HB 1183,
HD2

EDT

NEIL ABERCROMBIE
GOVERNOR

BRIAN SCHATZ
LT. GOVERNOR

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## SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY

## TESTIMONY OF THE DEPARTMENT OF TAXATION
## REGARDING HB 1183, HD 2
## RELATING TO THE GENERAL EXCISE TAX

| | |
|---|---|
| **TESTIFIER:** | **FREDERICK D. PABLO, DIRECTOR OF TAXATION (OR DESIGNEE)** |
| **COMMITTEE:** | **EDT** |
| **DATE:** | **MARCH 23, 2011** |
| **TIME:** | **1:15PM** |
| **POSITION:** | **SUPPORT** |

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This measure clarifies the nexus standard for taxing out-of-state businesses on their business activity in Hawaii. The Department supports efforts to collect tax on transactions with internet sellers. To address the new business model of internet retail, Hawaii needs to change its tax laws to ensure that everyone pays their fair share of tax and that the tax burden is not borne solely by brick-and-mortar businesses.

The revenue impact for this bill would be similar to the revenue impact for SB 1355, the streamlined sales tax, since this bill is designed to address the same problem. For SB 1355, the revenue impact is indeterminate but could provide $25-30 million per year, if federal legislation passes that mandates streamlined sales tax for all vendors.

DMA
Direct Marketing Association

The Power of Direct
Relevance. Responsibility. Results.

**TESTIMONY IN OPPOSITION BY ALICIA MALUAFITI**
**ON BEHALF OF THE DIRECT MARKETING ASSOCIATION**

**SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TECHNOLOGY**
**MARCH 23, 2011 – 1:15 P.M., ROOM 016**
**HB 1183 HD 2 – RELATING TO THE GENERAL EXCISE TAX**

Aloha Chair Fukunaga, Vice Chair Wakai, and members of the committee,

Mahalo for the opportunity to testify on HB 1183 HD 2. I am here today representing the more than 2,400 members of the Direct Marketing Association (DMA), the leading global trade association of businesses and nonprofit organizations using and supporting multichannel direct marketing.

DMA asks you respectfully not to advance this bill. The bill might seem simple enough in redefining nexus for the purposes of sales tax collection and requiring a notice to the Department of Taxation in lieu of collecting sales tax. However, the bill treads into an area of settled and recently reaffirmed law with regards to sales taxes and the burdens states can, or in this case, cannot, place on businesses with no physical nexus in a state.

By way of background, in 1992 the United States Supreme Court held in *Quill Corp. v. North Dakota* that a state cannot impose sales/use tax collection obligations on out-of-state vendors unless those retailers have a "physical presence" in the taxing state. The decision in *Quill* applied the holding of an even earlier decision in a 1967 case, *National Bellas Hess v. Dep't of Revenue*. So, the notion that states cannot force sales tax collection on remote sellers has been around for more than 40 years. The bill's attempt to define nexus in such as way as to corral remote sellers contravenes the *Quill* decision.

Just one month ago Federal District Court Judge Robert Blackburn in Colorado issued a **preliminary injunction enjoining the Colorado Department of Revenue from enforcement of a similar law.** In February 2010, the Colorado legislature enacted and the governor signed legislation that required remote sellers to notify customers of their obligation to pay use tax, required annual summaries of customers' purchases to be sent by the seller to the customer each January and required the seller to report to the Department in March how much each Colorado customer purchased from them in the previous calendar year.

Judge Blackburn determined that the entire law, including the annual notice to the Department of Revenue, "imposed a notice and reporting burden on [these] out-of-state retailers and that burden is not imposed on in-state retailers." The concept of this disparate treatment between in-state and out-of-state companies is the basis of this bill and puts it on questionable legal ground. Moreover, Judge Blackburn also concluded that "these requirements likely impose on out-of-state retailers use tax-related responsibilities that trigger the safe-harbor provisions of *Quill*." The committee should carefully consider the Judge's determination when deciding what course of action to take with regards to HB 1183.

Judge Blackburn found that the obligations being placed on remote sellers under the Colorado law are tantamount to enhancing the state's collection of use taxes and are therefore impermissible. Section three of the bill gives a false choice to remote sellers by suggesting that they can either collect sales tax or file the annual report. By requiring out-of-state marketers to report customers' purchase histories to the Department of Revenue, HB 1183 imposes upon out-of-state retailers the very burden the Federal District Court found objectionable. So, under current federal law, neither collecting sales tax nor filing a report can actually be required of remote sellers. While use taxes are owed by Hawaii residents, that tax relationship is between the taxpayer and the state; remote sellers should not be conscripted into the process.

Notwithstanding Judge Blackburn's decision, there are privacy considerations that make the bill particularly troubling. Requiring, or for that matter even asking, businesses to report the buying histories and habits of customers, information can be highly sensitive and assumed to be private, to the state of Hawaii -- the government -- is an unprecedented invasion of privacy and one not imposed on in state sellers. No consideration seems either to have been given to federal privacy laws such as those covering video or health.

While the bill declares that no "information describing the tangible personal property sold" should be provided in the report, this underestimates the extent to which the type of product or expressive content sought by a purchaser can be gleaned from the vendor alone. Purchases from hypothetical catalogs like "The Communist Literature Store," "The Cancer Patient's Resource Center" or "The Sexy Lingerie Shop," or from hypothetical websites such as www.leninisgreat.com, www.stopyourcancer.org, or www.tinybikiniphotos.com all would reveal to the government considerable private and sensitive information about the purchaser, even if the specific items purchased are not disclosed. Additionally, why should a marketer be required to report to the state where a purchase from "The Sexy Lingerie Shop" was shipped? Consider how valuable or enticing this information, particularly about well-known Hawaii residents, would be to prying eyes or computer hackers. Even if leaks could be avoided, the state simply should not be privy to this information nor should it require that it be reported.

The committee should carefully weigh the implications of the invasive annual report collection requirement, the consequences on consumer trust, the potential harm to Hawaii businesses if other states follow this errant path and the serious, strong, and legitimate privacy concerns its own citizens will have. The bill itself neither raises nor guarantees any new tax revenue to the state, but it is virtually certain to raise concerns as more citizens learn about their government's attempt to collect and stockpile their buying histories.

DMA is neither arguing against use taxes nor suggesting that customers should not meet their obligations under state law to remit that tax, much as they do with property taxes or licensing fees or any number of other monies owed by citizens to the state. Where we diverge is in the attempt to export Hawaii-specific requirements to companies in the 49 other states. This taxing arms race will ultimately cause problems for all businesses, and there is no way to insulate those companies in Hawaii who would have to comply with other states' laws, should the Colorado example be further mirrored.

Mahalo again for the opportunity to testify and I would be happy to answer any questions.

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF COLORADO**
**Judge Robert E. Blackburn**

Civil Case No. 10-cv-01546-REB-CBS

THE DIRECT MARKETING ASSOCIATION,

Plaintiff,

v.

ROXY HUBER, in her capacity as Executive Director, Colorado Department of Revenue,

Defendant.

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**ORDER GRANTING MOTION FOR PRELIMINARY INJUNCTION**

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**Blackburn, J.**

This matter is before me on the **Plaintiff's Motion for a Preliminary Injunction and Incorporated Memorandum of Law** [#15][1] filed August 13, 2010. The defendant filed a response [#50], and the plaintiff filed a reply [#56]. Having considered the evidence, the parties' written arguments, the relevant law, and the oral arguments presented by counsel for the parties at a hearing held on January 13, 2011, I find and conclude that the motion for preliminary injunction should be granted.

## I. JURISDICTION & STANDING

I have jurisdiction over this case under 28 U.S.C. § 1331 (federal question). Although the defendant challenges the plaintiff's standing to pursue certain of its claims in this case, the defendant does not challenge the plaintiff's standing to present its claims under the Commerce Clause. The plaintiff seeks a preliminary injunction based

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[1] "[#15]" is an example of the convention I use to identify the docket number assigned to a specific paper by the court's case management and electronic case filing system (CM/ECF). I use this convention throughout this order.

only on its Commerce Clause claims. Therefore, I need not and do not address standing.

## II. BACKGROUND

The plaintiff, The Direct Marketing Association (DMA), asks the court to enjoin the defendant from enforcing the notice and reporting obligations imposed on many out-of-state retailers under a new Colorado law, now codified at §39-21-112(3.5), C.R.S. (2010) (the Act), and under the concomitant regulations promulgated by the Colorado Department of Revenue (DOR) to implement the Act, 1 Colo. Code Regs. § 201-1:39-21-112.3.5 (2010) (the Regulations). A copy of the Regulations is attached to the DMA's motion [#15] as Exhibit 2. In general, the Act and Regulations require retailers that sell products to customers in Colorado, but do not collect and remit Colorado sales tax on those transactions, to report certain information about the customers' purchases from the retailer to each customer and to the Colorado Department of Revenue. DMA is an association of businesses and organizations that market products directly to consumers via catalogs, magazine and newspaper advertisements, broadcast media, and the internet. The Act and the Regulations will affect many members of the DMA. The defendant, Roxy Huber, is the Executive Director of the Colorado Department of Revenue, the state agency charged with enforcing the Act and the Regulations. The DMA alleges that certain requirements of the Act and the Regulations violate the constitutional rights of many members of the DMA. In its motion for preliminary injunction, the DMA relies on its allegation that the Act and the Regulations violate the rights of many of its members under the Commerce Clause of the United States Constitution. ***U.S. Const.*** art. I, § 8. The DMA asserts other claims in its complaint, but the DMA does not rely on those claims as bases for its motion for preliminary injunction.

The Act and the Regulations establish three new obligations for retailers who sell products to customers in Colorado, but do not collect and remit Colorado sales tax on those transactions. First, such retailers must notify their Colorado customers that the retailer does not collect Colorado sales tax and, as a result, the purchaser is obligated to self-report and pay use tax to the DOR (Transactional Notice). Second, such retailers must provide to each of their Colorado customers an annual report detailing that customer's purchases from the retailer in the previous calendar year, informing the customer that he or she is obligated to report and pay use tax on such purchases, and informing the customer that the retailer is required by law to report the customer's name and the total amount of the customer's purchases from that retailer to the DOR (Annual Purchase Summary). The Annual Purchase Summary must be provided only the customers who spend more than 500 dollars in the calendar year with a particular retailer. Third, such retailers must provide the DOR with an annual report concerning each of the retailer's Colorado customers stating the name, billing address, shipping addresses, and the total amount of purchases from the retailer by each of the retailer's Colorado customers (Customer Information Report). The Law exempts retailers with less than 100,000 dollars in gross annual sales in Colorado. In its motion for preliminary injunction, the DMA asks the court preliminarily to enjoin Huber from enforcing those provisions of the Act and the Regulations that require retailers to provide Transactional Notices, Purchase Summaries, and Customer Information Reports.

## III. STANDARD OF REVIEW

FED. R. CIV. P. 65 authorizes federal courts to issue preliminary injunctions. Because a preliminary injunction is an extraordinary remedy, the plaintiff's right to such relief must be clear and unequivocal. ***See Federal Lands Legal Consortium ex rel. Robart Estate v. United States***, 195 F.3d 1190, 1194 (10th Cir. 1999). The plaintiff is entitled to a preliminary injunction only if it proves (1) that there is a substantial likelihood that it will prevail on the merits; (2) that it will suffer irreparable harm unless the preliminary injunction is issued; (3) that the threatened injury to the plaintiff outweighs the harm the preliminary injunction might cause defendant; and (4) that the preliminary injunction is in the public interest. ***Prairie Band of Potawatomi Indians v. Pierce***, 253 F.3d 1234, 1246 (10th Cir. 2001).

## IV. ANALYSIS

### A. LIKELIHOOD OF SUCCESS

To secure a preliminary injunction, the plaintiff first must establish a substantial likelihood that it is likely to prevail on the merits of the substantive claims that are the basis for its motion. ***Prairie Band of Potawatomi Indians v. Pierce***, 253 F.3d 1234, 1246 (10th Cir. 2001). "The determination of a motion for a preliminary injunction and a decision on the merits are different." ***Valdez v. Applegate***, 616 F.2d 570, 572 (10th Cir. 1980). "It is not necessary that plaintiffs show positively that they will prevail on the merits before a preliminary injunction may be granted." ***Atchison, Topeka and Santa Fe Railway. Co. v. Lennen***, 640 F.2d 255, 261 (10th Cir. 1981). Rather, plaintiff need only establish "a reasonable probability of success, . . . not an 'overwhelming' likelihood of success[.]" ***Id.***

The plaintiff asserts two claims under the Commerce Clause of the United States Constitution and argues that it has demonstrated a substantial likelihood of success on both of these claims. The Commerce Clause expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." ***U.S. Const.***

art. I, § 8. The Commerce Clause long has been read as having a negative or dormant sweep as well. The clause, "'by its own force' prohibits certain state actions that interfere with interstate commerce." ***Quill Corp. v. North Dakota By and Through Heitkamp***, 504 U.S. 298, 309 (1992) (quoting ***South Carolina State Highway Dept. v. Barnwell Brothers, Inc.***, 303 U.S. 177, 185 (1938)). The negative Commerce Clause "denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." ***Oregon Waste Systems, Inc. v. Department of Environmental Quality of State of Or.***, 511 U.S. 93, 98 (1994). A state law violates the discrimination aspect of the dormant Commerce Clause if it discriminates against interstate commerce either facially or in practical effect. ***Hughes v. Oklahoma***, 441 U.S. 322, 336 (1979). If a law discriminates against interstate commerce, then the state has the burden to demonstrate a legitimate local purpose served by the law which cannot be achieved through reasonable nondiscriminatory alternatives. ***Id***. at 336 - 337. If the law in question regulates evenhandedly among in-state and out-of-state interests, "and its effects on interstate commerce are only incidental, [the law] will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." ***Pike v. Bruce Church, Inc.***, 397 U.S. 137, 142 (1970).

i. Discrimination Claim

In its first claim for relief, the DMA alleges that the Act and the Regulations discriminate against out-of-state retailers who do not collect Colorado sales tax, because the Act and the Regulations impose on those retailers notice and reporting obligations that are not imposed on Colorado retailers. Under Colorado law, all retailers doing business in Colorado and selling to Colorado purchasers must obtain a sales tax license and must collect and remit the sales tax applicable to each sale. §§39-26-103, 104, C.R.S. Under the Act and the Regulations, retailers who collect and remit Colorado sales tax are not obligated to provide the Transactional Notice, the Annual Purchase Summary, and the Customer Information Report otherwise required by the Act and the Regulations. Under the law established in ***Quill*** and related cases, Colorado may not impose any duty to collect sales and use taxes on out-of-state retailers whose only connection to Colorado is by common carrier or the U.S. mail. ***Quill***, 504 U.S. at 315. Thus, out-of-state retailers that do not have a physical presence in Colorado generally are not obligated to collect and remit sales tax on their sales in Colorado. The plaintiff contends that the Act and the Regulations discriminate against this group of out-of-state retailers by imposing on those retailers burdens that need not be borne by in-state retailers.

In the context of the dormant Commerce Clause, a law discriminates against interstate commerce if it imposes "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." ***Oregon Waste Systems, Inc. v. Department of Environmental Quality of State of Or.***, 511 U.S. 93, 99 (1994). In ***Oregon Waste Systems***, for example, the Supreme Court concluded that Oregon's two dollar and twenty-five cent per ton surcharge on out-of-state solid waste brought into Oregon for disposal was discriminatory in violation of the dormant Commerce Clause, when compared to the eighty-five cents per ton surcharge imposed on in-state solid waste. ***Id***. at 100. The ***Oregon Waste Systems*** Court noted that the degree of a differential burden or charge on interstate commerce "is of no relevance to the determination whether a State has discriminated against interstate commerce." ***Id***. at n. 4 (internal quotation and citation omitted).

The text of the Act and the Regulations does not explicitly target out-of-state retailers as opposed to in-state retailers. The defendant argues that the plain language of the Act and the Regulations applies to all retailers, in-state and out-of-state, that sell to Colorado purchasers but do not collect Colorado sales tax. Accordingly, the defendant contends that the Act and the Regulations are not discriminatory. I note, however, that under Colorado law, in-state retailers long have been required to collect and remit Colorado sales tax and are subject to civil and criminal penalties if they fail to do so. §§39-26-103 (4); 39-21-118(2), C.R.S. Unless they defy these legal requirements, these retailers are not subject to the notice and reporting requirements of the Act and the Regulations. Evidence submitted by the defendant indicates that the Tax Compliance Section of the Colorado Department of Revenue discovers each year only a very small number of Colorado retailers who are not complying with their legal obligation to collect and remit sales tax. *Response* [#50], Exhibit 16 (Reiser Affidavit).

Under Colorado law, any retailer who is not subject to the statutory obligation to collect and remit Colorado sales tax necessarily is an out-of-state retailer. The Act and the Regulations impose a notice and reporting burden on these out-of-state retailers and that burden is not imposed on in-state retailers, except for the very few in-state retailers who defy their statutory sales tax obligations. Given these circumstances, I conclude that the plaintiff has shown a substantial likelihood that it will succeed in showing that the Act and the Regulations are discriminatory because, in practical effect, they impose a burden on interstate commerce that is not imposed on in-state commerce.

If the DMA succeeds in showing that the Act and the Regulations are discriminatory, then “the burden falls on the State to justify [them] both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake." ***Hughes v. Oklahoma***, 441 U.S. 322, 336 (1979). However, it is exceedingly difficult to meet this standard. "If a restriction on commerce is discriminatory, it is virtually per se invalid." ***Oregon Waste Systems***, 511 U.S. at 99. In this case, the defendant asserts Colorado's need to collect tax revenue as the local benefit that justifies the Act and the Regulations. Without question, this is a legitimate local interest. However, the DMA has noted the availability of non-discriminatory alternatives. For example, like other states, Colorado might collect use tax from Colorado taxpayers via the Colorado income tax form. Given this and other alternatives, I conclude that it is unlikely that the defendant will be able to show a lack of nondiscriminatory alternatives to the Act and the Regulations.

Regardless of the state's salutary local purposes, its enactment of a statutory scheme and concomitant regulations that produce, in effect, a geographic distinction between in-state and out-of-state retailers discriminates patently against interstate commerce, ***id***. at 100, which triggers the virtually per se rule of facial invalidity that has not been surmounted by a demonstration by the state of a legitimate local purpose that can not be served adequately by reasonable nondiscriminatory alternatives. ***Id***. (internal quotation and citations omitted). Thus, on the current record, I conclude that the DMA has demonstrated a substantial likelihood of success on its discrimination claim under the dormant Commerce Clause.

ii. Undue Burden Claim

In its second claim for relief, the DMA alleges that the Act and the Regulations impose improper and burdensome regulation of interstate commerce. The DMA relies heavily on the law established in ***Quill Corp. v. North Dakota By and Through Heitkamp***, 504 U.S. 298, 309 (1992) to support its undue burden claim. In ***Quill***, the

Court concluded that undue burdens on interstate commerce sometimes may be avoided by the application of a bright line rule. The ***Quill*** court concluded that the dormant Commerce Clause and the Court's earlier holding in ***National Bellas Hess, Inc. v. Department of Revenue of State of Ill.***, 386 U.S. 753, 758 (1967) create a bright line rule with regard to the collection of sales and use tax. This law creates a "safe harbor for vendors whose only connection with customers in the [taxing] State is by common carrier or the United States mail. Under ***Bellas Hess***, such vendors are free from state-imposed duties to collect sales and use taxes." ***Quill***, 504 U.S. at 315 (internal quotation omitted).

The ***Quill*** Court examined and applied the quadripartite test enunciated in ***Complete Auto Transit, Inc. v. Brady***, 430 U.S. 274, 279 (1977). Under ***Complete Auto***, a state tax will be sustained against a Commerce Clause challenge as long as the tax (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. ***Complete Auto***, 430 U.S. at 279. ***Complete Auto*** rejected the previously applied distinction between direct and indirect taxes on interstate commerce "because that formalism allowed the validity of statutes to hinge on legal terminology, draftsmanship and phraseology." ***Quill***, 430 U.S. at 310 (internal quotation, citation, and brackets omitted). The ***Complete Auto*** test emphasizes the importance of looking past the formal language of a tax statue to its practical effect. ***Quill***, 504 U.S. at 310. The first and fourth prongs of the ***Complete Auto*** test "limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." ***Quill***, 504 U.S. at 313. The safe harbor established in ***Quill*** is a meant to delineate and define the limits of the substantial nexus requirement of the ***Complete Auto*** test to ensure that a state tax law does not impose an undue burden on interstate commerce. ***Id***.

The Act and the Regulations do not require out-of-state retailers to collect sales and use taxes. However, they do require out-of-state retailers to gather, maintain, and report information, and to provide notices to their Colorado customers and to the defendant about their Colorado customers. The sole purpose of these requirements is to enhance the collection of use taxes by the State of Colorado. I conclude that these requirements likely impose on out-of-state retailers use tax-related responsibilities that trigger the safe-harbor provisions of ***Quill***. Although the burden of the notice and reporting obligations imposed by the Act and the Regulations may be somewhat different than the burden of collecting and remitting sales and use taxes, the sole purpose of the burdens imposed by the Act and the Regulations is the ultimate collection of use taxes when sales taxes cannot be colleted. Looking to the practical effect of the Act and the Regulations, I conclude that the burdens imposed by the Act and the Regulations are inextricably related in kind and purpose to the burdens condemned in ***Quill***. The Act and the Regulations impose these burdens on out-of-state retailers who have no connection with Colorado customers other than by common carrier or the United States mail. Those retailers likely are protected from such burdens on interstate commerce by the safe-harbor established in ***Quill***.

iii. Conclusion

I find and conclude that the DMA has demonstrated a substantial likelihood of success on both its discrimination claim and its undue burden claim under the dormant Commerce Clause. Thus, consideration of this first factor weighs in favor of the issuance of a preliminary injunction.

B. IRREPARABLE INJURY

The parties dispute whether or not a deprivation of the Commerce Clause rights at issue here, without more, constitutes irreparable injury. In a recent case, the United States Court of Appeals for the Tenth Circuit indicated that violation of Commerce Clause rights constitutes irreparable injury. ***American Civil Liberties Union v. Johnson***, 194 F.3d 1149, 1163 (10th Cir. 2010) (citing ***American Libraries Ass'n v. Pataki***, 969 F.Supp. 160, 168 - 183 (S.D.N.Y. 1997)). Although the Tenth Circuit's statement in ***Johnson*** is dicta, I conclude that violation of the constitutional Commerce Clause rights of DMA's members constitutes irreparable injury.

In addition, it is undisputed that many DMA members will face compliance costs if they are required to comply with the Act and the Regulations in the future. The amount of those costs is disputed. Huber's expert concludes that the smallest retailers affected by the Act and the Regulations will incur first-year compliance costs ranging from about 3,100 dollars to 7,000 dollars. *Response* [#50], Exhibit 6 (Report of Dieter G. Gable), p. 2. If, in the end, the Act and the Regulations are found to be unconstitutional because they violate the Commerce Clause, the affected retailers would be unable to recover these compliance costs from the State of Colorado. Under the Eleventh Amendment, Colorado is immune from suit for such damages. Under these circumstances, the compliance costs faced by retailers subject to the Act and the Regulations constitute irreparable injury. ***Chamber of Commerce of U.S. v. Edmondson***, 594 F.3d 742, 770 - 771 (10th Cir. 2010) (compliance costs of more than a thousand dollars per year per business constitute irreparable injury if such costs cannot later be recovered because of sovereign immunity). Thus, consideration of this second factor weighs also in favor of the issuance of a preliminary injunction.

C. BALANCE OF HARMS

When considering the balance of harms, a court must balance "the competing claims of injury and must consider the effect on each party of the granting or withholding of the requested relief." ***Amoco Prod. Co. v. Gambill***, 480 U.S. 531, 542 (1987). The DMA argues that the need to protect the constitutional rights of certain of its members outweighs the interest of the State of Colorado in enforcing a law that likely is constitutionally infirm. In addition, absent an injunction, some DMA members will incur compliance costs that cannot later be recovered. Huber argues that these considerations do not outweigh Colorado's interest in enforcing a state law that will provide revenue to its strapped coffers.

If, ultimately, the Act and the Regulations are upheld against the DMA's challenge, the reports and notices required by the Act and the Regulations can be prepared and delivered. This might delay the state's collection of some use taxes, but it will not prevent the ultimate collection of those taxes. On the other hand, preserving the status quo with a preliminary injunction will prevent the irreparable injuries discussed above while the issues raised by the DMA are resolved completely. Given these circumstances and considerations, I find and conclude that the balance of harms favors the DMA, and thus, the issuance of a preliminary injunction.

D. PUBLIC INTEREST

Generally, the public interest is served by enjoining the enforcement of a law that likely violates the Constitution. ***Chamber of Commerce of U.S. v. Edmondson***, 594 F.3d 742, 771 (10th Cir. 2010). Huber argues that it is not in the public interest to enjoin the enforcement of a law which has the primary goal of raising revenue to ensure the fiscal well-being of the state. As Huber notes, a court of equity must "pay particular regard for the public consequences in employing the extraordinary remedy of injunction." ***Winter v. Natural Resources Defense Council, Inc.***, 555 U.S. 7, ___, 129 S.Ct. 365, 376 -377 (U.S. 2008). I find and conclude that the public's interest in revenue raising by the state will not be impaired substantially by the issuance of a preliminary injunction. At most, the state may suffer some delay in implementing its new technique for enforcing its use tax laws, if the Act and the Regulations are upheld against the DMA's challenge. On the other hand, the enforcement of a law that likely is unconstitutional, even if the goal of the law is important and legitimate, does not serve the public interest. Thus, the public interest factor weighs in favor of the issuance of a preliminary injunction.

## V. ORDERS

**THEREFORE, IT IS ORDERED** as follows:

1. That the **Plaintiff's Motion for a Preliminary Injunction and Incorporated Memorandum of Law** [#15] filed August 13, 2010, is **GRANTED** on the following terms;

2. That effective forthwith defendant Roxy Huber, in her capacity as Executive Director, Colorado Department of Revenue, together with her agents, servants, employees, attorneys-in-fact, or anyone acting on their behalf, are **ENJOINED AND RESTRAINED** from enforcing the provisions of §39-21-112(3.5), C.R.S. (2010) (the Act) and the regulations promulgated thereunder, 1 Colo. Code Regs. § 201-1:39-21-112.3.5 (2010) (the Regulations), to the extent that the Act and the Regulations require

A. that a retailer must notify their Colorado customers that the retailer does not collect Colorado sales tax and, as a result, the purchaser is obligated to self-report and pay use tax to the Colorado Department of

Revenue (Transactional Notice); and

B. that a retailer must provide to each of its Colorado customers an annual report detailing that customer's purchases from the retailer in the previous calendar year, informing the customer that he or she is obligated to report and pay use tax on such purchases, and informing the customer that the retailer is required by law to report the customer's name and the total amount of the customer's purchases from that retailer to the Colorado Department of Revenue (Annual Purchase Summary); and

C. that a retailer must provide the Colorado Department of Revenue with an annual report concerning each of the retailer's Colorado customers stating the name, billing address, shipping addresses, and the total amount of purchases from the retailer by each of the retailer's Colorado customers (Customer Information Report);

3. That this preliminary injunction **SHALL LIMIT** the enforcement of the Act and the Regulations against retailers who sell to customers in Colorado, but whose only connection to the State of Colorado is by common carrier or the United States Mail;

4. That this preliminary injunction **SHALL NOT LIMIT** the enforcement of the Act and the Regulations against retailers who do not fall into the class of retailers defined in paragraph three (3), above;

5. That under FED. R. CIV. P. 65(c), the plaintiff, the Direct Marketing Association, **SHALL POST** with the Clerk of the Court a bond in the amount of five thousand (5,000) dollars on or before Friday, January 28, 2011, at 12:00 p.m. (mountain standard time); and

6. That this preliminary injunction **SHALL REMAIN IN EFFECT** until modified or rescinded by further order of the court.

Dated January 26, 2011, at Denver, Colorado.

**BY THE COURT:**

Bob Blackburn

Robert E. Blackbum
United States District Judge

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|---|---|
| **From:** | Dean |
| **To:** | EDTTestimony |
| **Subject:** | Testimonial HB1183 - 3/23/2011 1:15:00 PM - Dean Takamine |
| **Date:** | Tuesday, March 22, 2011 3:04:58 PM |
| **Attachments:** | hb1183_testimonial_dean_takamine.txt |

Testimonial for HB1183 - 3/23/2011 1:15:00 PM.

Dean Takamine
http://www.synertechmedia.com

Synertech Media LLC
Online Marketing

Honorable Hawaii State Senators,

My name is Dean Takamine, I am the President of Synertech Media LLC a Internet Marketing company based in Honolulu, Hawaii. I have been in the Internet Marketing business for over 8 years. I am providing a testimonial to HB1183 also known as the "Amazon Tax Bill". In particular, I would like to clarify some common misconceptions about this bill and it's impact on Hawaii.

I would like to inform you on 3 very important issues about HB1183.

1. **The consequences of HB1183.**
2. **How much tax revenue would HB1183 generate.**
3. **Who would benefit from this bill.**

1. The consequences of HB1183.

HB1183 will hurt Hawaii's Online Media Industry as it will handicap them by limiting their revenue options. I also believe it will hurt our rapidly growing markets like social marketing, blogging, online videos (Youtube), photographers and even the software industry (Apple iPhone Apps generate revenue with advertising).

Competing mainland and international companies will have a competitive advantage in generating revenue. This will cause a "brain drain" as these companies will have no choice but to take their business to another state or internationally. Millions of dollars in advertising revenue would be lost, most of this revenue comes from out-of-state.

## 2. How much tax revenue would HB1183 generate.

This bill will not generate the income most people believe. This is because all of the large online retailers will just terminate their relationships with Hawaii advertising affiliates, thereby not needing to collect any taxes from Hawaii residents. What this means is we would not be able to collect even one penny from Amazon.com. I can't overstate this enough, we would not be able to collect one penny from every major online retailer that does not have a physical storefront in Hawaii (i.e. Amazon.com).

What we will end up doing is losing millions of dollars in affiliate advertising revenue (Virtually all this revenue comes from out-of-state). This bill will end up costing Hawaii more money than it generates. We will have to spend money to regulate this tax. On top of that, we will need even more money set aside for litigation.

3. Who would benefit from this Bill?

The real benefit of this bill is the Big Box Retailers like Best Buy, Walmart, etc. They are spending millions of dollars to lobby across the nation and to fool the public that they are "pro small business". They are making a case for a Internet tax help small businesses. Since when is Walmart pro small business? Will Hawaii fall for this trap?

The state of Illinois recently passed a similar bill and here are some recent quotes by the media.

"Wal-Mart welcomes Amazon and Overstock Illinois Affiliatesl"
"Sears Holdings Applauds"
"Walgreens Congratulates Illinois"
"Maybe Gov. Quinn of Illinois should have figured something was up when Walmart put their full support behind it."

Illinois effectively eliminated jobs and lost millions of dollars in state revenue. For what reason? They will not collect one penny from online retailers like Amazon.com.

Please connect the dots

Once you are able to see the true consequences of HB1183 you will realized just how damaging this bill is. HB1183 does nothing to generate revenues while killing off millions of dollars flowing into the State.

I would like to conclude, that we all agree that Hawaii needs to diversify it's economy. Hawaii's Online Media and Software Industry is a rapidly growing and clean industry. It is low impact and a vast majority of its revenues come from out-of-state. We should be promoting this industry not creating a bill like HB1183 and destroying it.

I urge you to "connect the dots" and vote for the people of Hawaii not the Big Box retailers. Please vote "No" on HB1183.

Mahalo for your precious time.

Aloha,
Dean Takamine
President, Synertech Media LLC

## Jody Nakanelua

**From:** mailinglist@capitol.hawaii.gov
**Sent:** Monday, March 21, 2011 12:00 PM
**To:** EDTTestimony
**Cc:** rmadigan@performancemarketingassociation.com
**Subject:** Testimony for HB1183 on 3/23/2011 1:15:00 PM

Testimony for EDT 3/23/2011 1:15:00 PM HB1183

Conference room: 016
Testifier position: oppose
Testifier will be present: No
Submitted by: Rebecca Madigan
Organization: Performance Marketing Association
Address:
Phone:
E-mail: rmadigan@performancemarketingassociation.com
Submitted on: 3/21/2011

Comments:
The Performance Marketing Association, and the Internet advertising businesses we represent in Hawaii, vehemently opposes HB 1183. It will not only result in $0 new sales taxes collected in Hawaii, it will devastate a vibrant and growing small business segment in your state.

The nexus tax scheme behind HB 1183 is based on the concept that if an out-of-state retailer places ads on websites owned by Hawaii citizens, those retailers have nexus and must collect sales tax from purchases made by state residents.

However this tax scheme has a major flaw: it provides an easy “out” for retailers to avoid collecting sales tax. Those retailers will simply stop advertising on Hawaii websites (and advertise on competitors’ sites in other states). We know this for a fact because that’s exactly what happened when similar laws passed in NY, NC and RI.

The result? No new sales tax revenue for the state, and overnight devastation to businesses who rely and prosper on advertising revenue.

The realization of this result is why over a dozen states have said no to this nexus tax scheme – it doesn’t work. If passed, the state will gain no new sales tax revenue, and will devastate an important small business segment.

It is on behalf of these small business owners in Hawaii, that we urge you to oppose HB 1183.

Tammy Cota, Executive Director
1615 L Street NW, Suite 1100
Washington, DC 20036-5624
Cell: 802-279-3534
Email: tammy@internetalliance.org
Web: www.internetalliance.org

March 21, 2011

Honorable Carol Fukunaga, Chair
Hawaii Senate Economic Development Committee
Hawaii State Capitol, Room 216
415 South Beretania Street
Honolulu, HI 96813

Dear Senator Fukunaga:

I am the executive director of the Internet Alliance (IA), a national organization of consumer companies that provide goods and services via the Internet. The IA's mission is to build consumer confidence and trust in the Internet so that it may become the leading global marketing medium of this century.

The IA is writing to express opposition to HB 1183, a bill that would create a nexus standard for taxing out-of-state businesses based on its local affiliate agreements or require an out-of-state business to file information with the state about Hawaii customer's purchases.

The bill will not raise any revenue for the state and in fact in-state businesses will suffer. Faced with an obligation to collect the tax, out-of-state businesses will simply cut off ties with in-state affiliates and eliminate any debate about the nexus standard. There will be no additional revenue for the State of Hawaii. In fact, as we explain below, such a tax could reduce state revenue, eliminate in-state jobs and drive business and consumer dollars out of state.

Also, the Direct Marketing Association (DMA) just won a landmark preliminary injunction in federal court through a lawsuit it filed against a similar tax notice law that passed in Colorado.

Instead of passing a new tax, Hawaii should look at states like Alabama and California who are focusing tax efforts on better education and enforcement of laws already on the books by sending letters out to in-state tax payers reminding them that taxes for Internet purchases may be due.

**Affiliate Nexus -** Section 237-2 of HB 1183 proposes to expand "engaging" in business to include the sale of tangible personal property by a person soliciting business through an independent contractor or other representative if the person enters into an agreement with a resident of Hawaii, under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the person.

This language is modeled after a flawed New York law that passed in 2008. The fact that the New York nexus tax generated revenue is an anomaly. In New York, one large retailer chose not to cut off affiliate relationships but only did so to have standing to challenge the law. Most experts believe the law will ultimately be struck down. The basis of the suit is that physical presence, or nexus, is necessary for states to compel companies to serve as tax collectors as the U.S. Supreme Court ruled in 1992 (see Quill Corp. v. North Dakota, 504 US 298 (1992)).

Evidence from two other states that passed similar laws – Rhode Island and North Carolina -- shows that the laws actually reduced revenue, eliminated jobs and drove business and consumer dollars out of state.

Former General Treasurer Frank T. Caprio said “the affiliate tax has hurt Rhode Island businesses and stifled their growth, as they’ve been shut out of some of the world’s largest marketplaces, and [it] should be repealed immediately.” In fact, the Rhode Island legislature is currently considering a repeal of this law (see R.I.HB 5115).

In the past two years, at least 14 states looked at this very issue and **rejected it**. Those states are California, Connecticut, Hawaii, Iowa, Kentucky, Maryland, Mississippi, Nevada, New Mexico, Oklahoma, Tennessee, South Carolina, Vermont and Virginia.

**Annual Notice -** Section 237 (b) is just as legally problematic as the affiliate nexus tax. This section would require an out-of-state business not collecting and remitting the excise tax to provide an annual statement to the Department of Taxation which must include the names of residents located in Hawaii, the date of the sale, the zip code of the shipping address of each sale and the dollar amount of each sale.

As I explained above, the Direct Marketing Association (DMA) just won a landmark preliminary injunction in federal court through a lawsuit it filed against a similar notice law that passed in Colorado. The ruling prohibits the State of Colorado from enforcing its controversial new law, H.B. 10-1193, that would have required out-of-state companies, among other things, to report to the state the names, addresses, and purchase amounts of their customers.

The Internet Alliance agrees with the DMA who rightly argued that the law violates the Commerce Clause of the United States Constitution by (a) imposing discriminatory obligations upon out-of-state retailers that do not apply to in-state Colorado retailers, and (b) unduly burdening interstate commerce under principles set forth by the Supreme Court in Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

The Court accepted these arguments in finding that the DMA had a likelihood of success on both Commerce Clause counts, and concluded that out-of-state retailers subject to the new law would suffer irreparable harm if enforcement of the statute was not barred.

The preliminary injunction effectively suspends the law while the litigation continues and until the Court makes a final ruling regarding the law's constitutionality. The notice requirement contained in HB 1183 would likely face similar litigation.

**Alternatives -** Instead of passing a new tax, other states found better solutions. For example, Alabama and California are focusing tax efforts on better education and enforcement of laws already on the books by sending letters out to in-state tax payers reminding them that taxes for Internet purchases may be due. Both states have a use-tax reporting line contained on the personal state income tax forms which taxpayers must fill out and submit annually**.**

The Alabama Department of Revenue (DOR) sent reminder letters to a random set of taxpayers that did not report making any online purchases from out-of-state retailers. The Alabama DOR reports that about one third of the taxpayers who received the letter complied and sent in checks, some for several thousand dollars.

The California Board of Equalization (BOE) revenue estimates from their education program are nothing less than remarkable. BOE projections are that education efforts will help revenue to grow to $81 million by the end of 2010; $183 million in 2011 and $367 million in 2012. The board even predicts that revenue will grow to whopping $600 million annually by 2013!

The success of the Alabama and California programs demonstrate that a purchaser-based approach to collecting taxes can and does work, without risking state jobs, losing income tax revenue or costly litigation.

The IA believes creating a new affiliate nexus tax is unconstitutional and bad policy that would harm the state's economy and instate local affiliates and creating an annual notice to the state violates the Commerce Clause of the United States Constitution. Therefore, the IA urges you to reject HB 1183.

Thank you for taking the time to consider our position. Please contact me if you would like to discuss this issue further or have questions.

Sincerely,

Tammy Cota

Tammy Cota

cc: House Education Committee members

# Natalie J. Iwasa, CPA, Inc.
**1331 Lunalilo Home Road**
**Honolulu, HI  96825**
**808-395-3233**


TO: Committee on Economic Development and Technology

HEARING
DATE: Wednesday, March 23, 2011, 1:15 p.m.

RE: HB1183, HD2 Relating General Excise Tax – **OPPOSE Information Reporting**

Aloha Chair Fukunaga, Vice Chair Wakai and Members of the Committee,

This bill creates a nexus standard for taxing out-of-state businesses and allows certain taxpayers to file an annual report with the state in lieu of paying the general excise tax (GET).

This bill would allow a person or business to report names of residents who purchased goods from out of state, as well as dates and amounts of sales instead of paying GET on the sales.  This bill simply goes too far in its attempt at gathering information about consumers presumably in the name of enforcing the use tax laws.

Please remove this reporting requirement from the bill.

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: ADMINISTRATION, GENERAL EXCISE, Taxation of out-of-state businesses

BILL NUMBER: HB 1183, HD-2

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that a person or entity conducting business in this state that has its commercial domicile in another state, shall be presumed to be systematically and regularly engaging in business in this state and taxable under Title 14 if during a year: (1) the person or entity engages in or solicits business with persons within this state; and (2) the person or entity earns income, gross proceeds, gross rental, or gross rental proceeds attributable to sources in this state.

If a person or entity is assessed and currently remits tax on a monthly basis under Title 14 and becomes taxable in this state by reason of this section, the person or entity may petition the director of taxation to allow the assessment and remitting of tax on a basis other than monthly for good cause. For purposes of this section, good cause includes compliance with the United States Constitution and the state constitution.

Adds a new section to HRS chapter 237 to require any person or entity conducting business in this state that: (1) has its commercial domicile in another state; (2) is presumed to be systematically and regularly engaging in business in this state under section 231- ; and (3) does not pay or is not otherwise required to pay the tax imposed by this chapter for sales of tangible personal property to residents of this state, to file an annual statement with the department of taxation.

The annual statement shall be filed on forms provided or approved by the department of taxation on or before the fourth month following the close of the taxable year and include: (1) names of residents of this state to whom the out-of-state business sold tangible personal property during the taxable year; (2) dates of each sale; (3) zip code of the shipping address of each sale; and (4) dollar amount of each sale. Stipulates that except for the dollar amount required under paragraph (4), no information describing the tangible personal property sold shall be provided in the annual statement. Any person or entity that files an annual report pursuant to this section shall be relieved of any duty to collect the tax imposed by this chapter for sales of tangible personal property to residents of this state for the taxable year for which the annual statement is filed.

A person or entity shall have a physical presence in the state if the person or entity's business activities during a taxable year include: (1) being an individual physically present in the state, or assigning one or more employees to be in the state; (2) using the services of an agent, excluding any employee, to establish or maintain the person or entity's business activities in the state if the agent does not perform business services in the state for any other person or entity during the taxable year; or (3) the leasing or owning of tangible personal property or real property in the state.

Adds a new section to HRS chapter 237 to require any person or entity conducting business in this state that is presumed to be systematically and regularly engaging in business in this state, unless otherwise required to pay the tax imposed by this chapter for sales of tangible personal property to residents of this state, to file an annual statement with the department of taxation. This section shall not be applicable to a person or entity that has a physical presence in the state.

Amends HRS section 237-2 to provide that the definition of "engaging" in business shall include the sale of tangible personal property by a person soliciting business through an independent contractor or other representative if the person enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the person. 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 taxable year in question.

EFFECTIVE DATE: July 1, 2112 for tax years beginning after December 31, 2010

STAFF COMMENTS: The proposed measure would establish nexus in this state for companies located out of state if the business: (1) engages in or solicits business; and (2) earns income, gross proceeds, gross rental, or gross rental proceeds from sources in the state. Once nexus has been established, then it appears that these businesses would be subject to the general excise tax.

The proposed measure would also require an out-of-state business conducting business in the state that does not collect the general excise tax, to file an annual statement with the department of taxation with the names of residents of this state who were sold tangible personal property, date of the sale, zip code and dollar amount of the sale. The filing of this annual statement would relieve the business of the duty to collect any general excise tax on such purchases. It would appear that if the amendment to HRS chapter 231, as noted above, is adopted this provision would be unnecessary since the chapter 231 amendment would establish nexus for these out-of-state businesses who would then be subject to the general excise tax and whose transactions conducted in this state would presumably be taxed under the general excise tax.

This measure also proposes that the definition of engaging in business shall include the sale of tangible personal property by a person who solicits business through an independent contractor or other representative, if the person enters into an agreement with a resident of this state who refers potential customers, whether by a link on an Internet website or otherwise, for which the resident receives a commission or other consideration. If this provision is adopted, it would appear that the out-of-state business would be considered to be "engaging" in business in this state and would then become subject to the general excise tax.

While these provisions proposed in this measure would attempt to impose the general excise tax on out-of-state businesses who sell tangible personal property to residents of the state, it is questionable why services are not included.

While 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 that places the onus of burden on the manufacturer to collect the tax from the consumer, it is a work in progress and serious consideration should be given to refining the provisions of this proposal. For example, if the amendment to HRS chapter 231 is sufficient to establish nexus and, therefore, subject the out-of-state vendor to the general excise tax, then the second amendment requiring the filing of information may not be necessary. Conversely, if the requirement for filing sales information is deemed adequate in capturing the information on these sales, then the amendment to HRS chapter 231 may not be necessary.

Digested 3/22/11

# State Privacy and Security Coalition, Inc.

LATE

March 23, 2011

Honorable Carol Fukunaga, Chair
Hawaii Senate Economic Development
and Technology Committee
Hawaii State Capitol, Room 216
415 South Beretania Street
Honolulu, HI 96813

Re: Opposition to HB 1183

Dear Senator Fukunaga:

As a coalition of leading technology companies and technology trade associations, we write in opposition to HB 1183.

HB 1183 seeks to impose tax nexus on out-of-state businesses based on affiliate agreements or require out-of-state businesses to file annual statements with the state about purchases by Hawaii customers. While we understand and have sympathy for the State's needs for tax revenue, HB 1183 would not achieve this goal and would do more harm than good from the perspective of expanding state revenues.

As explained below, HB 1183 would raise little or no tax revenue. It would, however, cost jobs at Hawaii small businesses that earn advertising revenue as Internet affiliates. These employers would no longer be viable affiliate partners for out of state businesses and would lose revenue immediately if the bill becomes law, and as a result would pay less in taxes and would lay off workers in the State. Moreover, if the law is struck down as unconstitutional for attempting to tax out of state commerce in violation of U.S. Supreme Court precedent, the State would owe hundreds of thousands of dollars of attorney's fees to the plaintiffs in the case.

Additionally, the Direct Marketing Association (DMA) just won a preliminary injunction in federal court through a lawsuit it filed against a similar tax notice law that passed in Colorado, with the court finding that the DMA would likely prevail in its claim that the Colorado reporting law violated the U.S. Constitution.

HB 1183 would have the unintended consequence of imperiling jobs at a broad range of small businesses in Hawaii that obtain advertising revenue from out-of-state businesses. Many of these employers threatened by HB 1183 advertise valuable products and services tailored to Hawaii residents on behalf of out-of-state retailers. These employers function very much like newspaper advertising. They operate entirely independently of the actual sellers and never touch the goods or provide the services that are sold.

500 8th Street, NW
Washington, DC 20004
202.799.4000 Tel
202.799.5000 Fax

If HB 1183 passes, many out-of-state businesses that use commission-based advertising would simply move their advertising out of Hawaii to other states, depriving many Hawaii small businesses of important revenue streams in a difficult economy that will cost Hawaii jobs.

When New York enacted a law similar to HB 1183, many out-of-state businesses terminated their commission program with New York residents. Similarly, in North Carolina and Rhode Island, two other states which have enacted laws like HB 1183, Internet retailers cancelled contracts with in-state affiliate businesses, and moved their affiliate arrangements to other states that do not tax commission-based advertising in this way, leading to a large North Carolina-based affiliate business leaving the state and laying off all its workers. In fact, in Connecticut, out-of-state businesses quickly cancelled their commission programs with state residents after a Senate *Committee* simply passed a similar bill through committee. The fear and concern of the bill actually passing led to immediate cancellation of the commission programs, demonstrating that the potential harm in this regard is far from theoretical.

The imposition of this tax would harm employment in Hawaii, while providing only negligible benefits. Indeed, by threatening the viability of Hawaii affiliates that rely on the advertising revenue targeted by HB 1183, Hawaii may actually *lose* tax revenue from small businesses that currently remit tax to the State. Moreover, as noted above, if out-of-state businesses simply choose to cancel their commission-based advertising programs, Hawaii will obtain no additional tax revenue at all.

In fact, while fiscal notes in Rhode Island and North Carolina predicted that similar laws that passed in those states would increase revenue, these predictions have proven false. Officials at the Rhode Island Department of Revenue have acknowledged that no additional sales tax has been collected as a result of its new affiliate taxation law. Moreover, the General Treasurer of Rhode Island, Frank Caprio, noted that "[t]he affiliate tax has hurt Rhode Island businesses and stifled their growth, as they've been shut out of some of the world's largest marketplaces, and [it] should be repealed immediately."

Separately, HB 1183 artificially and unconstitutionally seeks to establish a nexus between out-of-state businesses and Hawaii where only the most attenuated link exists. HB 1183 seeks to circumvent the limitations on nexus imposed by the Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

Notably, the Supreme Court characterized Quill's operations in a way that is substantially similar to the operations of out-of-state businesses who, under HB 1183, would be unconstitutionally compelled to collect taxes on Hawaii' behalf. The Court noted that "Quill sells office equipment and supplies; it solicits business through catalogs and flyers, advertisements in national periodicals, and telephone calls." *Id.* at 302. In outlining the constitutional contours of cases in which the imposition of sales and use taxes were upheld, the Court emphasized that



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"[t]hese cases all involved some sort of *physical presence* within the State..." *Id.* at 306 (emphasis added); *see also National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 758 (1967)("But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail.").

The Court has never held that mere advertising is sufficient to establish nexus with an out-of-state corporation HB 1183, however, creates a legal fiction in which this well-settled principle can simply be ignored. Despite the fact that *Quill* remains settled law, HB 1183 would ignore the rule in this case.

Moreover, in *Quill*, the Court opined that a "a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Id.* at 316. If enacted, HB 1183 would eviscerate the significant benefits specifically cited by the *Quill* Court in explaining its rationale for a bright line rule in this area. The settled expectations of both out-of-state businesses and Hawaii businesses would be significantly disrupted, which would discourage advertising dollars from flowing into Hawaii.

For all of these reasons, we strongly oppose HB 1183.

Sincerely,

Adrian B. Copiz
Counsel

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