

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING SB 2391 RELATING TO GENERAL EXCISE TAX

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

DATE: JANUARY 29, 2008

TIME: 1:15PM

ROOM: 224

This legislation exempts from the general excise tax, commissions earned by a manufacturer's representative received from the direct purchase of imported tangible personal property by a manufacturer's customer.

The Department of Taxation (Department) **has concerns** with this legislation and cites its revenue estimate.

I. NARROW EXEMPTIONS TO THE GENERAL EXCISE TAX (GET) ERODES ITS EFFECTIVENESS.

The Department's primary concern with this legislation is that it provides a narrow exemption for gross proceeds received by a commission agent, which is typically taxed at the 4% rate for the privilege of doing business in Hawaii.

The GET is a privilege tax, the success of which as a stream of consistent revenue is due in large part to the fact that it taxes a broad array of transactions and therefore taxpayers enjoy a relatively low rate. The GET is assessed at varying rates for wholesale, retail, and other transactions. This exemption is simply another move toward eroding the effectiveness of the tax by exempting additional common transactions that constitute one sale.

Effectively, this legislation exempts salespersons doing business in Hawaii that arrange sales of imports. This exemption could place salespersons for out-of-state manufacturers on an unequal footing as those that are salespersons for local companies.

II. CONCERN REGARDING REVENUE ESTIMATE

The Department is also concerned with this legislation's revenue estimate. There are numerous salespersons in Hawaii that could enjoy this exemption. This bill will result in revenue loss of approximately as follows:

- FY2009 (loss): \$2.2 million
- FY2010 (loss): \$2.3 million

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Exempt commissions of manufacturer's representative

BILL NUMBER: SB 2391

INTRODUCED BY: Fukunaga

BRIEF SUMMARY: Adds a new paragraph (13) to HRS section 237-24.3 to exempt from the general excise tax, the commissions earned by a manufacturer's representative on the direct purchase of imported tangible personal property from a manufacturer by a customer.

Makes conforming amendments to HRS section 237-13.

The amendment made by this measure shall remain in force when this section is reenacted on December 31, 2009 pursuant to Act 239, SLH 2007.

EFFECTIVE DATE: Tax years beginning after December 31, 2007

STAFF COMMENTS: The general excise tax exemption proposed by this measure would grant preferential treatment to a very specific group of taxpayers, manufacturers' representatives who receive commissions on purchases of imported tangible personal property from a manufacturer by a customer.

The treatment of commissions received by a manufacturer's representative varies depending on whether the representative is the sole representative of the commissioned taxpayer. If this is the case, then the representative becomes an "employee" of the manufacturer which results in the manufacturer gaining nexus in the state. Thus, the goods imported for sale to the client place a use tax burden on the manufacturer because the manufacturer now has presence in the state. Whether or not this is the result the manufacturer desires it is indeed the outcome of this proposal as the commission would then be treated as salary to the commissioned agent as the representative is then considered an employee of the manufacturer. On the other hand, the current treatment of imposing the general excise tax on the commission of the representative infers that the manufacturer has no presence in the state and the commission of the representative is treated as a straight commission subject to the full retail rate of 4%.

Before serious consideration is given to this proposal, clarification should be sought on just how the commission agent is to be characterized and recognized for the purposes of determining if the manufacturer has nexus in the state.

As drafted, this measure would grant preferential treatment to a select group of taxpayers and, no doubt, would lead to requests from other similarly situated taxpayers. If it is the intent of the legislature to grant such preferential treatment to these taxpayers, then consideration should be given to maintain horizontal equity by extending similar tax treatment to all those who receive commissions.

Digested 1/25/08