue Losses from E-Commerce, Estimates as of July 2004, conducted by Doctors Donald Bruce and William Fox of the Center for Business and Economic Research at the University of Tennessee estimated that, by 2008, the revenue loss for state and local governments would range between \$21,500,000,000 and \$33,700,000,000, with the greatest losses occurring in states that rely most heavily on the sales tax as a revenue source (emphasis added). Hawaii's estimated share of this loss ranged between \$86,000,000 and \$130,300,000 for 2008. However, Hawaii ranks seventh among all states in the United States, with its general excise tax (GET) collections accounting for 50.2% of all state tax collections. As a result, Hawaii is more vulnerable than most in terms of its heavy reliance on GET revenues for its tax base; its GET base is vulnerable to sharp fluctuations in visitor traffic to Hawaii - which can result in reduced retail, hospitality, restaurants, entertainment and related spending. This means that the proportional share of sales tax burdens borne by Hawaii's local



retailers and businesses is that much greater when compared against the use taxes not being collected by their competitors.

In less than six years, states participating in the Streamlined Sales and Use Tax project have worked, with the assistance of the private sector, to develop a new sales tax system that is fairer, simpler, more uniform and technologically proficient. Today, nineteen states (Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, and Wyoming) have already enacted legislation to become full members of the Streamlined Sales and Use Tax Agreement. Another three states (Ohio, Tennessee, and Utah) are currently associate members and are expected to be in full compliance with the Streamlined Sales and Use Tax Agreement by July 1, 2009. As of January 28, 2009, eleven states, including California, will consider conforming to the Streamlined Sales and Use Tax Agreement this year. Among the states in which 2009 compliance legislation has been introduced are Florida, Georgia, Hawaii, Illinois, Maryland, Massachusetts, Missouri, Texas, Virginia, and Wisconsin. In total, almost half of all the states with a sales tax have enacted legislation to comply with the changes required under the Streamlined Sales and Use Tax Agreement.

Since October 1, 2005, over 1,166 retailers have volunteered to begin collecting sales taxes for member states; and those states have collected over \$334,000,000 in previously-uncollected revenues for sales taxes on transactions involving out-of-state retailers. The voluntary collection process, however, is just the first step in providing Congress with the evidence that states working together have sufficiently streamlined their tax systems to require remote sellers to collect their sales taxes for them. In reviewing the listing of participating states and their experiences with voluntary collections, your Committee finds that Hawaii's reliance on its GET for over fifty per cent of annual tax collections would mean that the State's revenue losses would be more like those states with high percentages of sales tax collections for their revenue base, rather than population alone.

In 2008, the Streamlined Sales and Use Tax Governing Board and project supporters have made congressional action on the federal streamlined sales tax legislation a key strategic goal. United States Senator Daniel Inouye has joined as a co-sponsor of The Sales Tax Fairness and Simplification Act in the United States



Senate, S. 34; and United States Representative Neil Abercrombie has joined as a co-sponsor of the Sales Tax Fairness and Simplification Act, H.R. 3396. Your Committee notes that, with Hawaii's congressional leadership joining in the national effort to approve the state-initiated streamlined sales/use tax system, it is critical for Hawaii's policymakers to take the necessary steps to fine-tune Hawaii's general excise and use tax laws so they will meet the national mandate. With the election of President Obama in 2008, the National Conference of State Legislatures (NCSL) and its project supporters are seeking congressional action on the federal streamlined sales tax legislation to close the gap between falling tax revenues and state budgets. Your Committee therefore endorses this year's state streamlined sales tax compliance legislation to assure that every effort to collect outstanding Hawaii sales and use taxes is made before reducing critically-needed government services.

Your Committee has examined and rejected the concern regarding implementation costs raised by the Department of Taxation. This issue would have substantially more merit if it were the first time the concern was being raised, and the Legislature had not dealt with the issue before. However, streamlined sale tax compliance legislation has been introduced during each of the past four legislative sessions, with the 2005 legislation establishing a working group comprised of representatives of the Department of Taxation, House of Representatives, State Senate, and other private sector stakeholders.

Between 2006-2008, the Legislature supported legislation to assist the Department of Taxation in upgrading its tax software system (Integrated Tax Information Management System, or "ITIMS") to provide an effective means of long-term implementation of streamlined sales tax compliance at minimal cost. The Department's system upgrade efforts would, for the most part, have been funded through increased tax collections resulting from various software enhancements and improved collection capabilities. Unfortunately, legislation to upgrade the Department of Taxation's tax software system failed to pass in 2006-2007 - and when it did finally pass in 2008, it was vetoed. For the Department of Taxation to now raise the issue of 'implementation costs' is completely unjustified. Your Committee notes that in 2006, the Department of Taxation estimated implementation costs of \$15,370,055; in 2008, the Department projected costs of between \$5,900,000 and \$9,600,000 for two



alternative scenarios. In 2009, the Department of Taxation has estimated its costs would be about \$375,312 if it adopted a relatively simple, non-computer systems approach.

With respect to another concern raised by the Department of Taxation, specifically that the amount of voluntary collections would be minimal - or about \$1,000,000 to \$5,000,000 annually, your Committee believes that the Department's estimates are inaccurate. In the Auditor's 2006 study titled *Implications of the Streamlined Sales Tax Agreement for General Excise Tax Revenues* evaluated the benefits of the State of Hawaii's participation in the Streamlined Sales and Use Tax Agreement implementation, Dr. William Fox examined tax data for one year - 2005 - in concluding that Hawaii's participation in the national project was warranted. Dr. Fox further concluded that voluntary collections by out-of-state retailers would yield \$10,300,000 in additional tax revenues per year. More importantly, the Streamlined Sales Tax Governing Board is currently updating the study of Dr. Bruce and Dr. Fox, and anticipates receiving the updated analysis on lost tax revenues shortly. This means that, as the United States Congress and President Obama review the best means of assisting cash-strapped states, the Streamlined Sales Tax Project will have the most current data and analysis available for evaluation.

Your Committee has amended this measure by:

- (1) Switching the order of sections 8 and 9;
- (2) Amending the terms "charges for mobile telecommunications services" and "serving carrier" to have the same meanings as provided in section 239-22, Hawaii Revised Statutes;
- (3) Updating the purpose section; and
- (4) Making technical, nonsubstantive amendments for the purpose of clarity.

As affirmed by the record of votes of the members of your Committee on Economic Development and Technology that is attached to this report, your Committee is in accord with the intent and purpose of S.B. No. 1678, as amended herein, and recommends that it pass Second Reading in the form attached hereto as S.B.



No. 1678, S.D. 1, and be referred to the Committee on Ways and Means.

Respectfully submitted on
behalf of the members of the
Committee on Economic
Development and Technology,

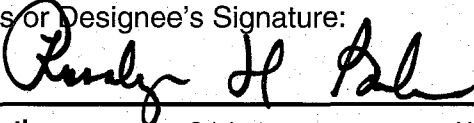


CAROL FUKUNAGA, Chair



The Senate
Twenty-Fifth Legislature
State of Hawaii

Record of Votes
Committee on Economic Development and Technology
EDT

Bill / Resolution No.:* SB167B	Committee Referral: EDT, WAM	Date: 2/6/09		
<input type="checkbox"/> The committee is reconsidering its previous decision on this measure. If so, then the previous decision was to: _____				
The Recommendation is: <input type="checkbox"/> Pass, unamended 2312 <input checked="" type="checkbox"/> Pass, with amendments 2311 <input type="checkbox"/> Hold 2310 <input type="checkbox"/> Recommit 2313				
Members	Aye	Aye (WR)	Nay	Excused
FUKUNAGA, Carol (C)	X			
BAKER, Rosalyn H. (VC)	X			
HEE, Clayton				X
IGE, David Y.	X			
SLOM, Sam			X	
TOTAL	3	-	1	1
Recommendation: <input checked="" type="checkbox"/> Adopted <input type="checkbox"/> Not Adopted				
Chair's or Designee's Signature: 				
Distribution: Original Yellow Pink Goldenrod File with Committee Report Clerk's Office Drafting Agency Committee File Copy				

*Only one measure per Record of Votes