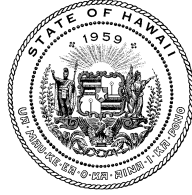


LINDA LINGLE
GOVERNOR

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 & TECHNOLOGY

TESTIMONY REGARDING SB 1678 RELATING TO TAXATION

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

DATE: FEBRUARY 6, 2009

TIME: 1:15PM

ROOM: 016

The intent of this bill is to conform Hawaii law to the requirements of the Streamlined Sales and Use Tax Agreement ("SSUTA"). The Streamlined Sales and Use Tax Agreement is a method developed by the states and businesses primarily to have internet and catalogue sellers voluntarily collect the sales and use tax from consumers on behalf of the States for those sellers who did not have nexus with the state. Currently, people who buy from catalogues and the internet are supposed to pay use tax on their purchases, however in practice, few do.¹ This bill would provide a *voluntary* mechanism for internet and catalog sellers to collect this tax from the consumers and pass it on to the Department, thereby resulting in a net revenue gain to the State.

The Department of Taxation ("Department") **provides comments** on this bill; however has **strong concerns regarding implementation costs** with the current fiscal restrictions. The Department also **proposes an alternative mechanism to capture the same revenue more effectively and efficiently.**

To be sure, this bill is not without its benefits. Given the state's current reduced projected tax collections, this measure may assist with generating additional tax revenue. However, costs are a large concern. The Department will set forth several benefits of this legislation for this Committee to consider. However, the Department also has certain concerns and issues that will be presented to the committee.

I. CONCERN OVER THIS LEGISLATION IN A SLOWING ECONOMY

Initially, the Department points out that it is a well-settled principle of economics that

¹ However, businesses generally comply with the use tax more than individuals.

when an economy is slowing, increasing taxes is strongly discouraged because people are already struggling to make ends meet financially. During economic slowing, economics suggests that money should remain with the people and in the economy in order to boost economic performance. The Department cautions further consideration of this legislation during a slowing economy based upon these economic concepts.

II. BENEFITS OF THE STREAMLINED SALES & USE TAX PROJECT.

The Streamlined Sales & Use Tax Project may provide benefits to Hawaii, including:

1. **Increased Revenue to the General Fund.** It is undetermined at this time exactly how much additional revenue Hawaii may stand to gain from this bill. The Department concedes that a revenue gain is likely, however, the Department is concerned that past projections have significantly overestimated this potential gain.
2. **Level the Playing Field.** Adopting this legislation will effectively bring equity to local retailers that lose business to internet or mail-order commerce. By purchasing goods on the internet, for example, local purchasers can realize a minor tax benefit by purchasing out-of-state. Each sale out-of-state is a lost sale in Hawaii, thus impacting local businesses.

II. CONCERNS REGARDING IMPLEMENTATION OF SSUTA IN HAWAII.

1. **Adds Complexity.** Because Hawaii has a general excise tax imposed on the seller rather than a sales tax, which is imposed on the buyer, the provisions of the SSUTA do not fit neatly into Hawaii's general excise tax regime. Therefore, the SSUTA provisions need to be modified to take Hawaii's different tax structure into account.

In addition, to comply with the SSUTA's requirement that the State and each local taxing jurisdiction have only one rate, except in certain circumstances not applicable in Hawaii, the different tax rates applicable under Hawaii general excise tax law need to be removed from the general excise tax chapter and shifted into another taxing chapter. The creation of three new chapters also adds complexity to Hawaii's tax law and may prove to be another source of confusion to taxpayers.

In addition, whether the approach taken in the bill would be considered a "replacement tax" is an issue. It is also unclear at this time whether replacement taxes are permitted under the SSUTA.

2. **Provides Amnesty.** The SSUTA requires the State to provide amnesty to out-of-state sellers that may or may not have nexus with the State. The State will be giving up its right to pursue these sellers for general excise tax on their operations in the State.
3. **Vendor Compensation.** The SSUTA requires the State to compensate out-of-state

vendors who voluntarily participate in the SSUTA for collecting the Hawaii tax. However, in-state businesses that are obligated to pay the Hawaii tax are not compensated for collecting and paying the tax.

4. **Voluntary.** Currently, participation by sellers pursuant to the SSUTA is voluntary. While hundreds of companies have agreed to participate, Amazon.com and eBay have indicated that they will not participate at this time. Therefore, it is unclear how much potential revenue will be generated for Hawaii by participating in SSUTA. Federal legislation could also change this.
5. **"Home Rule" Concerns.** Participation in SSUTA requires the State to annually certify to the national governing board that the state's laws are in compliance with SSUTA. Therefore, **any tax law changes in the future must meet the requirements of SSUTA** in order for the State to continue to comply with SSUTA. Therefore, **the State is limiting its ability to adopt legislation in favor of decisions made by a national governing board regarding a state's tax law.**

In addition, now that the City and County of Honolulu has enacted the county surcharge, the City and County of Honolulu must be bound to follow the SSUTA with respect to the surcharge.

6. **Appropriations.** The Department will need an appropriation to implement the SSUTA compliance, which, among other things, requires the development of a database of zip codes and tax rates. The Department is currently working on developing an accurate and comprehensive cost estimate for implementing this legislation. The complexity associated with updating the Department's current tax collection systems and the required labor and incidental costs require further analysis. The resource cost has not been factored into the budget and will provide additional stress on budgeting and the financial plan this legislative session.
7. **Further Study.** The Department believes that further study is warranted on this issue. The general excise tax is a major revenue source for the State and any substantial revisions, such as those contained in this bill, should only be enacted after a thorough and thoughtful analysis can be done. In addition, time would also enable the Department to learn from other states' experiences with the SSUTA. Other states did not actually begin implementing SSUTA until late 2005. On this date, nineteen states² have become full members of SSUTA and begun implementing SSUTA. If the State waits, it could learn from the problems the other states' experience. Some states remain cautiously guarded about implementing the SSUTA. For example, New York issued a report that cautioned joining the project because it was unclear whether the project would yield net benefits to taxpayers and local businesses. Again, further study of these paramount issues is

² The full member states are Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Oklahoma, Rhode Island, South Dakota, Vermont, Washington, West Virginia, Wyoming.

advised.

III. GENERAL COMMENTS.

Delayed Effective Date—The delayed effective date of the bill is appreciated, but the delay may not be long enough to allow these changes to be fully integrated into the computer systems of the Department. A longer delayed effective date would give time for practitioners and businesses to adjust to these changes. When the corporate statutes were substantially revised, the effective date was delayed one year to allow professional associations, businesses, and practitioners sufficient time to analyze the changes in the law, prepare conferences, or other industry analysis. Given the challenges the Department would face integrating such large, wholesale changes into its operations, longer than two years may be more realistic of a time frame. The delayed effective date would also provide time to obtain approval from the National SSTP Governing Board to assure that Hawaii's amendments conform to the SSUTA. This is very important since Hawaii's general excise tax is not a sales tax.

Frequent Changes to the SSUTA Will Require Legislative Action. The legislature needs to be aware that the SSUTA is not a static document. It has undergone substantial and frequent changes since it was adopted on November 12, 2002. It has been amended 14 times.³ It has been amended 10 times since the SSUTA became effective on October 3, 2005. Each change requires member States to amend its law in order to remain in conformity with the SSUTA. The debate at the Governing Board meetings currently includes allowing intra-state origin based taxes, the extension of associate member status beyond the original deadline, and very relevant to this bill, the issue of using "replacement taxes" by States to circumvent the provisions of the SSUTA, such as New Jersey's fur tax.⁴

IV. REVENUE IMPACT & START UP COSTS

Joining the SSUTA would entail start-up costs of several million dollars in the first year and annual ongoing costs. The Department is still working on figuring the costs.

In a study produced for the State's Auditor in April 2006, Dr. William Fox estimated that joining the SSUTA would provide Hawaii with less than \$10 million in additional GET revenues annually. He reaffirmed his estimate in 2007. The Department projects that joining SSUTA would yield between \$1-\$5 million in additional revenue. However, should Congress pass legislation allowing states to assess GET and use tax notwithstanding the *Quill* Supreme Court case, such congressional action could result in additional GET revenues of approximately \$25 million annually.

³ November 19, 2003, November 16, 2004, April 16, 2005, October 1, 2005, January 13, 2006, April 18, 2006, August 30, 2006, December 14, 2006, June 23, 2007, September 20, 2007, December 12, 2007, April 2, 2008, June 18, 2008, and September 5, 2008.

⁴ As of January 1, 2009, New Jersey repealed its fur tax, delaying resolution of the replacement tax issue.

The exemption for blind, deaf, and disabled taxpayers would cost about \$500,000 annually.

V. POTENTIAL ALTERNATIVE TO COLLECT USE TAX

In the interest of shoring up revenue collections without implementing a tax increase, the Department suggests that, in lieu of SSTEP, the Legislature consider enacting a use tax amnesty provision in the income tax law that would require taxpayers to answer on their income tax return whether they imported internet or other tax-free purchases into Hawaii.

If the taxpayer answers "YES" on the return, they could be given the opportunity to insert the actual amount of tax owed, or as is more likely the case, where taxpayers do not have records, the legislation could provide for a use tax amnesty/settlement amount based upon adjusted gross income or other measurement that could be added to the income tax return as tax owed. In short, the legislation could utilize the income tax return, which nearly all Hawaii residents file, as a means of educating taxpayers of the use tax liability, giving them the simple means of payment through the income tax regime, and where records do not exist, the legislation could provide an amnesty amount (*i.e.*, a \$10 amnesty is equal to approximately \$250 in imported purchases). Therefore, for example, in exchange for a \$10 payment on their income tax return, a taxpayer would be treated as having satisfied their use tax liability for the year. Exceptions could be provided if the taxpayer purchased items subject to the use tax with a large cost, such as cars, boats, and jewelry. All of this revenue would be additional revenue to the general fund without all of the costs that are required with the SSUTA.



Senator Carol Fukunaga, Chair
Senator Rosalyn Baker, Vice Chair
Committee on Economic Development and Technology
State Capitol, Honolulu, Hawaii 96813

HEARING Friday, February 06, 2009
 1:15 pm
 Conference Room 016

RE: SB1678, Relating to Taxation

Chair Fukunaga, Vice Chair Baker, and Members of the Committee:

Retail Merchants of Hawaii (RMH) is a not-for-profit trade organization representing about 200 members and over 2,000 storefronts, and is committed to support the retail industry and business in general in Hawaii.

RMH supports SB1678, which adopts amendments to Hawaii's tax laws to implement Streamlined Sales and Use Tax Agreement.

Through our affiliation with the National Retail Federation, the world's largest retail trade association, and a major participant in the Streamlined Sales Tax Project, RMH has watched the development and progress of this program over the past eight years and has supported Hawaii's initiatives to participate in the multi-state discussions. As electronic commerce increased dramatically in recent years, traditional brick and mortar retailers, which are required by law to collect taxes for government, have experienced an erosion of their sales base to remote sellers, which, under most circumstances, are not subject to tax mandates. The Streamlined Sales and Use Tax Project will level the playing field.

Retailers nationally are encouraged that current initiatives in Congress hold greater promise to ameliorate this unfair situation, and there is consensus that federal legislation will be enacted soon. HB735 makes the necessary amendments to Hawaii tax laws to facilitate our compliance.

We respectfully request that you pass SB1678. Thank you for your consideration and for the opportunity to comment on this measure.

A handwritten signature in cursive script, appearing to read 'Carol Prejill'.

President

February 4, 2009

The Honorable Carol Fukunaga, Chair
Senate Committee on Economic Development
and Technology
State Capitol, Room 016
Honolulu, Hawaii 96813

RE: S.B. 1678 Relating to Taxation

HEARING DATE: Friday, February 6, 2009 at 1:15 p.m.

Aloha Chair Fukunaga and Members of the Committee on Economic Development and Technology:

On behalf of our 9,600 members in Hawai'i, the Hawai'i Association of REALTORS® (HAR) **supports** S.B. 1678, which adopts amendments to Hawai'i tax laws to implement the streamlined sales and use tax agreement.

The Report of the 2001-2003 Tax Review Commission states that Hawai'i would potentially achieve not only the benefit of better definitions, uniformity, and certainty, but also increase tax compliance by interstate vendors (primarily mail order and e-commerce merchants) who agree to pay state taxes under the Streamlined Sales Tax Project. The Report goes on to state that because of Hawai'i's uniquely broad-based General Excise and Use Tax system, by joining the Streamlined Sales Tax Project, Hawai'i may be able to better maintain the viability of its broad revenue base.

The Report of the 2005-2007 Tax Review Commission, however, states that while the Commission believes that the goal of coordinating the collection of taxes on interstate sales, such as via the internet, is desirable, and that Hawai'i should remain involved in discussions on the Streamlined Sales Tax Project, the Commission did not think that Hawai'i should make a formal commitment yet.

HAR believes that the delayed effective date contained in Section 35 of S.B. 1678 should help alleviate the concerns of the 2005-2007 Tax Review Commission, and that S.B. 1678 should eventually level the playing field for local merchants who must deal with the high cost of doing business in Hawai'i and still compete with mail order and e-commerce merchants from outside of the State.

HAR looks forward to working with our state lawmakers in building better communities by supporting quality growth, seeking sustainable economies and housing opportunities, embracing the cultural and environmental qualities we cherish, and protecting the rights of property owners.

Mahalo for the opportunity to testify.