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TO: Representative Angus L.K. McKelvey
Chair, Committee on Economic Revitalization & Business
Hawaii State Capitol, Room 427
Via Email: ERBtestimony@capitol.hawaii.gov

FROM: Mihoko E. Ito

DATE: March 10, 2012

RE: **S.B. 2226, SD2, Proposed HD1 – Relating to Taxation**
Hearing Date: Thursday, March 15, 2012 at 9:45 a.m.
Conference Room 312

Dear Chair McKelvey and Members of the Committee on Economic Revitalization & Business:

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** S.B. 2226, SD2, proposed 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 unless preempted by federal law.

Walgreens believes that all retailers can conduct their business in a fair, competitive environment. Walgreens supports this measure to the extent that it seeks to level the playing field so that local "brick-and-mortar" stores operate under the same rules and online sellers.

Thank you very much for the opportunity to submit comments regarding this measure.

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Via Email: ERBtestimony@capitol.hawaii.gov

FROM: Mihoko E. Ito

DATE: March 10, 2012

RE: **S.B. 2226, SD2 – Relating to Taxation**
Hearing Date: Tuesday, March 13, 2012 at 8:30 a.m.
Room 312

Dear Chair McKelvey and Members of the Committee on Economic Revitalization & Business:

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 the intent** of S.B. 2226, SD2 which adopts amendments to Hawai`i tax laws to implement the streamlined sales and use tax agreement.

Walgreens believes that all retailers can conduct their business in a fair, competitive environment. Walgreens supports this measure to the extent that it seeks to level the playing field so that local "brick-and-mortar" stores operate under the same rules and online sellers.

Thank you very much for the opportunity to submit comments regarding this measure.



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March 15, 2012

The Honorable Angus L.K. McKelvey, Chair
House Committee on Economic Revitalization & Business
State Capitol, Room 312
Honolulu, Hawaii 96813

RE: S.B. 2226, S.D.2, Proposed H.D.1, Relating To Taxation

HEARING: Thursday, March 15, 2012 at 9:45 a.m.

Aloha Chair McKelvey, Vice Chair Choy 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 S.B. 2226, S.D.2, Proposed H.D.1, 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 S.B. 2226, S.D.2, Proposed H.D.1, to the extent that it may become consistent with any proposed federal legislation.

Mahalo for the opportunity to provide testimony.





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March 13, 2012

The Honorable Angus L.K. McKelvey, Chair
House Committee on Economic Revitalization & Business
State Capitol, Room 312
Honolulu, Hawaii 96813

RE: S.B. 2226, S.D.2, Relating To Taxation

DECISION MAKING: Tuesday, March 13, 2012, at 8:30 a.m.

Aloha Chair McKelvey, Vice Chair Choy and Members of the Committee:

I am Craig Hirai, a member of the Subcommittee on Taxation and Finance, submitting written comments on behalf of the Hawaii Association of REALTORS® (“HAR”), the voice of real estate in Hawaii, and its 8,500 members. HAR supports S.B. 2226, S.D.2, Relating to Taxation, which adopts amendments to Hawaii tax laws to implement the Streamlined Sales and Use Tax Agreement.

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

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

HAR believes that the procedures set forth in Section 40 of S.B. 2226, S.D.2, should help alleviate some of the concerns of the 2005-2007 Tax Review Commission, and that S.B. 2226, S.D.2, should eventually level the playing field for local merchants who must deal with the high cost of doing business in Hawaii and still compete with mail order and e-commerce merchants from outside of the State.

Mahalo for the opportunity to submit written comments.



TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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

BILL NUMBER: SB 2226, Proposed HD-1

INTRODUCED BY: House Committee on Economic Revitalization and Business

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 entering into an agreement under which any person, other than a common carrier acting in its capacity, that has substantial nexus in this state and that: (A) delivers, installs, assembles, or performs maintenance services for the seller's customers within this state; or (B) facilitates the seller's delivery of property to customers in the state by allowing the seller's customers to pick up property sold by the seller at an office, distribution facility, warehouse, storage place, store front, or similar place of business maintained by the in-state person; (3) 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 (4) 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 \$20,000. Specifies that these conditions of "engaged in business" shall be subject to the use tax.

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 of the legislature, 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 a seller, including an entity affiliated with a seller that has a substantial nexus in the state and includes: (1) a seller that is a member of a commonly controlled group that includes an entity that has a substantial nexus with the state and sells a similar line of products as the seller with the same or similar trademarks, service marks, or trade names; (2) a seller entering into an agreement under which any person, other than a common carrier acting in its capacity, that has substantial nexus in this state that delivers, installs, assembles, or performs maintenance services for the seller's customers within this state or facilitates the seller's delivery of property to customers in the state by allowing the seller's customers to pick up property sold by the seller at any place of business maintained by the in-state person; (3) a 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 (4) any seller entering into an agreement under which a person, for a commission or other consideration, refers potential purchasers of tangible personal property to the seller. 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 \$20,000; 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 the

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 placing 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 that 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 month, 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 instate customers by out-of-state vendors.

The proposed amendment further strengthens the identification of an out-of-state vendor gaining “physical presence” in the state which again was the turning point in the case of ***Baker & Taylor v. State of Hawaii (2004)*** where the Hawaii Supreme court affirmed that the vendor had gained physical presence in the state and therefore was subject to the general excise tax even though they had no goods or inventory in the state as the title to those goods had passed outside the state. This latter point was the basis for the Court’s recognition that the taxpayer, while subject to the general excise, was not necessarily subject to the use tax as it did not cause the goods to be imported into the state.

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 based on 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 3/14/12

TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

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SUBJECT: MISCELLANEOUS, Streamlined sales and use tax

BILL NUMBER: SB 2226, SD-2

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Adds a new chapter to the law to set out sections of HRS chapter 237 which establish transactions subject to the 0.5% general excise tax rate.

Adds a new chapter to the law to set out sections of HRS chapter 238 which establish transactions subject to the 0.5% use tax rate.

Adds a new chapter to the law to set out sections of HRS chapter 237 which establish transactions subject to the 0.15% general excise tax rate. The measure delineates provisions governing commissioned sellers of insurance to replace references to agents, general agents, subagents, or solicitors with the term "insurance producers."

Adds several new sections to HRS chapter 237 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 a new section to HRS chapter 237 to allow a seller to take a deduction from taxable sales for bad debts.

Adds several sections to HRS chapter 255D 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 tax and rate changes, and customer refund procedures.

Amends HRS sections 237-8.6 and 238.2.6 to prohibit a county to conduct an independent audit of sellers registered under the streamlined sales and use tax agreement.

Amends HRS section 237-24.3 to redefine the term "prosthetic device."

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 this 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.

Permits the department of taxation to seek technical assistance with legal professionals that have a background and practice in taxation. Allows the department of taxation to secure services necessary to support the project in an expeditious manner as soon as possible. Defines “project” as the implementation, administration, and compliance with the streamlined sales and use tax agreement. The legislative reference bureau shall assist the department of taxation or contractor in drafting any legislation.

This act shall take effect when the state becomes a party to the streamlined sales and use tax agreement; provided that: (1) the amendments made to HRS section 237-9 by this act shall not be repealed when that section is reenacted on June 30, 2014, pursuant to section 13(3) of Act 134, SLH 2009; (2) the amendments made to HRS section 237-24 by this act shall not be repealed when that section is reenacted on December 31, 2013, pursuant to section 4, Act 70, SLH 2009; and (3) the amendments made to HRS section 237-24.3 by this act shall not be repealed when that section is reenacted on December 31, 2014, pursuant to section 4, Act 239, SLH 2007, as amended by section 5, Act 196, SLH 2009, as amended by section 1 of Act 91, SLH 2010.

EFFECTIVE DATE: Upon approval as noted in the measure

STAFF COMMENTS: 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.

Goals of the project include the establishment of a single sales tax rate, uniform definitions of sales and use tax terms, requiring states to administer any sales and use taxes, and a central electronic registration system to allow a seller to register to collect and remit sales and use taxes for all states.

At the national level, there appears to be a number of difficulties in the negotiations and unanimous agreement is far from reality. Before jumping on the band wagon, lawmakers should exercise care as it should be remembered that Hawaii does not have a sales tax as found in other states. To the contrary, the general excise tax, while viewed as a sales tax, is a far cry from the retail sales tax structure found on the mainland.

The 2005 legislature had approved a measure to direct 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 repealed 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. When this measure was sent to the governor, the governor vetoed it due to the repeal of the advisory council, unrealistic deadlines in the measure, and concerns of allowing a third party to access confidential tax return information. A special session of the legislature overrode the governor’s veto and the measure passed as Act 3 of the Special Session of 2005.

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 we know it today, would be radically changed to accommodate the format adopted by the Streamline 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 why is there such enthusiasm on the part of the legislature to participate in the SSTP? Lawmakers have been promised hundreds of millions of dollars that could be had if the state would just participate in the project. The suggestion came to the 2001-2003 Tax Review Commission on the recommendation of their consultant who was already an advocate of the project.

Of course, no thought was given to how this would affect Hawaii businesses and what additional costs there would be. Given the fact that Hawaii businesses will now have to operate in a different mode insofar as the general excise/SSTP sales tax, will lawmakers compensate businesses for undertaking the collection of other states' retail sales taxes? Indeed, the law being proposed in this measure is a hybrid of the current general excise tax law and a retail sales tax. It retains the two-tiered wholesale/retail system and keeps the tax imposed on services as well as on business-to-business transactions. So the measure attempts to have the best of both worlds - to force other states to collect our general excise tax while retaining the pyramiding features of the general excise tax. This is a major change in the state's largest source of general fund revenues. Care should be taken in making this transition as it could alter not only the past interpretation of the general excise tax, but it may also have a major impact on the revenue producing capacity of the tax.

One of the key issues still under discussion amongst the members who have already signed on is "where" does the sale occur. For a number of the larger states like California, Illinois, and Texas that have much at stake since they are states that manufacture goods shipped to other states, the sourcing rules they adopted use "origin" based rules, that is the tax that is imposed at the place from which the goods are shipped and not where the purchaser takes possession. The proposed bill is ambiguous, at best, as in some cases being origin based as long as the purchaser takes possession of the goods at the place of the business but provides, on the other hand, for the taxation at the address to which the goods are delivered. It is this destination rule that causes the most problems for businesses as they must now deal with a plethora of rates depending on the number of states from which they receive orders.

While some states may elect destination, there is no doubt that the larger states will elect origin sourcing as they are probably net exporters of goods. That being the case, Hawaii residents will probably end up paying the Illinois or California sales tax on their purchases from out-of-state vendors and, in the long run, the purported windfall will turn into a disaster for Hawaii. Under current law, the use tax would otherwise have been due on those sales and while it has been difficult to enforce and collect on individual sales, more of an effort should be placed on the collection of the use tax where Hawaii already has jurisdiction.

Again, a main area of concern is whether the states can afford the streamlined system itself. Given the promises that have been made and not delivered upon such as the software that is supposed to facilitate the collection and remittance of the various states' sales taxes, to the promise to pay the cost of funding the administrative structure of the governing board, it appears that all of these are promises with no intent to make it happen. As such, it is premature for Hawaii to jump on the throttling locomotive engine that appears to be headed for a brick wall. This proposal needs more discussion in the interim and further clarification as well as a discussion with taxpayers who must carry out the duty of the actual collection.

Curiously, this is what the 2005-2007 Tax Review Commission recommended, that until the member states of the SSTP agreement come to a definitive conclusion, it is premature for Hawaii to jump on board. With this latest development, it appears that Hawaii will be a net loser as its residents will end up paying other states' sales taxes.

While the proposed measure attempts to conform Hawaii's general excise and use tax laws to the streamlined sales and use tax agreement, due to its complexity and technical aspects, it is questionable whether members of the legislature are qualified to determine whether this measure will be sufficient to comply with the Streamlined Sales and Use Tax Agreement.

In 2006 a bill that would adopt the streamline sales tax agreement was introduced and nearly passed the legislature but for a small glitch in the closing moments of the session. This, despite the fact that the State Auditor had a consultant assess the revenue potential of participating in the project. Instead of the hundreds of millions of dollars the promoters of the project had promised, the consultant estimated that Hawaii would benefit at the very least by about \$10 million and at the most \$50 million.

At the same time, when the department of taxation was asked what it estimated it would cost the department to implement the project for Hawaii, the price tag was set at \$15 million. Thus, it came as no surprise that when the Tax Review Commission looked at the issue, the decision was a no brainer, Hawaii would stand to gain about \$10 million in revenue, but it would cost the state \$15 million to implement. And that doesn't include the cost to businesses in Hawaii that would be required to collect the sales taxes of other states.

So the Commission's advice to the legislature and administration was to wait. In its recommendation it was noted that "the largest states (by economic size) have failed to sign on to the project, jeopardizing the chances of becoming an effective vehicle for collecting the Use Tax. Until the Project shows greater promise of producing results, it is premature for Hawaii to incur the expense to join it."

In 1992, in *Quill Corp. v. North Dakota*, the U.S. Supreme Court reaffirmed that the power of states to impose taxes on interstate commerce is limited by their geographic border. Although some academics resent this "physical presence rule," it remains the law of the land and is essential to prevent revenue officials from wreaking havoc on national markets by reaching beyond their borders for tax revenues. Since no working alternative to the physical presence rule has been developed, abandoning it would result in states harming themselves by harming the whole.

The SSTP was formed in reaction to *Quill*, though not necessarily to create an alternative to the physical presence rule. The SSTP is a working group of revenue officials and experts with the stated purpose of bringing simplicity and uniformity to sales taxes in the United States. (The governance structure raises some questions of democratic accountability and whether SSTP receives or seeks genuine public input.) Member states must adopt reforms to align their tax code with the SSTP. The hope is that simple and uniform sales tax statutes will allow the collection of interstate sales taxes without placing burdens on interstate commerce.

Simplicity and uniformity are both important goals, but the SSTP has, at best, mixed success in achieving them. There are nearly 8,000 sales taxing jurisdictions in the United States, each with their own bases and rates, and the enormous complexity involved in tracking borders and changes is a huge stumbling block to state efforts to impose taxes on online sales.

While the SSTP has made some progress on uniformity (they have succeeded, for instance, in a single accepted definition of “candy”- something everyone defined differently before), the SSTP appears to be giving up the effort on simplicity. At their New Orleans meeting in July 2008, for instance, the SSTP panel was asked if any effort was being made to reduce the number of sales taxing jurisdictions, and/or to align them with 5-digit zip codes. “No and no,” were the short, but honest answers.

Rather than requiring that states simplify before reaching out beyond their borders to tax out-of-state companies, the SSTP seems content to let states continue the status quo. One panelist noted that far from requiring substantial reforms, “States still get to do 99.9% of what they want to do” under the SSTP agreement. This demonstrates either disingenuousness or how little the SSTP recognizes that many existing sales taxes are in need of substantial reform.

The SSTP already abandoned the notion of taxing like transactions alike when they adopted “destination sourcing” for online sales, but permitted states to adopt “origin sourcing” for intrastate sales. This, in effect, requires Internet companies to collect sales taxes based on where their customer is located, but allows brick-and-mortar stores to collect sales taxes based on where the store is located. In this way the SSTP prevents a level playing field between Internet businesses and brick-and-mortar businesses.

Coupled with the SSTP’s non-worry about reducing the number of jurisdictions (they spoke optimistically of providing maps of sales tax jurisdictions, having rejected even aligning jurisdictions with 9-digit zip codes), full implementation of the SSTP, at this time, without serious reforms, could result in a serious and inequitable burden on e-commerce.

Another recent example involves clothing taxes. The SSTP requires that all states have a uniform definition of clothing, and tax all of it (or none of it) at the same rate. Minnesota did so, but then imposed a “separate” fur tax on fur sales. Rather than recognizing this as an end-run around tax uniformity, the SSTP upheld Minnesota’s action.

The SSTP is attempting to persuade Congress to permit SSTP member states to begin collecting sales taxes on online purchases, premised on the belief that the SSTP’s simplification and uniformity mission has been accomplished. The SSTP has not accomplished its mission. The SSTP should look again at serious simplification efforts before declaring themselves a success and seeking to expand state taxing power.

States should be willing to adopt uniform definitions worked out by the SSTP so as to reduce transaction costs between state statutes. However, the ability of any state to collect sales tax on online transactions is wholly dependent on the willingness of other states to simplify their laws and adopt uniform definitions as well. It is also dependent on the creation of a working alternative to the physical presence standard that provides certainty and prevents multiple taxation. Neither the wholesale adoption nationwide of uniform sales tax statutes, nor the development of a working alternative that provides the certainty needed for long-term investment, are likely in the foreseeable future.

For these reasons, lawmakers and other states should understand that SSTP membership does not lead to a sudden influx of free tax money. In any event, this money will come from Hawaii residents and should be looked at as a tax increase notwithstanding the existing liability under the use tax laws. The SSTP’s goals are good ones, but their success is mixed at best, and whatever effect it has will not be seen in the short-term.

A few years ago, a similar measure was vetoed by the governor. In her veto message, she stated that the “bill is objectionable because it would abdicate the authority of the state to establish, administer, and change its general excise tax structure; grants amnesty to certain taxpayers, absolving them of the requirement to pay taxes due the state, and treats out-of-state vendors more favorably than in-state vendors.” She further stated that in order to comply with the Streamline Sales and Use Tax Model Agreement and Act (SSUTA), the state and each county would have to establish a single tax rate and once the state participates in the SSUTA, the state must certify to a national governing board that the state’s law complies with the SSUTA and may relinquish control over the state’s ability to determine its own tax revenue collections. The governor also had concerns about the provision of the SSUTA requiring the state to pay out-of-state vendors for collecting Hawaii taxes since the taxes the state would be receiving would be reduced by the collection fee paid to the out-of-state vendor, thereby giving out-of-state vendors an unfair advantage since local businesses are not compensated for collecting and paying required taxes.

The long and short of this measure is that it is nothing more than a tax increase that will probably end up benefitting other states if the majority of states adopt “origin” based sourcing and continuing a tradition of passing the cost to administer and complying with the proposal on to businesses in Hawaii, adding yet another nail in the coffin for businesses in Hawaii. It is certainly a reflection of the lack of understanding of Hawaii’s unique general excise tax and how generous it is in producing revenues for the state.

Given the resistance on the part of other states to the streamlined sales tax project, it is questionable why this measure continues to be introduced in the Hawaii Legislature. Other than personal agenda, there is no good reason for this bill when many other states are moving in the direction of what is known as the “Amazon” bill which utilizes the local jurisdiction to collect sales taxes on these cross- state sales. If nothing else, this measure reflects that the sponsors of do not realize how efficient and productive Hawaii’s general excise tax system is. It certainly makes one wonder if lawmakers truly understand the state’s tax system.

Digested 3/9/12



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

The Twenty-Sixth Legislature, State of Hawaii
House of Representatives
Committee on Economic Revitalization & Business

Testimony by
Hawaii Government Employees Association
March 15, 2012

S.B. 2226, S.D. 2 (Proposed 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 Proposed H.D. 1 version.

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. 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.

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

S.B. 2226, S.D. 2
March 15, 2012
Page 2

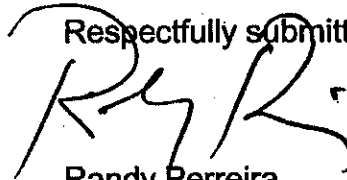
\$23 billion in uncollected taxes this year from out-of-state sales, with almost half of that coming from Internet transactions.

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 S.B. 2226, S.D. 2.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'RyR', is written over the typed name.

Randy Perreira
Executive Director



HAWAII GOVERNMENT EMPLOYEES ASSOCIATION
AFSCME Local 152, AFL-CIO

RANDY PERREIRA, Executive Director • Tel: 808.543.0011 • Fax: 808.528.0922

The Twenty-Fifth Legislature, State of Hawaii
House of Representatives
Committee on Economic Revitalization & Business

Testimony by
Hawaii Government Employees Association
March 13, 2012

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

The Hawaii Government Employees Association supports the purpose and intent 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). 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 National Conference of State Legislatures 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 this important measure.

Respectfully submitted,



Randy Perreira
Executive Director



Representative Angus McKelvey, Chair
 Representative Isaac Choy, Vice Chair
 Committee on Economic Revitalization & Business
 State Capitol, Honolulu, Hawaii 96813



HEARING Thursday, March 15, 2012
 9:45 am
 Conference Room 312

RE: SB2226, SD2 Proposed HD1, Relating to Taxation

Chair McKelvey, Vice Chair Choy, 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 SB2226, SD2, Proposed HD2, 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; effective July 1, 2012.

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. SB2226, SD2, Proposed HD2 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.

We respectfully request that you pass SB2226, SD2, Proposed HD1. Thank you for your consideration and for the opportunity to comment on this measure.

Carol Pregill
 Carol Pregill, President

RETAIL MERCHANTS OF HAWAII
 1240 Ala Moana Boulevard, Suite 215
 Honolulu, HI 96814
 ph: 808-592-4200 / fax: 808-592-4202



Representative Angus McKelvey, Chair
Representative Isaac Choy, Vice Chair
Committee on Economic Revitalization & Business
State Capitol, Honolulu, Hawaii 96813

HEARING Tuesday, March 13, 2012
 8:30 am
 Conference Room 312

RE: SB2226, SD2 Relating to Taxation

Chair McKelvey, Vice Chair Choy, 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 SB2226, SD2, which adopts amendments to Hawaii's tax laws to implement Streamlined Sales and Use Tax Agreement.

Through our affiliation with the National Retail Federation, the world's largest retail trade association, and a major participant in the Streamlined Sales Tax Project, RMH has watched the development and progress of this program over the past ten years and has supported Hawaii's initiatives to participate in the multi-state discussions.

As electronic commerce continues its dramatic increase, traditional brick and mortar retailers, which are required by law to collect taxes for government, are experiencing continued erosion of their sales base to remote sellers, which, under most circumstances, are not subject to tax mandates. The Streamlined Sales and Use Tax Project will level the playing field. The unfair disadvantage our local small businesses are experiencing leads to less commerce at brick-and-mortar establishments that most certainly affects employment. It's important to understand that collecting the sales tax won't hurt small businesses that operate online; in fact, there will be exemptions for the smallest sellers.

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.

Retailers nationally are encouraged that current initiatives in Congress, Main Street Fairness Act, Marketplace Fairness Act and Marketplace Equity Act hold greater promise to ameliorate this unfair situation, and there is consensus that this legislation will be enacted soon. SB2226, SD2 makes the necessary amendments to Hawaii tax laws to facilitate our compliance.

We respectfully request that you pass SB2226, SD2. Thank you for your consideration and for the opportunity to comment on this measure.

Carol Pregill, President



Chair: Rep. Angus L.K. McKelvey, Chair
Rep. Isaac W. Choy, Vice Chair

Committee: Committee on Economic Revitalization & Business
Bill No & Title: SB2226 SD2 HD1 Proposed

Day, Date, Time: Thursday, March 15, 2012
9:45am

Place: State Capitol Conference Room 312

Chair Angus L.K. McKelvey , Vice Chair Isaac W. Choy and Members of the Committee on Economic Revitalization & Business:

I am Jared I. Kuroiwa and am one of the founding members of the Hawai'i Innovation Alliance (HIA). The Hawai'i Innovation Alliance is an organization formed earlier this year that aims to create a more unified voice representing the islands' innovation community to foster innovation, educate lawmakers, and advocate appropriate policy.

The Hawai'i Innovation Alliance **opposes SB2226 SD2 HD1 Proposed**, Relating to Taxation. The purpose of this measure is, unless preempted by federal law, to require 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.

While we agree that the collection of use taxes that are already in place should be a priority of the State, it is our belief that this law attempts to circumvent the U.S. Supreme Court's *Quill* decision by extending the definition of physical presence to include Internet-based affiliates. The effect would not be the more efficient collection of taxes, but rather the end of affiliate-based relationships in Hawai'i. Ending the relationship would remove the requirement to pay use taxes while still affording the out-of-state companies the ability to do business in Hawai'i. This would result in an actual reduction in tax collections as the local businesses with affiliate relationships would lose that revenue.

Thank you for the opportunity to submit testimony in opposition of this bill.



**Testimony to the House Committee on Economic Revitalization and Business
Tuesday, March 13, 2012 at 8:30 a.m.
Conference Room 312, State Capitol**

RE: SENATE BILL NO. 2226 SD2 RELATING TO TAXATION

Chair McKelvey, Vice Chair Choy, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") supports the intent of SB 2226 SD2 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 and "brick and mortar" retailers, many of which provide employment opportunities for our residents. The bill would help eliminate this tax gap. 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 to provide testimony.