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To: The Honorable Angus L. K. McKelvey, Chair  
and Members of the House Committee on Consumer Protection and Commerce

Date: Thursday, February 2, 2017  
Time: 3:00 P.M.  
Place: Conference Room 329, State Capitol

From: Maria E. Zielinski, Director  
Department of Taxation

Re: H.B. 345, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 345 and provides the following comments for your consideration.

H.B. 345 amends the definition of business in the general excise tax (GET) to state that doing “business,” for purposes of the GET, does not require a physical presence as long as the taxpayer has \$100,000 or more of gross receipts attributable to Hawaii. The bill would also add two exceptions to the definition of “business.” The bill exempts taxpayers who only have a website hosted on a local and nonaffiliated server. The bill also exempts taxpayers who are only using a nonaffiliated call-center to process orders for primarily out of state customers. The bill becomes effective July 1, 2017.

The Department has the following concerns regarding this measure:

First, the Department notes that this measure addresses the State law issue of whether a seller without physical presence in Hawaii is engaged in business and therefore subject to GET. A bright line test like \$100,000 or more of Hawaii sales will clarify the State’s position. However, amending state law, as this bill proposes, would only remove the main challenge based on State law; this measure would not also prevent a Commerce Clause (nexus) challenge under the United States Constitution.

The Hawaii Supreme Court has applied the nexus test from *Tyler Pipe Indus., Inc. v. Washington Dept. of Revenue*, 483 U.S. 232 (1987) when determining whether application the GET statute violates the Commerce Clause. See *Tax Appeal of Baker & Taylor*, 82 P.3d 804 (2004). The *Tyler Pipe* test does not depend on physical presence, but instead turns on “whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer’s ability to establish and maintain a market in the state.” Thus, under current Hawaii Supreme Court jurisprudence, the proposed \$100,000 sales threshold may withstand a

Commerce Clause (nexus) challenge despite the explicit exclusion of a physical presence requirement.

However, any taxpayer challenging the statute would attempt to apply *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In this case, the United States Supreme Court held that a seller must have a physical presence in a State to be subject to that State's sales and use tax collection requirements. This requirement of physical presence is rooted in the Commerce Clause of the United States Constitution and will not be affected by the amendment to State law proposed by this bill. If the rule from *Quill* is applied, any application of the GET to a taxpayer without a physical presence in the State will be in violation of the Commerce Clause.

Thus, if passed and enforced, this measure will likely lead to litigation and may not lead to additional revenue for the State because affected taxpayers may still obtain relief under the Commerce Clause of the U.S. Constitution.

Second, the intent and scope of the exceptions to the no physical presence rule are not clear. The exceptions seem counter to the overall intent of the bill. This is because the exceptions seem to exempt from taxation taxpayers with more connection to the State rather than less connection to the State.

For example, a seller with no physical presence, but \$100,000 or more in would be subject to GET, whereas a similar seller, also with \$100,000 or more in sales, that is hosting its website on an unaffiliated local computer would not be subject to GET. Both taxpayers have \$100,000 or more in sales into Hawaii, but the one with more connection to Hawaii through the locally hosted website, is exempted.

Third, these exceptions, as written, could be interpreted to exempt even sellers that have a physical presence in the State. This is because these are written as exceptions to the overall definition of "business" for GET purposes. If this interpretation prevailed, a seller with a physical store in Hawaii would not be doing "business" if they could prove they had a website hosted on a nonaffiliated computer in the State.

If the intent of the legislature is to explicitly state that physical presence is not required for the State to impose GET on taxpayers whose sales are \$100,000 or more, then the Department recommends the bill be amended to read as follows:

"237-2 "Business", "engaging" in business, defined. (a)  
"Business" as used in this chapter, includes all activities  
(personal, professional, or corporate), engaged in or  
caused to be engaged in with the object of gain or economic  
benefit either direct or indirect, without regard to  
physical presence in the State, but does not include casual  
sales.

(b) A person with no physical presence in the State is  
engaged in "business" in this State if the person has gross

receipts attributable to this State of \$100,000 or more.”

This amendment would clarify the operation of the definition of “business” and make clear how the \$100,000 gross receipts threshold is intended to operate.

Thank you for the opportunity to provide comments.



**TESTIMONY OF TINA YAMAKI  
PRESIDENT  
RETAIL MERCHANTS OF HAWAII  
February 1, 2017**

**Re: HB 345 Relating to Taxation.**

Good afternoon Chairman McKelvey and members of the House Committee on Consumer Protection and Commerce. I am Tina Yamaki, President of the Retail Merchants of Hawaii and I appreciate this opportunity to testify.

The Retail Merchants of Hawaii (RMH) is a statewide not-for-profit trade organization representing 200 members and over 2,000 storefronts, and is committed to support the retail industry and business in general in Hawaii. The retail industry is one of the largest employers in the state, employing 25% of the labor force.

The Retail Merchants of Hawaii strongly supports HB345 Relating to Taxation. Our local brick and mortar stores are the economic backbones of our communities that provide employment and tax revenue to fund vital services throughout the State.

Currently under the existing state law, consumers are required to pay the General Excise Tax on the goods they purchase in stores physically located in the state of Hawaii. However, if they shop on line, sellers are not required to collect a tax in the same way these local businesses do. This puts our local retailers at a disadvantage as this effectively makes products purchased at brick-and-mortar stores more expensive than products purchased online.

Many of our retailers statewide are already operating on a thin margin, especially mom and pop stores. This measure would provide e-fairness by leveling the playing field for businesses in our community.

Again mahalo for this opportunity to testify.

# TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: GENERAL EXCISE, Define Doing Business Without Physical Presence

BILL NUMBER: HB 345

INTRODUCED BY: SOUKI, MCKELVEY

EXECUTIVE SUMMARY: This measure is an attempt to adopt a form of “factor presence nexus,” namely a statement that substantial sales in a state constitute a sufficient connection between the state and the seller to enable that state to impose sales tax or use tax collection obligations. While the measure may be subject to constitutional challenge, it is in line with other states’ measures increasing pressure on remote sellers to collect and remit sales and use taxes owed on purchases by customers in the state.

BRIEF SUMMARY: Amends the definition of “business” or “engaging” in business in HRS section 237-2 to provide that it is to be applied without regard to having a physical presence, including the presence of a representative acting on behalf of the person in this State.

Exceptions are provided for casual sales (existing law); having a website on a third-party content provider on a computer physically located in this State; using a nonaffiliated third-party call center in Hawaii to accept and process orders; and activity, together with the person’s affiliates, aggregate less than \$100,000 of gross receipts in the prior calendar year.

EFFECTIVE DATE: July 1, 2017.

STAFF COMMENTS: The United States Constitution has been interpreted as providing two limits on the states’ powers to tax. These limits come from at least two places: first, the Due Process Clause, requiring a person to have “minimum contacts” with a state before that state is allowed to exercise police powers, including the power to tax, against that person; and second, the Commerce Clause, where the Supreme Court held in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), that if the Congress does not otherwise define the threshold for taxability, state tax may not be imposed upon a person unless there is “substantial nexus” with that person. Substantial nexus is more than minimum contacts, and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), appears to stand for the proposition that some physical presence is needed to establish substantial nexus.

In Hawaii, section 237-22(a) HRS, states that there shall be excepted or deducted from the values, gross proceeds of sales, or gross income so much thereof as, under the Constitution and laws of the United States, the state is prohibited from taxing, but only so long as and only to the extent that the state is so prohibited. *In re Grayco Land Escrow, Ltd.*, 57 Haw. 436, 559 P.2d 264, cert. denied, 433 U.S. 910 (1977), established that Hawaii already extends its general excise and use taxes to reach the limit of the Constitution (“Thus, in plain and unmistakable language, the statute evidences the intention of the legislature to tax every form of business, subject to the taxing jurisdiction, not specifically exempted from its provisions.”).

This bill is, of course, trying to solve the problem, faced by all states that have enacted sales and use taxes, about collecting sales and use taxes on remote sellers. A seller with no physical presence in a customer's state might see no obligation to collect and remit tax in the customer's state. The customer would be liable for use tax, but tax departments throughout the country have met with little success in motivating such customers, especially those with small purchases, to pay use tax.

Nothing the legislature enacts will change the U.S. Constitution, and the bill may face constitutional challenge if enacted. Even so, the Multistate Tax Commission has recommended, and many states have enacted, "factor presence nexus" standards saying that nexus should be found when a taxpayer has a significant dollar amount of sales activity in the state, and these standards have motivated some of the larger remote sellers to agree to collect and remit sales and use taxes on that activity.

Digested 1/27/2017



# Chamber of Commerce HAWAII

*The Voice of Business*

**Testimony to the House Committee on Consumer Protection & Commerce**  
**Thursday, February 2, 2017 at 3:00 P.M.**  
**Conference Room 329, State Capitol**

**LATE**

**RE: HOUSE BILL 345 RELATING TO TAXATION**

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

The Chamber of Commerce Hawaii ("The Chamber") **supports** HB 345, which amends the definition of "business" in the State's general excise tax law.

The Chamber is Hawaii's leading statewide business advocacy organization, representing about 1,600+ 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 retailers and vendors 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. This bill amends the definition of "business" in the State's general excise tax law and could 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.