



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

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The Twenty-Sixth Legislature, State of Hawaii
House of Representatives
Committee on Finance

LATE

Testimony by
Hawaii Government Employees Association
April 2, 2012

S.B. 2226, S.D. 2, H.D. 1 – RELATING TO TAXATION

The Hawaii Government Employees Association prefers the approach of S.B. 2226, S.D. 2, which makes specific changes to Hawaii's tax law that will enable the State to tax Internet-based transactions through its participation in the national Streamlined Sales and Use Tax Agreement (SSUTA) to the H.D. 1 version as amended by the Committee on Economic Revitalization and Business.

According to the National Conference of State Legislatures (NCSL), eight (8) states (Arkansas, California, Connecticut, Illinois, New York, North Carolina, Rhode Island and Vermont) have enacted what are called affiliate nexus legislation. These bills require out-of-state retailers that have contracts with "affiliates", which are independent entities within the state who link to an out-of-state business on their website and get a share of revenues from that business, to collect the state's sales and use tax.

Except for New York, little sales or use taxes have been collected because online vendors, including Amazon.com and Overstock.com, have cancelled their in-state affiliate arrangements. It was recently reported that Illinois collected \$12 million dollars less from their use tax during second half of 2011 after their affiliate nexus legislation took effect. Not surprisingly, Overstock.com and Amazon.com terminated their affiliate programs, meaning they avoided the new law completely.

The cancellation of these affiliate agreements means not only the affiliate nexus law does not apply, but also that state revenues may drop because of the reduced income of the affiliates. In New York, Amazon.com challenged the constitutionality of the legislation and has been collecting the use tax for the state while the matter is in litigation. Even if affiliate nexus laws are somewhat successful, they only reach remote vendors with affiliate arrangements, leaving states unable to collect full amount of use taxes owed.

Participation in the SSUTA requires Hawaii to change its tax law to be in conformity with the agreement. If enough states agree to a uniform framework, taxing Internet transactions could overcome constitutional barriers against infringements on interstate commerce by Congress enacting the necessary legislation in 2012.



There are several compelling reasons for taxing Internet-based transactions. Retail trade has been transformed by the Internet. As the popularity of "e-commerce" grows, fairness dictates that Internet-based transactions should be treated in the same manner as other retail transactions. Retail transactions that are taxable by "bricks and mortar" retailers should also be taxable when sold through the Internet.

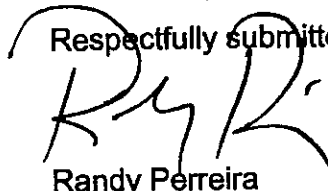
People in Hawaii and across the country are going online to buy a variety of goods (clothes, furniture, computers and electronics) in an effort to save money. While buying such goods may cost less than in a retail store, the purchases are costly to states and local government that miss the streamlined sales tax revenue. Hawaii has already lost millions of dollars in Internet-based sales, and the losses will likely increase as the importance of the Internet continues to grow. The NCSL estimates that states will lose \$23 billion in uncollected taxes this year from out-of-state sales, with almost half of that coming from Internet transactions.

These losses exacerbate the budget problems we face and affect the ability of state government to provide essential services such as education, health care, social services along with other important priorities. S.B. 2226, S.D. 2 will also allow the state to begin collecting use taxes that currently exist under Chapter 238, HRS, which are presently going uncollected on the majority of out-of-state purchases.

Therefore, we support S.B. 2226, S.D. 2 that makes the changes to the tax code to comply with the SSUTA. The ongoing loss of millions in tax revenue from e-commerce is a problem that will get worse over time unless we take appropriate action. The revenues gained through the Internet sales may be used to fund public education, health care, social services and other important state priorities.

Thank you for the opportunity to testify in support of the approach contained in S.B. 2226, S.D. 2.

Respectfully submitted,



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To: The Honorable Marcus R. Oshiro, Chair
and Members of the House Committee on Finance

Date: Monday, April 2, 2012
Time: 3:00 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 2226, S.D. 2, H.D. 1, Relating to Taxation

The Department of Taxation (Department) supports S.B. 2226, S.D. 2, H.D., but notes concerns regarding sections 1 through 3 of the measure as drafted. The Department recommends further amendments as set forth below.

S.B. 2226, S.D. 2, H.D. 1 prohibits penalties for substantial understatements or misstatements and for erroneous claims for refund or credit from being added to tax underpayments on which certain other penalties are already imposed. Unless preempted by federal law, this measure 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. The penalty stacking provisions of this bill (section 1-3), if passed, apply to taxable years beginning after December 31, 2011. The effective date of section 4 was changed to July 1, 2012 to facilitate further discussion.

Prohibition Against Penalty Stacking:

While the Department understands the concerns of the parties, the Department would note that the proposed draft may have the unintended consequence of preventing criminal prosecution in cases of fraud and willful failure to collect and pay over tax. This is because HRS §§ 231-36 and 231-36.4 are not civil penalty sections, but are rather criminal penalties, which are imposed only upon conviction of a crime by a competent court of law. By preventing the imposition of these penalties in cases where civil penalties have already been imposed under HRS §§ 231-36.6 and/or 231-36.8, this bill could prevent criminal prosecutions.

If the Legislature's intent is to only prevent the stacking of civil penalties, and not to prevent criminal prosecution in cases of fraud or willful failure to collect and pay over the tax, the Department recommends that the Committee amend the bill to refer only to HRS §§ 231-36.6 and 231-36.8.

The Department notes that even if the committee amends the bill to provide that the anti-stacking provisions of this measure apply solely to HRS §§ 231-36.6 and 231-36.8, the State would still not be in full conformance with the IRS's civil penalty procedures. Under federal law, willful failure to collect and pay over a tax, or to attempt to evade or defeat such tax, is subject to both civil penalties under IRC § 6672 and to criminal penalties under IRC § 7202.

Under IRC § 6672, the willful failure to collect and pay over tax, or to attempt to evade or defeat such tax, allows the imposition of a penalty of up to 100% of such tax otherwise due. This 100% penalty is intended to and does in fact act as a major deterrent in preventing a taxpayer failing to collect and/or pay over the subject tax or attempting to evade or defeat the tax. This 100% penalty is the primary reason why the IRC contains an anti-stacking provision.

Under Hawaii tax law, however, there is no 100% civil penalty for willful failure to collect and pay over the tax or to attempt to evade or to defeat such tax. Consequently, the anti-stacking protection is much less of an issue.

If this anti-stacking penalty provision is adopted, then the Department suggests that Legislature should also amend the various penalty provisions to authorize the imposition of a 100% penalty in cases of failure to collect and pay over a tax or in attempting to evade or defeat a tax. To do so, the Department recommends that: 1) section 2 of this measure be deleted; and 2) new subsection (e) in section 3 of the bill be replaced with the following language instead:

"(e) This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 231-36.6."

Finally, the Department would note that if a taxpayer desires to contest the imposition of multiple penalties, there are various remedies available to the taxpayer under existing law. For example, under HRS §231-3(12), the Department has the authority to remit penalties and interest in cases not involving fraud or willful violation of law. A taxpayer also has all rights of appeal and judicial review concerning the imposition of any tax or addition to tax, such that the rights of the taxpayer are already adequately protected.

Section 4: Amending the Use Tax Law, Section 238-6, HRS

If approved, this measure would be effective July 1, 2112 provided that section 1 of S.B. 2226, S.D. 2, H.D. 1 shall take effect on July 1, 2112, 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 regards to location of the seller.

The Department supports further clarity to the state's existing use tax law, as proposed in this measure, particularly with respect to interstate sales. The problem of collecting taxes owed on

interstate sales transactions is not unique to Hawaii. However, our solution must be consistent with the unique structure of Hawaii's general excise and use tax. These amendments to Chapter 238 are consistent with the existing tax structure.

Section 6 – Application of Law, if Adopted

The Department recommends that the following language be inserted into section 6 of the bill, or where deemed appropriate, to avoid administrative difficulties with respect to sections 1 through 3 of the bill, if adopted:

"This Act does not affect rights and duties that matured, penalties that were incurred, and proceedings that were begun before its effective date."

Thank you for the opportunity to provide comments.