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**WRITTEN TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-SIXTH LEGISLATURE, 2011**

ON THE FOLLOWING MEASURE:

S.B. NO. 755, S.D. 1, RELATING TO ECONOMIC DEVELOPMENT.

BEFORE THE:

SENATE COMMITTEE ON WAYS AND MEANS

DATE: Tuesday, March 1, 2011 TIME: 9:20 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): WRITTEN TESTIMONY ONLY.

(For more information, contact Mary Bahng Yokota,
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Chair Ige and Members of the Committee:

This bill provides for an annual exemption from general excise tax on retail sales of certain school items, creating an annual general excise tax holiday.

The Department of the Attorney General has the following comment on this bill. It may be challenged that this bill facially violates the Commerce Clause of the United States Constitution ("Commerce Clause"). To avoid confusion and unnecessary litigation, we nonetheless recommend that the bill be amended so it is not facially discriminatory under the Commerce Clause.

The United States Supreme Court recognized that although the Commerce Clause is phrased merely as a grant of authority to Congress to "regulate Commerce . . . among the several States," article I, section 8, cl. 3, it is well established that the Commerce Clause also embodies a negative command forbidding the states to discriminate against interstate trade. Associated Industries v. Lohman, 511 U.S. 641, 646, 114 S. Ct. 1815, 1820 (1994). The Commerce Clause prohibits regulatory measures designed to benefit in-state economic interests by burdening

out-of-state competitors. Id. at 647, 114 S.Ct. at 1820 *citing New Energy Co. of Ind. V. Limbach*, 486 U.S. 269, 273-74, 108 S.Ct. 1803 (1988). The fundamental command of the Commerce Clause is that "a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." Id. citing Armco Inc. v. Hardesty, 467 U.S. 638, 642, 104 S. Ct. 2620, 2620 (1984).

This bill may be challenged as being discriminatory under the Commerce Clause because: (1) although it provides for a general excise tax holiday, it does not provide for a corresponding use tax holiday; and (2) it expressly provides that the general excise tax holiday does not apply to mail, telephone, e-mail, or internet orders with businesses operating outside the State of Hawaii.

1. There is No Corresponding Use Tax Holiday

Use tax under chapter 238, Hawaii Revised Statutes (HRS), provides for "an excise tax on the use in this State of tangible personal property which is imported . . . for use in this State." Matter of Hawaiian Flour Mills, Inc., 76 Hawaii 1, 13, 868 P.2d 419, 431 (1994), *citing* HRS § 238-2. The general theory behind such a tax is "to make all tangible property used or consumed in the State subject to a uniform tax burden irrespective of whether it is acquired within the State, making it subject to the [general excise] tax, or from without the State, making it subject to a use tax at the same rate." Hawaiian Flour Mills, Id., citing Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 66, 83 S. Ct. 1201, 1202, 10 L. Ed. 2d 202, 204 (1963). In the absence of a use tax that complements a general excise tax, sellers of goods, which are acquired out-of-state, theoretically enjoy a competitive advantage over sellers of goods acquired in-state: not being

subject to the general excise tax, out-of-state products would be less expensive than in-state products, the prices of which would presumably reflect some pass-on of the general excise tax.

Hawaiian Flour Mills, Id. Thus,

[t]he [use] tax buttresses the general excise tax as it is designed to prevent the avoidance of excise taxes through direct purchases from the mainland. Its ultimate purpose is to remove the competitive advantage an out-of-state wholesaler or retailer would otherwise have over a seller subject to the payment of State excise taxes.

Hawaiian Flour Mills, Id., citing In re Habilitat, Inc., 65 Haw. 199, 209, 649 P.2d 1126, 1133-34 (1982).

It may be argued that the use tax exceeds the general excise tax under this bill because it provides for a general excise tax holiday but no corresponding use tax holiday. It may be argued that this is facially discriminatory under the Commerce Clause. In Associated Industries v. Lohman, 511 U.S. 641, 114 S.Ct. 1815 (1994), the Missouri use tax on imported goods, depending on the buyer's location in the State, exceeded the local sales tax. Id. at 645, 114 S.Ct. 1815. One of the issues was whether such taxes violated the Commerce Clause. In Associated, the U.S. Supreme Court held that a state's use tax that exceeds the local sales tax violates the Commerce Clause. Id. at 649, 114 S. Ct. at 1821. It stated:

Where a state imposes equivalent sales and use taxes, we have upheld the system under the Commerce Clause . . . Where the use tax exceeds the sales tax, the discrepancy imposes a discriminatory burden on interstate commerce.

Id. at 648, 114 S. Ct. 1821. Hawaii has a general excise tax, not a sales tax. However, the same analysis applies.

This Commerce Clause concern may be addressed by action taken by the Director of Taxation pursuant to section 238-3, HRS, which provides in part:

§ 238-3 Application of tax, etc. (a) The tax imposed by this chapter shall not apply to any property, services, or contracting or to any use of the property, services, or contracting that cannot legally be so taxed under the Constitution or laws of the United States, but only so long as, and only to the extent to which the State is without power to impose the tax.

To the extent that any exemption . . . is necessary to comply with the preceding sentence, the director of taxation shall:

(1) Exempt or exclude from the tax under this chapter, property, services, or contracting or the use of property, services, or contracting exempted under chapter 237; . . . [Emphasis added.]

However, to avoid confusion and unnecessary litigation, we recommend that the bill be amended so it is not facially discriminatory by expressly adding a corresponding use tax holiday.

2. The Exclusion of Mail, Telephone, E-mail, or Internet Orders with Businesses Operating Outside the State of Hawaii from the General Excise Tax Holiday

The bill expressly provides that the general excise tax holiday does not apply to "[m]ail, telephone, e-mail, or internet orders with businesses operating outside the State of Hawaii" (p. 4, lines 14-15).

It is not clear what is meant by "businesses operating outside the State of Hawaii." For example, does this include businesses that operate inside as well as outside the State of Hawaii? Further, as currently drafted, it may be argued that this is facially discriminatory under the Commerce Clause because the State is taxing a transaction or incident more heavily when it crosses state lines than when it occurs entirely

within the State. This Commerce Clause concern may be addressed by section 237-22, HRS, which provides in part:

§ 237-22 Conformity to Constitution, etc. (a) In computing the amounts of any tax imposed under this chapter, there shall be excepted or deducted from the values, gross proceeds of sales, or gross income so much thereof as, under the Constitution and laws of the United States, the State is prohibited from taxing, but only so long as and only to the extent that the State is so prohibited.

(b) To the extent that any . . . method to determine tax liability is necessary to comply with subsection (a), each taxpayer liable for the tax imposed by this chapter shall be entitled to full offset for the amount of the legally imposed sales, gross receipts, . . .

To avoid confusion and unnecessary litigation, we nonetheless recommend that this exclusion to the general excise tax exemption on page 4, lines 14-15, of the bill be deleted.