



**NEIL ABERCROMBIE**  
GOVERNOR

**SHAN TSUTSUI**  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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DEPUTY DIRECTOR



To: The Honorable Sylvia Luke, Chair  
and Members of the House Committee on Finance

Date: Wednesday, February 19, 2014  
Time: 2:00 p.m.  
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

Re: H.B. No. 2135, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 2135, but is opposed to the bill for the reasons discussed below.

H.B. 2135 proposes to amend existing tax law to conform to the requirements of the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA is a multi-state undertaking with the intent of collecting unpaid use taxes on online purchases.

The Department has followed the evolution of the SSUTA since its inception in the early 2000s. The Department has identified the following serious issues with the SSUTA: the obvious limitation of a voluntary system of collection by vendors; the impossibility of projecting potential revenue gains when collection is voluntary; and policy limitations inherent in the participation requirements for full members of the SSUTA.

The Department believes that Hawaii's general excise tax (GET) statute is sufficient to extend taxation to remote sellers. Although the Department is not able to share any details of its enforcement plans, the Department is continuing to pursue non-filing remote sellers under the current GET law. The full enforcement of the existing GET law is more likely to benefit the State and its taxpayers, than the adoption of the SSUTA.

The Department also notes that the adoption of the SSUTA would take a few years to implement, and require a substantial commitment of resources and staff. Due to the demand on resources, including new forms and publications, and major reprogramming of the Department's computer system, implementation of the SSUTA would be very difficult for the Department to manage at this time.

Thank you for the opportunity to provide testimony.

# TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: MISCELLANEOUS, Streamlined sales and use tax

BILL NUMBER: HB 2135

INTRODUCED BY: Mizuno

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. 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: the amendments made to HRS section 237-24 by this act shall not be repealed when that section is reenacted on December 31, 2018, by Act 70, SLH 2009, as amended by Act 164, SLH 2013.

EFFECTIVE DATE: Upon approval as noted in the measure

STAFF COMMENTS: The Streamlined Sales Tax Project's (SSTP) 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 per state, 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 bandwagon, lawmakers should exercise care because Hawaii does not have a sales tax as found in other states. Our general excise tax, while viewed by some as comparable to a sales tax, actually is a far cry from the retail sales tax found on the mainland.

The bill, as presently drafted, attempts to turn Hawaii's gross receipts tax imposed for the privilege of doing business in Hawaii into a retail sales tax with respect to where the tax is imposed. Much of the bill is devoted to separating the wholesale rate tax from the retail rate tax 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 SSTP.

What is not evident in the measure is that by participating in 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.

If Hawaii businesses have to operate in a different mode relating to collecting and remitting sales taxes, 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 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 among 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 manufacture goods shipped to other states, the sourcing rules they favor are “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. Hawaii uses “destination sourcing” providing for 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. The SSTP theoretically sets up a mechanism to deal with those rates.

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 the devil will be in the details. 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.

Not surprisingly, 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.

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.

In 2006 a bill that would adopt the streamlined 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 onto 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."

The SSTP was formed in reaction to the 1992 case, *Quill Corp. v. North Dakota*, where the U.S. Supreme Court reaffirmed that the power of states to impose taxes on interstate commerce is limited by a "physical presence rule." As a result, national mail order sellers with no physical presence in Hawaii may sell to Hawaii customers without worrying about the Hawaii general excise tax. In such a situation the customer is legally required to pay use tax, but individuals with relatively small purchases almost never pay the tax – not only in Hawaii but in other states that impose a use tax.

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 codes 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. If approved by the U.S. Congress, the SSTP's rules could displace the physical presence rules in *Quill*.

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 in order to make meaningful progress toward uniformity and simplicity.

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 governing body 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 itself 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. 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.

Finally, the most recent Tax Review Commission (2010-2013) concurred with its consultant, Dr. William Fox, that enactment of federal legislation is the only viable means to provide states to collect on remote sales. Thus, it recommended that the "state urge the Congressional delegation to support and enact federal legislation to address" the litigation and "address the 'nexus' question would allow states to tax e-commerce sales and collect needed revenue."



# Chamber of Commerce HAWAII

*The Voice of Business*

**Testimony to the House Committee on Finance  
Wednesday, February 19, 2014 at 2:00 P.M.  
Conference Room 308, State Capitol**

**RE: HOUSE BILL 2135 RELATING TO TAXATION**

Chair Luke, Vice Chairs Nishimoto and Johanson, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports** HB 2135 Relating to Taxation.

The Chamber is the largest business organization in Hawaii, representing over 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 members and the entire business community 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 provide fairness and equity for all businesses.

Thank you for the opportunity to testify.



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February 19, 2014

**The Honorable Sylvia Luke, Chair**

House Committee on Finance  
State Capitol, Room 308  
Honolulu, Hawaii 96813

**RE: H.B. 2135, Relating to Taxation**

**HEARING: Wednesday, February 19, 2014, at 2:00 p.m.**

Aloha Chair Luke, Vice Chair Nishimoto, Vice Chair Johanson, and Members of the Committee:

I am Myoung Oh, Government Affairs Director, here to testify on behalf of the Hawaii Association of REALTORS® (“HAR”), the voice of real estate in Hawaii, and its 8,300 members. HAR **supports** H.B. 2135, 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 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 testify.







**Executive Officers:**  
Stanley Brown, ConAgra Foods - Chairperson  
John Schilf, RSM Hawaii - Vice Chair  
Derek Kurisu, KTA Superstores - Treasurer  
Lisa DeCoito, Aloha Petroleum - Secretary  
Lauren Zirbel, Executive Director

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TO:  
HOUSE COMMITTEE ON FINANCE  
Rep. Sylvia Luke, Chair  
Rep. Scott Nishimoto and Rep. Aaron Johanson, Vice Chairs

FROM: HAWAII FOOD INDUSTRY ASSOCIATION  
Lauren Zirbel, Executive Director

DATE: February 19, 2014  
TIME: 2pm  
PLACE: Conference Room 308

RE: HB 2135

Position: Support

The Hawaii Food Industry Association is comprised of two hundred member companies representing retailers, suppliers, producers and distributors of food and beverage related products in the State of Hawaii.

HFIA supports HB 2135, which adopts amendments to Hawaii's tax laws to implement Streamlined Sales and Use Tax Agreement. We have been encouraged by Hawaii's initiatives to participate in the multi-state discussions of this program over the past several years.

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. We believe that enacting what is commonly referred to as the "Amazon Law" would be the quickest and easiest way to address these disparities. We also know that 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. HB 2135 would make the necessary amendments to Hawaii tax laws to facilitate our compliance.

We respectfully request that you pass HB 2135.

Thank you for the opportunity to testify.



**Testimony of  
Mihoko E. Ito  
on behalf of  
Walgreens**

DATE: February 18, 2014

TO: Representative Sylvia Luke  
Chair, Committee on Finance  
*Submitted Via [FINTestimony@capitol.hawaii.gov](mailto:FINTestimony@capitol.hawaii.gov)*

RE: **H.B. 2135 – Relating to Taxation**  
**Hearing Date: Wednesday, February 19, 2014 at 2:00pm**  
**Conference Room: 308**

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Dear Chair Luke and Members of the Committee on Finance:

I am Mihoko Ito, testifying 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 H.B. 2135 which adopts amendments to Hawai`i tax laws to implement the streamlined sales and use tax agreement, but prefers the approach proposed in H.B. 1651 because the Use Tax model provides flexibility to both tax payers and the State.

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 testimony regarding this measure.

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Gary M. Slovin  
Mihoko E. Ito  
Tiffany N. Yajima  
Jennifer C. Taylor

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## HAWAII GOVERNMENT EMPLOYEES ASSOCIATION

AFSCME Local 152, AFL-CIO

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

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

**LATE**

Testimony by  
Hawaii Government Employees Association  
February 18, 2014

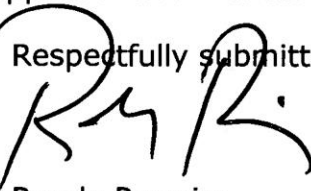
### H.B. 2135 – RELATING TO TAXATION

The Hawaii Government Employees Association supports the purpose and intent of H.B. 2135, 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.

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 online 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. This measure will allow the State to begin collecting use taxes that current exist under Chapter 238, HRS. Therefore, we support H.B. 2135 that makes the necessary 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 important state priorities.

Thank you for the opportunity to testify in support of this measure.

Respectfully submitted,  
  
Randy Perreira  
Executive Director