

STAND. COM. REP. NO.

2483

Honolulu, Hawaii

FEB 15 2008

RE: S.B. No. 2829
S.D. 1

Honorable Colleen Hanabusa
President of the Senate
Twenty-Fourth State Legislature
Regular Session of 2008
State of Hawaii

Madam:

Your Committee on Economic Development and Taxation, to which was referred S.B. No. 2829 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 the Hawaii Association of Realtors, the Hawaii Government Employees Association, the Retail Merchants of Hawaii, and Hawaii State Teachers Association. Comments on this measure were submitted by the Department of Taxation and the Tax Foundation of Hawaii.

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



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 and erosion of sales tax revenues due to e-commerce. For example, a study conducted by the Center for Business and Economic Research at the University of Tennessee in 2003 estimated that, by 2008, the revenue loss for state and local governments could be as high as \$33,600,000,000. Hawaii's estimated share of this loss for 2008 was estimated at \$130,300,000 for e-commerce losses, and \$245,500,000 for all remote sales. 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, twenty-two states – almost half of all the states with a sales tax – have enacted legislation to comply with the changes, and the system is working. By April 2008, twenty of those states (Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota,



Oklahoma, Rhode Island, South Dakota, Vermont, West Virginia, Arkansas, Nevada, Tennessee, Washington and Wyoming) will be in full compliance with the Streamlined Sales and Use Tax Agreement.

During December 2007, the Streamlined Sales and Use Tax Governing Board adopted amendments to allow origin-based sourcing (as opposed to destination-based sourcing) for intrastate transactions to help large states like Arizona, California, Illinois, Missouri, New Mexico, Texas and Virginia obtain greater flexibility in adopting the Streamlined Sales and Use Tax Agreement.

Since October 1, 2005, over 1,100 retailers have volunteered to begin collecting sales taxes for member states; and those states have collected over \$125,000,000 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 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.

Accordingly, it is the intent of your Committee to support this measure to participate in the Streamlined Sales and Use Tax Agreement.

Your Committee received a 2006 estimated cost statement from the Department of Taxation that detailed the startup, implementation, and operating costs for the Department's administration of the Streamlined Sales Tax Project during the first year. The statement concluded that the total costs for the first year would be \$15,370,055. Their methodology is as follows:



One-time estimated costs for the first year are Integrated Tax Information Management System modification and implementation of \$4,990,000, hardware and software costs of \$2,100,000, operational support and project management of \$1,115,000, operations infrastructure of \$2,220,000, overtime staffing and leasehold improvement of \$747,926, for a total one-time startup, implementation, and operating costs of \$11,172,926. Your Committee notes that some of these cost estimates include features that have been paid for, such as the Department of Taxation's implementation of collections of the one-half of one per cent county surcharge in 2007.

Annual recurring costs are estimated to include staffing requirements of \$2,089,629, project management of \$350,000, hardware and software maintenance of \$1,063,500, office space rental of \$594,000, office janitorial of \$26,400, operational costs of \$44,000, and travel of \$29,600, for total annual recurring costs of \$4,197,129. Your Committee notes that these ongoing costs may also include staffing or resources costs that were appropriated to the Department of Taxation in 2007.

Thus, your Committee finds that the Department of Taxation's estimated costs to implement the Streamlined Sales Tax Project of \$15,370,055 must be adjusted to reflect additional staffing or resources, and program activity costs undertaken in 2007. Projected costs of implementation that involve modification to the Department of Taxation's Integrated Tax Information Management Systems software system may also be addressed in Senate Bill No. 3115, which authorizes the Department of Taxation to implement a benefits-funded Integrated Tax Information Management Systems software upgrade.

Your Committee has amended this measure by 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 Taxation that is attached to this report, your Committee is in accord with the intent and purpose of S.B. No. 2829, as amended herein, and recommends that it pass Second Reading in the form attached hereto as S.B. No. 2829, 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 Taxation,



CAROL FUKUNAGA, Chair



