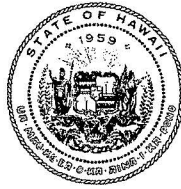


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GOVERNOR

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**HOUSE COMMITTEE ON FINANCE  
TESTIMONY REGARDING HB 1405 HD 1  
RELATING TO TAXATION**

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

**DATE: FEBRUARY 26, 2009**

**TIME: 10:00AM**

**ROOM: 308**

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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 for money who refer customers to the person.

The House Committee on Economic Revitalization, Business & Military Affairs amended the measure by deleting any reference to services.

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.

**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 all Hawaii 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.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Engaging in business

BILL NUMBER: HB 1405, HD-1

INTRODUCED BY: House Committee on Economic Revitalization, Business & Military Affairs

**BRIEF SUMMARY:** Amends HRS section 237-2 to provide that the sale of tangible personal property by a person soliciting business through an independent contractor or representative if the person enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, refers potential customers to the person, whether by a link on an internet website or otherwise, and if the cumulative gross receipts from sales by the person to customers in the state who are referred to the person by such a resident are in excess of \$10,000 during the preceding four quarterly periods ending on the last day of February, May, August, and November, shall be taxable under the general excise tax.

This presumption may be rebutted by proof that the resident with whom the person has an agreement did not engage in any solicitation in the state on behalf of the person that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question.

Directs the state tax department to adopt rules interpreting and providing guidance for this section.

EFFECTIVE DATE: July 1, 2009

**STAFF COMMENTS:** This measure proposes that the sale of products by an out-of-state person in excess of \$10,000 during the four quarterly periods ending on the last day of February, May, August, and November shall be subject to the general excise tax if the sales were due to referrals by a Hawaii resident. It appears that this measure is proposed to impose the general excise tax on the person out-of-state who is selling the products to Hawaii residents.

This approach to collecting the general excise tax on out-of-state purchases deserves serious consideration as an alternative to the proposed "streamlined sales tax" project which places the onus of burden on the manufacturer to collect the tax from the consumer. It is plausible that the department could audit the records of the commissioned agent making the referral to the out-of-state seller of the goods, determine the amount of sales made to consumers in the state by backing out the commission income based on the percentage agreed upon by the agent and the seller of the goods. Then the state could go after the out-of-state person arguing that because the seller employed a commissioned agent in the state, the seller gained nexus in the state and, therefore, becomes subject to the general excise tax. This proposal would at least address a portion of the untaxed sales made to customers in the state and deserves further consideration. While the draft of the measure has limited the application of the bill to only goods, it should be remembered that the general excise tax is also applied to services purchased by in-state Hawaii residents and should also be addressed by this measure.

Reference to quarterly periods ending on the last day of February, May, August, and November, begs the question of why these months?

Digested 2/24/09

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**THE HOUSE OF REPRESENTATIVES  
THE TWENTY-FIFTH LEGISLATURE  
REGULAR SESSION OF 2009**

**COMMITTEE ON FINANCE**

**Hearing February 26, 2009  
Testimony on H.B. 1405, HD1  
(Relating to The General Excise Tax)**

Chairs Oshiro, Vice-Chair Lee and members of the Committee:

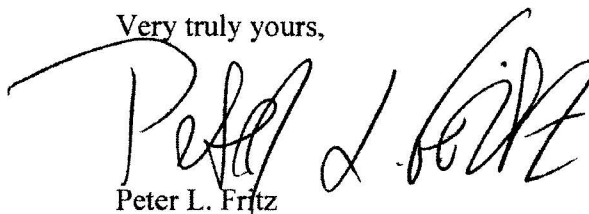
My name is Peter Fritz. I am an attorney specializing in tax law. I was also an Administrative Rules Specialist under Directors Kamikawa, Okamura and Kawafuchi. I am testifying as a taxpayer and concerned citizen.

I support this bill because:

1. This bill adds to the definition of engaging in business for purposes of being required to pay General Excise Tax ("GET") and presumes that certain sellers of tangible personal property or services are sales tax vendors that are required to register for sales tax purposes and collect state and local sales taxes. Under the law, a seller is presumed to be a vendor 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 on these puts local sellers on the same footing as these out of state merchants.
4. If the law is declared unconstitutional, it is more likely than not that the State will not have to return any taxes because the amount collected will be equal to the amount that the Hawaii resident would have to pay under Chapter 238, Hawaii Revised Statutes.

Thank you for the opportunity to testify.

Very truly yours,



Peter L. Fritz