



**STATE OF HAWAII
DEPARTMENT OF TAXATION**

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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Tuesday, March 13, 2018

Time: 10:00 A.M.

Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2416, H.D. 1, Relating to Tax on Intangible Property

The Department of Taxation (Department) supports the intent of H.B. 2416, H.D. 1 and offers the following comments for the Committee's consideration.

H.B. 2416, H.D. 1 clarifies that for purposes of the general excise tax (GET), intangible property is sourced to the location where it is used. Specifically, the bill adds an exemption to GET for intangible property used outside the State. The bill also imposes the use tax on intangible property acquired from an unlicensed seller that is imported or used in the State. The bill is effective on July 1, 2030.

First, the Department notes that this bill is consistent with its position that intangible property is sourced to the location where it is used. For example, if a taxpayer creates custom software and licenses it to a customer for use in the State, the taxpayer will be subject to GET on the income it receives. If, on the other hand, the customer will be using the software outside the State, the income that the taxpayer receives will be exempt from GET. The Department further notes that this sourcing rule is consistent with the sourcing of income from services, which is sourced to where the services are used and consumed pursuant to Hawaii Revised Statutes section 237-29.53.

Second, the Department notes that imposing the use tax on intangible property will further the purpose of the use tax, which is complementary to the GET and "is designed to prevent the avoidance of excise taxes through direct purchases from the mainland." Matter of Habilitat, Inc., 65 Haw. 199, 209 (1982). As explained by the Hawaii Supreme Court in Habilitat, the use tax's "ultimate purpose is to remove the competitive advantage an out-of-state wholesaler or retailer would otherwise have over a seller subject to the payment of State excise taxes." Id. Currently, income received from intangible property is subject to GET, but the

import of intangible property is not subject to use tax. Accordingly, under current law, the purchase of intangible property rights from an out-of-state seller without nexus would not be subject to GET or use tax. This bill will impose the use tax on intangible property, thereby leveling the playing field for sales of intangible property.

Third, the Department notes that a concern was raised at the hearing before the House Committee on Finance regarding the bill's imposition of the use tax as applied to stocks and bonds, which are exempt from GET. To clarify that the use tax does not apply to these types of intangible property, the Department suggests amending the definition of "property" in Section 3 of the bill as follows:

"Property" means tangible personal property, intangible property, and prepaid telephone calling services but does not include: newspapers or other periodical publications purchased on the subscription plan, issued at stated intervals as frequently as four times a year, and of the class admitted to the United States mails as second class matter under the laws and regulations governing the postal service on January 1, 1965[-]; securities as defined in 15 United States Code section 78c or similar laws of jurisdictions outside the United States; commodities for future delivery and other agreements, options, and rights as defined in 7 United States Code section 2 that are permitted to be traded on a board of trade designated by the Commodities Futures Trading Commission under the Commodity Exchange Act; evidence of indebtedness; interest in land; or dividends as defined by chapter 235.

Finally, the Department requests that the bill is amended to apply to taxable years beginning after December 31, 2018 to allow the Department sufficient time to make form and computer system changes.

Thank you for the opportunity to provide comments.