

TAXBILLSERVICE

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SUBJECT: USE, Taxation of out-of-state businesses

BILL NUMBER: HB 1694, Proposed HD-2

INTRODUCED BY: House Committee on Finance

BRIEF SUMMARY: Adds a new section, paragraph (g), to HRS section 238-6 to provide that the use tax shall not be collected by a seller engaged in business in the state if: (1) the seller can demonstrate that the person in the state with whom the seller has an agreement did not engage in referrals in the state on behalf of the seller that would satisfy the requirements of the commerce clause of the U.S. Constitution; (2) the person in the state with whom the seller has an agreement did not engage in any activity within the state that was significantly associated with the seller's ability to establish or maintain the seller's market in the state during the preceding twelve months.

Defines "engaged in business in the state" to mean a seller, including an entity affiliated with a seller within the meaning of Section 1504 of the Internal Revenue Code (IRC), that has substantial nexus in the state for purposes of the commerce clause of the U.S. Constitution which would permit the state to impose the use tax, and includes: (1) any seller that is a member of a commonly controlled group that includes an entity that has a substantial nexus with the state and: (A) sells a similar line of products as the seller and does so under the same or similar business name; or (B) uses trademarks, service marks, or trade names in the state that are the same or substantially similar to those used by the seller; (2) any seller that is a member of a commonly controlled group that includes another member that performs services in the state in connection with tangible personal property to be sold by the seller, including the design and development of tangible personal property sold by the seller, or the solicitation of sales of tangible personal property on behalf of the seller; and (3) any seller entering into an agreement where a person in the state, for a commission or other consideration, refers potential purchasers of tangible personal property to the seller, whether by an internet-based link or an internet website provided that: (A) the total cumulative sales price from all of the seller's sales, within the preceding twelve months, of tangible personal property to purchasers in the state is in excess of \$10,000; and (B) the seller, within the preceding twelve months, has total cumulative sales of tangible personal property to purchasers in the state in excess of \$10,000.

An agreement under which a seller purchases advertisements from a person in the state, to be delivered on television, radio, in print, or on the internet, shall not be considered an agreement for the purposes of this paragraph unless the advertisement revenue paid to the person in the state consists of commissions or other consideration that is based upon sales of tangible personal property. An agreement where a seller engages a person in the state to place an advertisement on an internet web site operated by that person, or operated by another person in the state, is not an agreement for the purposes of this paragraph unless the person entering the agreement with the seller also directly or indirectly solicits potential customers in the state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in the state.

Requires the director of taxation, prior to the convening of the 2013 regular session, to certify in writing to the governor and the legislature whether federal law has been enacted by December 31, 2012 authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller.

Defines “commonly controlled group” for purposes of the measure.

This Act shall take effect on July 1, 2012 if the state does not, by June 30, 2013, enact a law in accordance with any federal law authorizing the states to require a seller to collect taxes on sales of goods to in-state purchasers without regard to the location of the seller.

EFFECTIVE DATE: July 1, 2112

STAFF COMMENTS: This measure provides that the definition of engaging in business shall include the sale of tangible personal property by an out-of-state seller that is a member of a commonly controlled group that includes another member that, pursuant to an agreement in cooperation with the seller, performs services in the state in connection with tangible personal property to be sold by the seller, including the design and development of tangible personal property sold by the seller, or the solicitation of sales of tangible personal property on behalf of the seller; and any seller who enters into an agreement with a person in the state.

Should that in-state person refer potential purchasers of tangible personal property to the seller, by an internet-based link or internet website, and receive a commission or other consideration, provided that: (a) the total cumulative sales from all of the seller’s sales, within the preceding twelve months, of tangible personal property to purchasers in the state that are referred pursuant to all of those agreements with a person in the state, are in excess of \$10,000; and (b) the seller, within the preceding twelve months, has total cumulative sales of tangible personal property to purchasers in the state in excess of \$10,000; then the seller will be considered to be engaging in business in the state. However, it is questionable whether the seller would be subject to the general excise tax or use tax. If the intent of this measure is to subject the sales of the seller to the general excise tax, then these provisions should be inserted into HRS chapter 237 rather than HRS chapter 238.

This approach to collecting the general excise or use 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 seller to collect the tax from the consumer. This approach is a work in progress and serious consideration should be given to refining the provisions of this proposal. However, it is far superior to the approach of the “streamlined sales tax” in that it continues to maintain the structure and philosophy of the general excise tax rather than attempting to change Hawaii’s tax into a “sales tax.”

It should be noted that “nexus” has been the defining standard as to whether a company must collect and remit sales and/or use taxes. **Quill Corp. v. North Dakota, 504 U.S. 298 (1992)** is a Supreme Court ruling concerning use tax. Quill Corporation is an office supply retailer that had no physical presence in North Dakota, but it had a licensed computer software program that some of its North Dakota customers used for checking Quill’s current inventories and placed orders directly. North Dakota attempted to impose a use tax on Quill, which was struck down by the Supreme Court that ruled that a business must have a physical presence in a state for that state to require its sales tax to be collected. If Congress

overturns the Quill decision by enacting legislation which would not require such a standard, all companies would have to begin collecting and remitting the appropriate sales tax on sales in interstate commerce.

This bill mirrors many others that have been adopted by other states in recent years. Leading the way has been New York which adopted a similar measure more than four years ago and has been collecting its sales tax on such cross-border sales from vendors who have no physical presence in that state. California reached an agreement with Amazon.com recently and will be requiring that internet giant to begin collecting its sales taxes on purchases made by its residents from that vendor in September. And just last week, the governor of Maryland announced that an agreement had been reached with Amazon and other stakeholders including the "brick and mortar" retailers of Maryland with the adoption of a measure that will require out-of-state vendors to collect sales taxes on the sale of goods to in-state customers by out-of-state vendors.

A recent study of the issue entitled "Collecting Hawaii's General Excise Tax on E-commerce" was issued by this office and provides a status report as of the end of the last calendar year as to where other states are in requiring the collection of their state sales taxes by out-of-state vendors. The study also notes that adoption of this measure does not represent a tax increase, but a mechanism by which taxes already due under the general excise/use tax can be collected. More importantly, the study underscores the fact that Hawaii does not have a retail sales tax structure like the forty some other retail sales tax states and that adoption of this approach to the collection of taxes from out-of-state vendors preserves the integrity of Hawaii's unique general excise tax, something that the Streamlined Sales Tax Project tends to ignore.

Digested 2/28/12

COLLECTING HAWAII'S GENERAL EXCISE TAX ON E-COMMERCE

Tax Foundation of Hawaii

February 2012

THE CHALLENGE

The issue of cross-state sales has plagued the taxation community for years. Beginning with the court case known as *National Bellas Hess v. Department of Revenue* and more recently the decision in the court case known as *Quill Corporation v. North Dakota*, the problem of collection of state sales taxes on purchases delivered to a customer in that state has led to a variety of efforts to try and force sellers or vendors to collect the sales taxes of the state to which the goods sold are delivered.

States where a vendor has presence or what is called nexus have no problem in getting those vendors to collect and remit the state's sales tax on goods delivered across state lines. The problem arises for those vendors who do not have a physical presence in a state where customers have placed orders for goods to be shipped to them. Both the *National Bellas Hess* and *Quill* decisions basically found that forcing vendors to collect state sales taxes on purchases made by customers located in a state where the vendor has no physical presence imposed a hardship on those vendors and infringed on the Interstate Commerce Clause.

While fifty years ago, the issue was largely limited to catalog or mail order sales and to some degree telephone sales, the explosion of the Internet in recent years has expanded the problem to the extent that Main Street retailers joined forces with lawmakers across the nation to address this problem. For the brick and mortar retailers on Main Street, this was viewed as unfair competition as out-of-state vendors did not have to add the local sales tax to the price of their products, resulting in unfair competition. For lawmakers, the growth of interstate sales represented the loss of sales tax revenues, especially in recent years when all state governments tried to grapple with the downturn in the economy and the loss of revenues from the variety of

taxes their jurisdictions impose, from sales to income taxes to real property taxes as workers lost their jobs or businesses closed.

As a result, the National Conference of State Legislatures undertook a project to design a system to allow states to force vendors located in another state and who do not have presence or “nexus” in their state to collect that state’s sales taxes. Known as the “Streamlined Sales Tax Project,” the proposal would have vendors collect the sales tax of the state to which the goods or products are shipped. In order to deal with the multiplicity of jurisdictions within a state that may impose a retail sales tax, the proposal would limit the number of rates each state could request vendors to collect to not more than two. Beyond those basic agreements, discussion on how the project would be implemented has raged on for more than a decade.

Some of the key issues include “sourcing” rules, that is, where are the sales taxes to be imposed on such cross-state sales be they the sales tax of the state where the vendor is located or is it to be the sales tax of the state where the customer receives the goods or products. Because so many states have specific exemptions, goods subject to the collection of sales tax need to be standardized. For example, food products in some states are exempt from the sales tax whereas in others, food products are taxable. Then within the exempt food category, some states tax candy while others exempt confectionaries.

Because the court rulings were based on the violation of the Interstate Commerce Clause, the implementation of any version of the Streamlined Sales Tax Project would require Congress to authorize the states to enforce the collection of sales taxes by these cross-state vendors. Delay in Congressional action certainly is a result of the lack of a compromised proposal, the likelihood that Congress will ever approve such an authorization grows dimmer by the day as the federal government is faced with its own financial challenges .

HAWAII'S GENERAL EXCISE TAX

For Hawaii, the key issue in the pursuit of taxing interstate sales is much more complex because basically, Hawaii does not have a retail sales tax as found in the some forty other states. Hawaii's general excise tax is a tax on gross income and it is levied on both retail and wholesale transactions. Further, unlike the retail sales tax, the general excise tax is levied on both goods and services. Again, because it is a tax on gross income, the rate is levied on every penny that is placed in the cash drawer including any amount that may have been shown out as the "sales tax" imposed on the transaction.

Hawaii's general excise tax is based on the philosophy that the tax is imposed for the privilege of doing business in Hawaii. Thus, any locally-based vendor selling goods or services in Hawaii pays for the "privilege" by paying the general excise tax. Recognizing that resident consumers may make purchases from vendors who have no physical presence in Hawaii and therefore do not pay for the privilege of doing business in Hawaii, a complementary "use" tax is imposed on the recipient of goods or services purchased from an out-of-state vendor. However, aside from large ticket items, such automobiles which must be registered with the local DMV and prefabricated structures which need a county building permit, monitoring individual purchases and enforcing the state's use tax is difficult if not impossible.

Although bills which would have Hawaii participate in the Streamlined Sales Tax Project by adopting the model legislation have been introduced in the Hawaii legislature, there has been subtle resistance in doing so. Although a measure did make it through the legislative process one year, it merely mandated the tax department to set up a study group. The measure was vetoed by the governor but was later overridden by the legislature.

The 2005 measure directed the department of taxation to identify issues that need to be resolved to effectuate the orderly enactment and operation of a streamlined sales and use tax based on the Streamlined Sales Tax Project's Model Agreement and Act. The act also deleted the streamlined sales and use tax advisory committee council which was to consult with the department of taxation on the implementation of the streamlined sales and use tax agreement in Hawaii.

Inasmuch as the model legislation basically would restructure the state's general excise tax to look more like a retail sales tax, lawmakers appear to fear the loss of the revenue generating capacity of the broad-based general excise tax.

NOVEL ALTERNATIVE

However, in recent years other states have come up with novel approaches to capturing sales taxes on these cross-state sales. These efforts have been largely focused on redefining the term "physical presence" or nexus. In the world of Internet sales, many websites carry marketing for other products or other websites to allow a broader reach of unfamiliar products and services to advertise because their products were seen on a more popular website. These websites which consider them affiliates, then pay a fee or commission to the website that referred a customer to them, which resulted in a sale. Thus, the target of this broadening of "physical presence" has been focused on the e-commerce vendor as they receive commissions by linking to the online vendor's site and facilitating a sale to the site.

Known as the "Amazon" bill, these proposals have been picked up and discussed in many states. Hawaii's legislature approved such a measure in 2009 and sent it to the governor for approval; however, when Amazon learned of its passage, it threatened to terminate all its

affiliates who were located in Hawaii. Those affiliates, in turn, brought pressure to veto the measure.

Since that time a number of states have adopted similar Amazon measures, the largest being California and New York. With large consumer bases, those states have become the turning point in this debate. New York has been collecting sales taxes on Internet sales since 2008 while California will begin collecting on Internet sales later this fall. A status report of where states are in finding ways to capture e-commerce transactions follows in PART III.

AND HOW MUCH?

While no one can put their finger precisely on how much capturing e-commerce sales will bring to Hawaii's coffers, there is no doubt money is to be had for the state treasury by collecting the general excise tax or the use tax that would otherwise have been imposed had the purchase of goods or services been made from Hawaii retailers. Estimates made for the National Conference of State Legislatures (NCSL) pegged the revenue gains for Hawaii in 2005 at \$112 to \$117 million and expected that number to grow to \$157 to \$245 million by the year 2008. In his report to the 2005-2007 Tax Review Commission, consultant Dr. William Fox of the University of Tennessee stated that the SSTP could raise as much as \$10 million. And in testimony provided by the department of taxation in 2009 on SB 1678, it was estimated that the SSTP would raise as much as \$25 million.

Indeed, if Hawaii consumers complied with the requirements of the use tax law, the tax should have been paid on those purchases from out-of-state vendors. Avoidance, whether intentionally or as a matter of ignorance, has meant that the overall tax burden has had to remain high and in recent years the burden of taxes has been increased because of the revenue shortfalls created by the economic downturn. Given the continuing sluggish pace of revenue growth,

proposals abound this session to raise more money by imposing new fees and taxes, but primarily in the area of fees. From an increase in the motor vehicle registration fee to fund the programs for the disabled to a new fee for single-use plastic bags, new sources of revenue are being sought by all departments.

Collection of the existing general excise and use tax on purchases made from out-of-state vendors is not a new tax, but enforcement of the existing laws would insure compliance with the law. Not only is it a collection of what is already owed to the state but it truly is enforcement of the tax structure that levels the playing field for licensed businesses in the state who have now found themselves competing with out-of-state vendors who not only enjoy the competitive advantage of not having to pay the general excise tax, but also do not have the high cost of doing business in Hawaii. Regardless, it would capture revenues that are not being collected at present.

NEXT STEPS

The time has come for the legislature to enact laws that will help in collecting the general excise and use tax on purchases made from out-of-state vendors, especially those who sell over the Internet where the volume of sales has grown in recent years. Such an effort would not only benefit the state coffers, but it would level the playing field for Hawaii's businesses. However, in doing so, lawmakers need to insure that the integrity of the general excise/use tax is not jeopardized. Lawmakers need to recognize that Hawaii's general excise tax has an extremely broad base by comparison to the retail sales tax structure that allows a very low rate to be imposed but produces extremely generous revenues.

To that end, lawmakers are presented this session with the two major approaches to the problem, the Streamlined Sales and Use Tax embodied in SB 2226, and the "Amazon" approach

which is embodied in HB 1694. PART II, which follows, provides a brief summary of the two bills and describes the different approaches to taxing e-commerce transactions.

PART II

PENDING IN THE LEGISLATIVE HOPPER

HB 1694 - (Introduced in 2012) - This measure provides that the definition of engaging in business shall include the sale of tangible personal property by an out-of-state seller that is a member of a commonly controlled group that includes another member that, pursuant to an agreement in cooperation with the seller, performs services in the state in connection with tangible personal property to be sold by the seller. This would include the design and development of tangible personal property sold by the seller, or the solicitation of sales of tangible personal property on behalf of the seller; and any seller who enters into an agreement with a person in the state sometimes known as “affiliates,” who refers potential purchasers of tangible personal property to the seller, by an Internet-based link or Internet web site or otherwise, and receives a commission or other consideration.

This agreement would trigger the application of this treatment provided that: (a) the total cumulative sales from all of the seller’s sales, within the preceding twelve months, of tangible personal property to purchasers in the state that are referred pursuant to all of those agreements with a person in the state, are in excess of \$10,000; and (b) the seller, within the preceding twelve months, has total cumulative sales of tangible personal property to purchasers in the state in excess of \$1,000,000.

The measure provides that if these conditions are satisfied, the out-of-state seller would be considered to be “engaging” in business in this state. However, it is not clear if the seller would be subject to the general excise tax or use tax. If the idea is that the agreement or

relationship gives rise to “physical presence” or “nexus,” the seller would then have to be a licensed “seller” under the general excise tax.

SB 2226 - (Introduced in 2012) - **Streamlined Sales Tax Measure** - The Streamlined Sales Tax Project’s Model Agreement and Act is a project undertaken with other states that is intended to simplify sales and use tax administration as it relates to multiple sales and use tax rates, definitions, and taxing jurisdictions

The measure adds new chapters to the law to set out sections of the general excise and use tax which would subject transactions to the 0.5% tax rate or the 0.15% tax rate on “commissioned sellers of insurance.”

The measure adds several new sections to the general excise tax to establish sourcing rules to determine when a product or service is taxed, including telecommunication services. The measure delineates provisions defining “direct mail” and how the sourcing of direct mail transactions will be ascertained.

Adds several sections to the current Simplified Sales and Use Tax Administration Act to establish provisions relating to the determination of the proper general excise or use tax rates between different tax jurisdictions, rounding on tax computations, amnesty for registered sellers who pay, collect, or remit general excise or use taxes in accordance with the terms of the Streamlined Sales and Use Tax Agreement, tax rate changes by a county, certified service provider, confidentiality of records, liability for uncollected taxes and rate changes, and customer refund procedures.

Adds provisions to the general excise and use tax chapters to prohibit a county from conducting independent audits of sellers registered under the Streamlined Sales and Use Tax Agreement.

Establishes a committee to oversee the department of taxation's implementation, administration, and compliance of the Streamlined Sales and Use Tax Agreement. The committee shall be administratively attached to the department of taxation. Requires the committee to hold meetings to carry out the act and serve as the state's official delegation to the Streamlined Sales and Use Tax governing board when establishing the state's criteria for compliance.

This act would take effect when the state becomes a party to the Streamlined Sales and Use Tax agreement.

Basically, the measure attempts to turn Hawaii's gross receipts tax imposed for the privilege of doing business in Hawaii into a retail sales tax structure with respect to where the tax is imposed. Much of the bill is devoted to separating the wholesale imposition of the tax from the retail and then reworking where the tax is applied otherwise known as "sourcing." The general excise tax, as it is known today, would be radically changed to accommodate the format adopted by the Streamlined Sales Tax Project (SSTP).

What is not evident in the measure is that by participating in the consortium known as the SSTP, Hawaii businesses will be required to collect the sales taxes of other states when purchases are made by residents of that state. The cost of collecting, accounting, and remitting those taxes will add even more overhead costs to operating a business in Hawaii.

So what are the other states doing in this arena? As noted earlier, New York has been collecting its sales tax on e-commerce transactions since 2008, while California is expected to start collecting its tax on such transactions beginning later this fall. The following is a compilation of what other states are doing and where they are as far as reaching the point of collecting sales taxes on such transactions.

PART III

States That Are Collecting Sales Taxes on Amazon.com Purchases:

Arkansas - Governor Mike Beebe signed a measure on April 1, 2011 that imposes sales tax-collection responsibilities on Internet retailers that are referred visitors by affiliate web sites based in Arkansas and generate more than \$10,000 a year in sales from Arkansas residents. The measure took effect in July of 2011.

Connecticut - Requires sales tax collection by all retailers who receive more than \$2,000 per year in sales from affiliate web sites based in the state on July 1, 2011. Other states have higher thresholds. This law covers more retailers than the laws in other states, because it has a lower sales threshold.

Illinois - Governor Pat Quinn signed legislation requiring Internet retailers like Amazon.com and Overstock.com to collect Illinois' 6.25% sales tax if they have affiliate sellers in the state on March 3, 2011. House Bill 3659, the Main Street Fairness Bill, was passed by the state's lame duck legislature in early January. Since then, the bill has been the subject of fierce lobbying by traditional brick and mortar retailers, who support it, and Illinois-based Internet-only businesses, who warned that if Quinn didn't veto it, some of them would flee the state. Subsequently, Amazon has terminated its Illinois' affiliates on April 15, 2011. Affiliates are paid a fee by Amazon and other retailers for sales brought in through advertisements and links on the affiliates' web sites.

Kansas - Amazon has a physical presence in Kansas so Amazon is collecting the sales tax on its sales in Kansas.

Kentucky - Amazon built a distribution center in Lexington, Kentucky so Amazon is collecting the sales tax on its sales in Kentucky.

New York - New York has been collecting sales taxes on Internet sales since 2008. The New York measure was first quietly floated in a memo from the state Department of Taxation and Finance in late 2007, but after it faced enormous opposition, then Governor Eliot Spitzer killed it. A few months later, Spitzer revived the idea in a budget proposal that aimed to fill a \$4.4 billion deficit and cope with the already slowing national economy. The measure states that any online retailer that generates more than \$10,000 in sales via in-state sales affiliates must collect New York sales tax. Many online retailers, including Amazon.com and Buy.com, have sales affiliates nationwide that link to the retailer's web site and are paid commissions on any sales generated from their referrals. New York's measure clarifies state tax law to say that sales affiliates based in the state are representatives of the online retailer. This means that the retailer has nexus (i.e., a physical presence) in the state and is required to collect state sales taxes.

Amazon brought suit challenging the constitutionality of the recently enacted legislation. On November 4, 2010, a New York state appellate court ruled that New York's law does not violate on its face, the commerce or due process clauses of the U.S. Constitution. The case was brought by Amazon.com and Overstock.com, which argued that the state did not have the authority to require online retailers to collect sales tax based on the nexus provided their in-state sales affiliates. The court did say that two of the online retailers' claims could be reinstated for further review. The claims dealt with the question of whether the retailers' affiliates solicit sales or are simply advertisers. The court said that there was not sufficient evidence in the record to make a determination on this question. However, the rest of the ruling suggests that Amazon.com and Overstock.com are unlikely to succeed on these points during further proceedings.

North Dakota - Amazon is collecting sales tax on Amazon.com sales in North Dakota.

Texas - Texas lawmakers approved legislation in 2011 that defined Amazon's distribution center

in Fort Worth as establishing a “physical nexus” in Texas, thereby obligating the Seattle-based company to collect the tax on sales to Texas residents.

Washington - Since Amazon is based in Washington, Amazon is collecting sales tax on their sales in the state of Washington.

States That Will Be Collecting Sales Taxes on Purchases from Amazon.com:

California - Amazon and other Internet companies would be required to collect sales taxes on September 15, 2012 if Congress fails to pass nationwide legislation regarding online sales tax collection. Governor Brown signed the measure on September 23, 2011. If Congress enacts federal legislation, then this measure will take effect in January 2013. The measure also delayed the deadline for one year by which the Internet companies would be required to collect the sales tax since Amazon has pledged to create at least 10,000 full-time jobs and hire 25,000 seasonal employees in California by 2015. Amazon will also be dropping a referendum campaign to overturn a new law that requires Internet retailers to collect sales tax if they have affiliates and subsidiaries in the state.

Indiana - Amazon will begin collecting Indiana’s 7% sales tax from customers in the state in 2014 under an agreement announced on January 9, 2012. The agreement follows a lawsuit by Indianapolis-based shopping mall owner Simon Property Group against the online retail giants and a lobbying push by traditional retailers to end what they call an unfair price advantage for all online retailers. The deal doesn’t include any other companies, but the state is asking Congress to require all online businesses to collect state sales taxes.

Oklahoma - Requires retailers who do not collect sales taxes to provide customers with notification on their website or catalog and invoices that a use tax is owed and must be paid by

the purchaser unless the purchase is otherwise exempt. The notification requirement also applies to “online auction websites.” This law is not effective until the Oklahoma Tax Commissioner enacts an administrative rule regarding the law.

Pennsylvania - The Department of Revenue of Pennsylvania on December 1, 2011 posted a regulatory bulletin on its website saying it will enforce the collection of sales taxes by any remote retailer, including catalog and online retailers with a physical presence in Pennsylvania.

Remote retailers have a 60-day grace period to determine if they have nexus in Pennsylvania, by which time they’ll be required to obtain a retail license and begin collecting sales taxes by February 1, 2012. The state also will treat associates and affiliated websites that promote online retail sales in Pennsylvania as equal to a physical nexus, according to the bulletin.

Pennsylvania’s law has required any business with a subsidiary, representative or agent and physical property to collect sales taxes since 1971, according to the bulletin. At least since 1992, many remote retailers hadn’t collected sales taxes due to a U.S. Supreme Court ruling that required nexus, or physical presence.

Rhode Island - Rhode Island passed a law in 2009 to force e-retailers that have local business affiliates to assess sales taxes on goods sold to Rhode Island residents.

Tennessee - Governor Bill Haslam announced that Amazon, which recently opened two distribution centers in the state in 2011, will be required to collect state sales tax beginning January 1, 2014. This compromise was reached as a way to bring new jobs to the state, address the concerns of traditional brick-and-mortar retailers, and provide increased revenue to Tennessee. Amazon anticipates that the new distribution centers, which currently employ 1,500 workers, will soon add an additional 2,000 full-time positions as well as numerous part-time and seasonal jobs.

States Considering Legislation Taxing Amazon's Sales:

Hawaii - In 2009, Hawaii Governor Linda Lingle vetoed a bill that would have required online retailers such as Amazon.com and Overstock.com to collect and pay sales taxes on their affiliate programs within the state. Both Amazon and Overstock had notified affiliates in the state that they would be ending their programs there due to the new tax requirements. Governor Lingle stated, "I am vetoing this bill immediately to help ensure Hawaii is not economically hurt by legislation that was not well thought-out and would have negative consequences for non-profits such as the University of Hawaii bookstore, and businesses throughout our State." Governor Lingle said, "I am hopeful by vetoing this bill that mainland-based companies will promptly restore their relationships with our State." Amazon said in an email it would be willing to reopen its associates program in Hawaii if the tax law was vetoed. It should be noted that Hawaii, like other states has a "use tax" which is imposed on the sale of goods purchased out-of-state to make the price of goods purchased out of state competitive with those purchased in state.

Florida, Massachusetts, Minnesota, Missouri, New Mexico, Vermont - are considering some type of "Amazon" tax.

Information Reporting - Tax Responsibility of Purchaser:

Colorado - In 2010, Colorado passed a law requiring "information reporting" on online retailers, instead of requiring them to collect and remit sales and use taxes. Under the bill, the obligation to report is placed on online retailers who do not already collect taxes on Internet sales. Shortly after the Colorado measure was signed by then Governor Bill Ritter in February 2010, policymakers suggested the law could be a game-changer for states facing budget crises and not an effective way to collect sales and use taxes on Internet sales. Under the law, out-of-state

retailers are not otherwise required to collect sales tax must report the identities and aggregate purchases of their customers to the Colorado Department of Revenue. They must also inform consumers of their obligation to remit sales and use taxes due the state. Failure to do so would result in significant penalties. This law was halted January 26, 2011 by a federal judge in Colorado citing constitutional concerns (*Direct Marketing Association v. Huber*, D. Colo., No. 10-cv-01546-REB-CBS, 1/26/11). Judge Robert Blackburn of the U.S. District Court for the District of Colorado said that the state's law and regulations imposed burdens on the out-of-state retailers who had no connection with Colorado customers other than by common carrier or the United States mail and, therefore, granted the preliminary injunction sought by the Direct Marketing Association. Blackburn said DMA demonstrated a substantial likelihood of success on both its discrimination claim and its undue burden claim under the dormant Commerce Clause.

Nevada - Amazon.com Inc.'s closure of a suburban Dallas distribution center amid a dispute with Texas officials over a bill issued for millions of dollars in uncollected taxes could mean the loss of jobs in other states that seek to force the online retailer to collect sales taxes. At issue is whether Amazon's distribution centers, where products are packed and shipped to buyers, count as a physical presence in a state, and whether sales taxes should be collected on merchandise shipped within that state. Under current law, Amazon is not required to collect sales tax in Nevada. Customers here must fill out tax forms concerning their purchases and send their sales tax payments to the Nevada Department of Taxation.

South Dakota - On March 11, 2011, South Dakota chose the Colorado approach, requiring businesses who sell in the state to notify their customers of their personal use tax obligation,

applicable to online auction websites who facilitate gross sales in South Dakota of more than \$100,000 per year; and online retailers who sell more than \$100,000 in South Dakota.

Other Strategies:

Virginia - Amazon is continuing its strategy of pursuing retail locations where it is exempted from collecting sales taxes. Amazon and Virginia Governor Bob McDonnell announced the company's plans to open an \$85 million, 1.1-million-square-foot center at Meadowville Technology Park in Chesterfield County that will create 1,000 jobs and invest \$50 million in a facility in Dinwiddie County, creating more than 350 jobs.



**Testimony to the House Committee on Finance
Wednesday, February 29, 2012
12:30 p.m.
State Capitol - Conference Room 308
Agenda #3**

RE: HOUSE BILL NO. 1694 HD1 RELATING TO TAXATION

Chair Oshiro, Vice Chair Lee, and members of the committee:

My name is Jim Tollefson and I am the President and CEO of The Chamber of Commerce of Hawaii ("The Chamber"). The Chamber supports the intent of HB 1694 relating to Taxation and respectfully asks the committee to pass this measure for further discussion.

The Chamber is the largest business organization in Hawaii, representing more than 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of its members, which employ more than 200,000 individuals, to improve the state's economic climate and to foster positive action on issues of common concern.

Currently, many internet-based sellers unfairly benefit from the State's inability to enforce the Use Tax against individual purchasers. The result is often lost revenue by the State, and lost sales by conventional retailers, many of which provide employment opportunities for our residents. The bill would help eliminate this tax gap by requiring internet-based sellers to collect Use Tax on behalf of local purchasers. We believe that measures such as these, which improve the enforceability of existing tax laws, are far preferable to new and higher taxes as the means of meeting the State's budgetary requirements.

Thank you for the opportunity provide testimony.

GOODSILL ANDERSON QUINN & STIFEL

A LIMITED LIABILITY LAW PARTNERSHIP LLP

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TO: Representative Marcus R. Oshiro
Chair, Committee on Finance
Via Capitol Web Page

FROM: Mihoko E. Ito

DATE: February 27, 2012

RE: **H.B. 1694, HD1 – Relating to Taxation**
Hearing: Wednesday, February 29, 2012 at 12:30 p.m., Agenda #3
Room 308

Dear Chair Oshiro and Members of the Committee on Finance:

I am Mihoko Ito, an attorney with Goodsill Anderson Quinn & Stifel, submitting comments on behalf of Walgreen Co. (“Walgreens”). Walgreens operates more than 8,200 locations in all 50 states, the District of Columbia and Puerto Rico. In Hawai‘i, Walgreens now has 11 stores on the islands of Oahu, Maui and Hawai‘i.

Walgreens **supports** H.B. 1694, HD1, which requires the collection of use taxes by sellers of tangible personal property who enter into agreements under which a person in the State refers potential purchasers to the seller, including by an internet link or web site, or performs related services in the State on behalf of the seller.

Walgreens supports this measure because it seeks to level the playing field so that local “brick-and-mortar” stores operate under the same rules and online sellers. Walgreens believes that all retailers can conduct their business in a fair, competitive environment. With the changes in the marketplace, e-commerce has become a critical marketplace for both retailers to sell and consumers to buy products 24 hours a day, regardless of geography. However, tax collection laws, including those in Hawaii, have not changed to address the marketplace changes. Accordingly, Walgreens supports this measure to the extent that it seeks to enable the collection of use taxes from internet retail sellers.

Thank you very much for the opportunity to testify.



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February 28, 2012

The Honorable Marcus R. Oshiro, Chair
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

RE: H.B. 1694, Proposed H.D.2, Relating To Taxation

HEARING: Wednesday, February 28, 2012 at 12:30 p.m.

Aloha Chair Oshiro, Vice Chair Lee and Members of the Committee:

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance, here to testify on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,500 members in Hawai'i. HAR supports the intent of H.B. 1694, Proposed H.D.2, Relating to Taxation, which requires the collection of use taxes by sellers of tangible personal property who enter into agreements under which a person in the State refers potential purchasers to the seller, including by an internet link or web site, or performs related services in the State on behalf of the seller, unless preempted by federal law.

Currently, many states and municipalities are encountering unprecedented budget deficits. In order to meet their obligations many public agencies must either cut jobs and services or raise revenue from increasing sales taxes, property taxes or other business fees. Proposed federal legislation may give the states the power to collect revenue they are owed and help offset current budget shortfalls -- all without costing the federal government a dime.

Every day, brick-and-mortar retailers of all sizes collect and remit sales taxes, putting them at a significant competitive disadvantage to online and catalogue retailers who continue to reap the benefits from an antiquated and biased system. Proposed federal legislation may provide a fairer and more transparent market for community based retailers and it will help keep our downtowns vibrant by protecting much needed local jobs, promoting community investment and maintaining access to essential goods and services in our neighborhoods.

HAR therefore supports the intent of H.B. 1694, Proposed H.D.2, to the extent that it may become consistent with any proposed federal legislation.

Mahalo for the opportunity to submit testimony.



Representative Marcus Oshiro, Chair
Representative Marilyn Lee, Vice Chair
Committee on Finance
State Capitol, Honolulu, Hawaii 96813



HEARING Wednesday, February 29, 2012
 12:30 pm
 Conference Room 308
 Agenda #3

RE: **HB 1694, HD1 Relating to Taxation**

Chair Oshiro, Vice Chair Lee, 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 supporting the retail industry and business in general in Hawaii.

RMH supports HB1694, HD1 which, unless preempted by federal law, requires the collection of use taxes by sellers of tangible personal property who enter into agreements under which a person in the State refers potential purchasers to the seller, including by an internet link or web site, or performs related services in the State on behalf of the seller.

We are in an era of omnichannel retailing, with brick and mortar retailers leveraging innovative digital technologies to improve the consumer experience. But unlike our omnichannel counterparts, brick and mortar retailers must comply with 7,600 different state and local sales tax systems.

As electronic commerce continues its dramatic increase, traditional brick and mortar retailers are experiencing continued erosion of their sales base to remote sellers, which, under most circumstances, are not subject to tax mandates. HB1694, HD1 will level the playing field. The unfair disadvantage our Hawaii retailers are experiencing results in unrealized sales, lower tax revenue to the state and minimized revenue and resources to expand their operations and create jobs.

Twelve states enacted e-fairness and/or consumer use laws since 2008: New York, Rhode Island, North Carolina, Colorado, Oklahoma, Illinois, South Dakota, Arkansas, Connecticut, Vermont, California and Texas. Ten other states have legislation pending in 2012: Arizona, Florida, Georgia, Michigan, Minnesota, Missouri, New Jersey, Virginia, Utah and Hawaii.

The reality is that the State of Hawaii has considerable liabilities and unfunded mandates that cannot be satisfied without additional revenue or cutting essential services. It is more than reasonable to collect a tax that's already due before instituting new taxes on everyone. Tax revenue generated from online sales can be used to pay down deficits and get Hawaii back on track toward fiscal solvency.

RMH has been in considerable discussion with our national members, and understands that there are proposed amendments to this measure that will strengthen the bill for Hawaii. We urge your support. Thank you for your consideration and for the opportunity to comment on this measure.

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

Carol Pregill, President

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