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**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION
TESTIMONY REGARDING HB 1405 HD 2
RELATING TO TAXATION**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: MARCH 20, 2009

TIME: 1:15PM

ROOM: 016

This measure clarifies the definition of engaging in business for purposes of taxing sales of tangible personal property by out-of-state sellers if the person enters into an agreement with a resident of Hawaii who refer customers to the person for money.

The Department of Taxation (Department) **supports** this measure; however prefers the approach in HB 1586 because it is more comprehensive.

I. THIS MEASURE IS THE "AMAZON.COM" NEXUS STATUTE

The Department supports the intent of this measure, which seeks to clarify the business activities of persons from out-of-state who utilize in-state persons as a means of attracting customers. Under current constitutional authority, the use of an agent in-state for purposes of maintaining a market for an out-of-state business is sufficient nexus to tax the person's business activities in the State.

II. PREFERENCE FOR HB 1586

The Department supports clarifying the definition of engaging in business in light of recent state and local nexus developments. Though the Department supports this measure, it believes that the concept of HB 1586 is more comprehensive and applies to all tax types. This bill only applies to the general excise tax.

The Department's preferred alternative, which captures more activity based upon cases in other jurisdictions, as well as other tax types, is as follows—

"§231- Businesses domiciled out-of-state; nexus presumptions. (a) Notwithstanding any law to the contrary, a person or entity conducting business in this State that has its commercial domicile in another state is presumed to be systematically and regularly engaging in business in this State and taxable under title 14 if, during any year:

- (1) The person or entity engages in or solicits business with twenty or more persons within this State; or
- (2) The sum of the value of the person or entity's income, gross proceeds, gross rental, or gross rental proceeds attributable to sources in this State equals or exceeds \$100,000.

(b) Notwithstanding any requirement under title 14 that a person or entity assess and remit tax on a monthly basis, if a person is taxable in this State by reason of this section, the person or entity may petition the director of taxation to allow the assessment and remitting of tax on a basis other than monthly for good cause. For purposes of this section, good cause includes compliance with the Constitution of the United States and compliance with the Constitution of the State of Hawaii."

III. THIS BILL CLARIFIES THE NEXUS STANDARD IN LIGHT OF DEVELOPMENTS IN OTHER STATES FACING SIMILAR NEXUS ISSUES.

This legislation, in addition to the *Amazon.com* litigation in New York, proposes to assert a nexus standard similar to the *MBNA* and *Lanco* cases for Hawaii general excise taxes. Though the analysis in *Amazon.com* and *MBNA* and *Lanco* differ, they are similar in the sense that they modify the traditional notions of nexus as physical presence only. Where a sufficiently high number of customers or amount of revenue is generated from contacts in Hawaii, these businesses are rightfully taxable.

IV. THIS BILL LEVELS THE PLAYING FIELD.

One of the most important aspects of this legislation is that it levels the playing field for in-state businesses who must comply with Hawaii's state and local tax regimes. Without this legislation, it is possible for an out-of-state business to receive a favorable advantage over an in-state business selling the same items. This legislation would make the taxation for in-state and out-of-state businesses more fair.

V. REVENUE IMPACT

There are no hard data on the amendments proposed in this legislation. The Department estimates that this legislation could result in a revenue gain of \$4 million per year. Importantly, this legislation allows for the clarification of current law, a potential revenue increase, without raising taxes.



LEGISLATIVE INFORMATION SERVICES OF HAWAII

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March 20, 2009

Testimony to: Senate Committee on Economic Development & Technology
Senator Carol Fukunaga, Chair
Senator Rosalyn H. Baker, Vice Chair

By: Richard C. Botti, President

Re: HB 1405 RELATING TO THE GENERAL EXCISE TAX

Chairs & Committee Members:

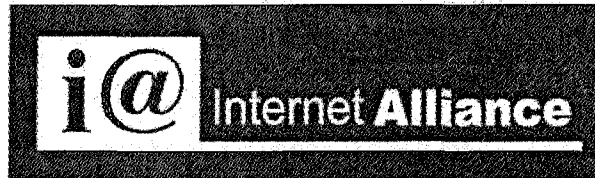
We oppose HB 1405, HD2 in its existing form.

The existing language of the bill may cost more money to implement than it will generate in positive revenues, because state auditors would be required to go to the Mainland to audit companies targeted, and those corporations would take one of two options. 1) stop selling to Hawaii because it is a pocket market that isn't worth dealing with in the big picture; 2) file a legal challenge against the state as they are doing in New York.

The bill is more of a disincentive than an incentive, and for this reason, we suggest the language in SB1678 SD1 relating to the Streamlined Sales Tax be inserted. This is a positive means of addressing the issue as it will establish a system that is seamless for sellers in a global economy.

We agree that something must be done, but it must be done in a cost effective manner as does the Streamlined Sales and Use Tax Agreement, and not in a manner that will create more conflicts, legal challenges, and disincentives.

Emily Hackett, Executive Director
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Web: www.internetalliance.org



March 18, 2009

Honorable Carol Fukunaga, Chair
Senate Economic Development and Technology Committee
Hawaii State Capitol, Room 216
415 South Beretania Street
Honolulu, HI 96813

Dear Senator Fukunaga:

My name is Emily Hackett, executive director of the Internet Alliance, the leading national Internet trade association operating in the states. My members include Amazon.com, AOL, AT&T, eHarmony, Expedia, Experian, Comcast, IAC, Match.com, TRUSTe, United Online, Overstock.com, Yahoo! and others.

The Internet Alliance opposes HB 1405, as this bill would subject Hawaii consumers to a unique tax collection scheme, build a wall around the state and inhibit commerce and communications with out of state business and consumers. The Internet Alliance and its member companies have worked with state officials across the country to break down artificial, unnecessary, and counterproductive barriers like this one.

There are several reasons to reject this bill:

It is unconstitutional. Not only is this attempt to redefine nexus poor tax policy, but it is clearly unconstitutional. The U.S. Supreme Court (see *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992)) has made plain that physical presence is necessary for states to compel companies to serve as tax collectors. This legislation would impermissibly attempt to require remote sellers with no physical presence in the state to collect and remit tax based on advertising dollars spent in Hawaii. A mere advertising relationship or making sales into the state – the basis of these proposals – does not constitute physical presence.

It will harm local businesses. This proposal strikes at the very heart of e-commerce. While it may not be intended, the nexus provisions contained in this bill will only discourage remote sellers from compensating a range of organizations, businesses and individuals for hosting advertisements in Hawaii. Inevitably it will be these entities that lose out as remote sellers move their marketing dollars elsewhere leaving the State without any additional revenue. Additionally, the technology sector in Hawaii would be negatively affected as remote sellers would reconsider using websites hosting services in Hawaii.

The bill is costly for the state. Hawaii will inevitably incur the cost of defending this unconstitutional law. Determining whether a remote seller “directly or indirectly” was able to obtain sales through a resident of Hawaii who assists in soliciting such sales is hardly a precise standard and

will likely result in protracted litigation. Lastly, resources spent by the Hawaii Department of Taxation in pursuing those subject to tax under these new provisions translates into lost opportunity costs in not having the Department seek the collection of tax from those the state can permissibly tax.

For all these reasons, the Internet Alliance urges you to reject HB 1405. Please contact me with questions, or if you would like to discuss this issue further.

Sincerely,

Emily Hackett

cc: Senate Economic Development Committee members



March 19, 2009

The Honorable Carol Fukunaga
Chair, Committee on
Economic Development and Technology
Hawaii State Senate
Hawaii State Capitol, Room 216
415 South Beretania Street
Honolulu, HI 96813

Re: Opposition to HB 1405

Dear Senator Fukunaga:

Amazon.com respectfully opposes HB 1405, which is unconstitutional and would not be an effective source of revenue.

The U.S. Supreme Court's *Quill* decision prohibits a state from requiring sales tax collection by sellers that lack physical presence in the state. HB 1405 is unconstitutional because it ultimately would require sellers with no physical presence in Hawaii to collect general excise tax merely on the basis of contracts with Hawaiian advertisers.

If HB 1405 were enacted, Amazon would have little choice but to end its advertising relationships with Hawaii-based participants in the Amazon "Associates Program." (Participants in the Associates Program place Amazon advertisements on their websites, and then are compensated by Amazon for purchases made by visitors whom they refer to Amazon's website.)

HB 1405 would provide no new tax revenue collected by Amazon or others who sever their relationships with Hawaii-based advertisers, and any revenue estimates should take this into account.

Hawaii instead could heed the direction of the Supreme Court, which said that out-of-state sellers may be required to collect only if states simplify and harmonize their sales tax laws. The well-established multistate Streamlined Sales Tax Project ("SSTP") is the legally-permissible path for states to follow.

Please let me know if you have any questions. I can be reached at pmisener@amazon.com.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Paul E. Misener". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Paul Misener
Vice President for Global Public Policy

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**THE SENATE
THE TWENTY-FIFTH LEGISLATURE
REGULAR SESSION OF 2009**

COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY

**Hearing March 20, 2009
Testimony on H.B. 1405 H.D. 2
(Relating to The General Excise Tax)**

Chairs Fukunaga, Vice-Chair Baker and members of the Committee:

I am an attorney specializing in tax law. I was also an Administrative Rules Specialist under Directors Kamikawa, Okamura and Kawafuchi. I am testifying as a taxpayer and concerned citizen.

I support this bill because:

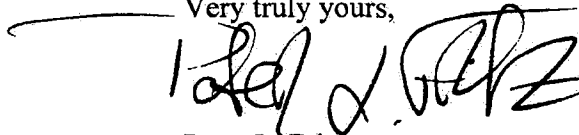
1. This bill modifies the definition of engaging in business for purposes of being required to pay General Excise Tax ("GET") by adding language that presumes that certain sellers of tangible personal property are vendors that are required to register for GET purposes and collect the state and local GET. The additional language presumes that a seller is engaging in business in Hawaii if the seller enters into agreements with Hawaii residents to refer customers to the seller.
2. Requiring an agreement between an out of state seller and a Hawaii resident who received payments for sales referrals creates the presence required to create the nexus that is necessary to requiring these sellers to collect GET.
3. It will put local sellers on the same footing as these out of state merchants.
4. It is fair to the citizens of Hawaii because it will mean that taxpayers who purchase from local business will no longer have to bear the full tax burden. GET will be collected on purchases from out of state sellers, who have an agreement to pay an instate agent for sales referrals.
5. A disadvantage of this bill is that some out of state sellers will terminate their agreements with their instate agents.
6. Another disadvantage is that it is more likely than not that out of state vendors will challenge the constitutionality the law. However, even if the law is declared

Peter L. Fritz
Testimony H.B. 1405 H.D. 2
March 20, 2009
Page 2

unconstitutional, Hawaii may be able to claim any collected taxes because the amount collected is the amount that would be owed by the purchaser under Chapter 237, Hawaii Revised Statute. Alternatively, Hawaii should be able to obtain the names of the purchasers and from the out of state vendor and send assessments to Hawaii residents.

Thank you for the opportunity to testify.

Very truly yours,



Peter L. Fritz



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March 20, 2009

Senator Carol Fukunaga
Chair, Senate Economic Development and Technology Committee
Hawaii State Capitol
Room 216
415 South Beretania Street
Honolulu, HI 96813

Dear Senator Fukunaga:

Respectfully, I am writing to express Direct Marketing Association's opposition to H.B. 1405, which seeks to extend general excise and/or use tax collection obligations to retailers located outside the State of Hawaii who have no physical presence in the state. DMA is the largest trade association for companies engaged in direct marketing to consumers and businesses via catalogs and the Internet. Founded in 1917, DMA today has over 3,600 member companies. H.B. No 1405 would amend the definition "engaging" under Section 237-2 of the Hawaii Revised Statutes to reach any out-of-state retailer whose website is commercially "linked" with the website of a Hawaii resident.

The scope of this legislative proposal is extraordinarily broad. For example, under this bill, if a Hawaii conservation group or youth organization placed a link on its website that enables members to make purchases from an out-of-state mail order or Internet company at a discount, and the Hawaii organization receives some form of consideration for agreeing to the link on its website, on those facts alone, the remote seller would be deemed to be "engaging in business" in Hawaii with all of the tax obligations associated with that status. This is an expansion of the Hawaii tax system across state borders to businesses that have no physical presence in the state. Such an aggressive expansion of tax jurisdiction should be rejected by the Legislature for the following reasons:

- The expanded definition of "engaging in business" is an attempted end-run around the Commerce Clause of the United States Constitution (Art. I, § 8, cl. 3), as it has been consistently interpreted and applied by the United States Supreme Court;
- The proposal is bad tax policy and will invite retaliatory legislation by other states;
- The legislation would be detrimental to Hawaii's economy and to its leadership in the field of electronic commerce.

The Direct Marketing Association's concerns are explained in greater detail below.

The Legislation Would Violate The Commerce Clause of the United States Constitution

The United States Supreme Court has been consistent, and unwavering, in holding that a state cannot impose sales/use tax collection obligations on out-of-state vendors unless those retailers have a

“physical presence” in the taxing state. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); (“Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence of a small sales force, plant or office”) *See also National Bellas Hess v. Dep’t of Revenue*, 386 U.S. 753 (1967). In both of these decisions, the United States Supreme Court explained that the furthest permissible extension of a state’s taxing power over an out-of-state retailer was set forth in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). In that case, the taxpayer retained ten wholesalers, jobbers and salesmen who directly and continuously conducted in-state solicitation of customers and physically took orders from buyers within the taxing state. The Court found that such feet-on-the-street sales activity was sufficient to constitute the requisite “physical presence” to establish constitutional “nexus.” The facts in that landmark case were certainly far different from the situation involving the mere presence of an electronic link between two websites.

The Proposed Legislation Is Bad Tax Policy

There are over 7,000 sales and use tax jurisdictions in the United States, with varying tax rates, taxable products, exempt transactions, filing requirements, audit arrangements and appeal procedures. The Supreme Court’s Commerce Clause jurisprudence is intended to give substantive meaning to the jurisdictional boundaries that allow the American federal system of government to accommodate the exercise of state sovereignty, including in the area of taxation. Clearly, each state is sovereign in regard to the tax obligations of persons and businesses within its territory, but that authority does not extend beyond a state’s boundaries.

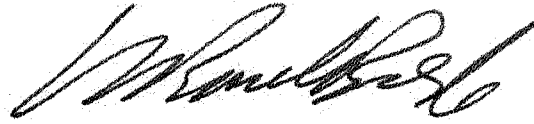
Federalism does not work efficiently, or fairly, when a legislature attempts to export its tax laws across state borders. A system in which 50 state governments, and thousands of localities, impose their myriad sales/use tax regimes on businesses in each of the other 49 states would be chaotic, both as a matter of tax administration and business compliance. If the Hawaii Department of Taxation were empowered to impose new burdens on businesses in distant states, it is inevitable that similar legislation would be enacted by other state legislatures (whose businesses would be adversely affected by the Hawaii law), and their state revenue departments will attempt to exert similar authority over Hawaii companies. Indeed, similar proposals are now pending in a handful of other states. The end result will be nothing less than a crazy quilt of non-uniform tax laws and compliance obligations that will further stagnate the consumer sector of the national economy and aggravate an already grossly inefficient system of multi-state tax administration. In addition, the new tax obligations on consumer transactions will be confusing to, and burdensome on, Hawaii residents.

Hanging Out The “Unwelcome” Sign To Electronic Commerce

It is beyond question that state tax policies greatly influence business decisions. Hawaii has benefited from the free flow of goods across state borders, as well as from the recognition the state has received as a strategic location for reaching out into Asian markets. The proposed nexus-expanding tax legislation, however, would carry a very different message. It would issue a warning to companies throughout the United States to beware of any connection with businesses and organizations located in Hawaii, because those relationships might be used as a pretext to impose new tax obligations on remote sellers, despite the absence of any physical facilities or personnel within the state. The inevitable effect of such a law will be that direct marketing companies will choose, if possible, not to associate with businesses located in Hawaii, but, instead, re-direct their relationships to companies located in other states. Such a development is a lose-lose proposition. It produces no new tax revenue for Hawaii, while, at the same time, directly harming Hawaii’s economy in the midst of the current recession.

DMA appreciates the opportunity to comment on H.B. 1405, and on behalf of its members, respectfully urges you to not advance this tax proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Ron Barnes". The signature is fluid and cursive, with the first name "Ron" being more prominent than the last name "Barnes".

Ron Barnes
Vice President, State Affairs

cc: Members of the Senate Commerce and Consumer Protection Committee