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STATE OF HAWAII
DEPARTMENT OF TAXATION
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DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

To: The Honorable Mark M. Nakashima, Chair
and Members of the House Committee on Economic Development and Business

Date: Wednesday, February 1, 2017

Time: 9:00 A.M.

Place: Conference Room 309, State Capitol

From: Maria E. Zielinski, Director
Department of Taxation

Re: H.B. 398, Relating to Taxation

The Department of Taxation (Department) appreciates the intent of H.B. 398 and provides the following comments for your consideration.

H.B. 398 requires retailers not required to pay general excise tax (GET) to report the amounts of purchases made from them for use in the State of Hawaii both to their purchasers and to the Department. The bill becomes effective July 1, 2017 and applies to taxable years beginning after December 31, 2016. The bill is similar to a Colorado law which was recently upheld in court.

First, Department notes that this measure focuses on informational use tax reporting. The information is important to use tax collection, however, the information itself does not answer the question about how these taxes can be collected from the purchasers in the State of Hawaii. The use tax, codified at Chapter 238, Hawaii Revised Statutes, is imposed on a Hawaii purchaser when goods, services, etc. are purchased from a seller that does not have nexus with Hawaii. The use tax may be imposed on any taxpayer, whether an individual or an entity.

Since the use tax is imposed per purchaser, the efficient enforcement and collection of this use tax revenue remains difficult. For example, if an individual purchases \$2,000 of products from a retailer and thus owes \$80 in use tax, the Department must bill and collect from an individual taxpayer to realize the \$80. This effort would be required for each potential taxpayer, which could be hundreds of thousands of individual taxpayers.

To address this, the Department recommends a provision to provide relief from the reporting requirements to retailers who voluntarily collect and pay use tax on their Hawaii sales. Voluntary collection would alleviate the heavy compliance burden on the Department and seems to be the most efficient method of collecting the use tax revenue.

Second, the Department notes that as written, the trigger for reporting is simply that the sale is made “for use in the State.” The Department suggests that this sourcing provision be clarified so that there is no confusion as to which transactions are subject to reporting under this measure. For example, the bill should specify how the sale of tangible personal property should be sourced.

Third, the Department suggests that a threshold for retailers subject to this measure be set at a specific dollar amount and allow the Department to mandate the electronic filing of the annual report.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, USE, Reporting Requirement for Direct Sellers

BILL NUMBER: HB 398

INTRODUCED BY: CHOY, OSHIRO

EXECUTIVE SUMMARY: This measure is based on a Colorado statute upheld in federal court. 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. It has the potential to aid significantly in the enforcement and collection of GET and use taxes imposed under current law.

BRIEF SUMMARY: Adds a new section to HRS chapter 231 requiring that each retailer or vendor making sales of tangible personal property from a place of business outside the State for use in the State that is not required to pay or collect general excise or use tax shall send notifications to all purchasers in the State by January 31 of each year to the effect that the State requires a use tax return to be filed and use tax paid.

Provides that the notification shall be sent separately to all purchasers by first class mail and shall not be included with any other shipments. The notification is to include "Important Tax Document Enclosed" on the exterior of the mailing.

Requires each retailer or vendor subject to this requirement to file an annual statement showing the total amount paid for purchases during the preceding calendar year. The statement is to be filed with the department on or before March 1 of each year.

Provides that the penalty for failing to comply is \$10 for each purchaser not notified, or \$10 for each purchaser that should have been included in a non-filed annual report. A reasonable cause exception is provided.

EFFECTIVE DATE: July 1, 2017, and applies to taxable years beginning after December 31, 2016.

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.

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. With the explosive growth of e-commerce, the states' inability to compel out-of-state retailers to collect sales tax has cost state and local governments significant revenue and disadvantaged in-state retailers, who must pay GET at the point of sale.

Colorado came up with an interesting solution to its problem. They figured they couldn't make all retailers collect and pay the tax over. However, they did pass a law saying that if a retailer selling to a Colorado consumer doesn't pay the tax, it must do three things. First, the retailer must advise the consumer that Colorado use tax is due on the purchase. Second, the retailer must send a summary of all purchases made during the year to the consumer if those purchases total \$500 or more. Third, the retailer must send a summary to the Colorado Department of Revenue similar to 1099 reporting requirements. Penalties are imposed against noncompliant retailers.

The Direct Marketing Association, or the DMA, whose members include many online retailers, sued in federal court asking for an injunction against enforcing these requirements, which they contended were discriminatory and unconstitutional. The U.S. District Court found them to be an undue burden on interstate commerce and granted a permanent injunction. The Department of Revenue appealed to the Tenth Circuit. After a trip to the U.S. Supreme Court, the Tenth Circuit reached the merits and upheld the statute. *Direct Marketing Association v. Brohl*, No. 12-1175 (10th Cir. Feb. 22, 2016). The Supreme Court denied review on December 12, 2016.

Nothing the legislature enacts will change the U.S. Constitution, and the bill may face constitutional challenge if enacted. However, this statute appears to be patterned after the Colorado statute upheld by the Tenth Circuit.

As a technical matter, the Committee may wish to consider a de minimis threshold, for example, not requiring the retailer to send notices or report to the department unless its total sales into Hawaii for the year is at least a certain dollar amount.



Chamber of Commerce HAWAII
The Voice of Business

**Testimony to the House Committee on Economic Development & Business
and Committee on Labor & Public Employment
Wednesday, February 1, 2017 at 9:00 A.M.
Conference Room 309, State Capitol**

RE: HOUSE BILL 398 RELATING TO TAXATION

Chairs Nakashima and Johanson, Vice Chairs Keohokalole and Holt, and Members of the Committees:

The Chamber of Commerce Hawaii ("The Chamber") **supports** HB 398, which requires retailers or vendors that are not located in the State and not required to pay or collect general excise or use tax for sales to send certain information to purchasers in the State; requires retailers or vendors to submit an annual report to the department of taxation.

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 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.



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

Re: HB 398 Relating to Taxation.

Good morning Chairman Nakashima and members of the House Committee on Economic Development & Business. 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 HB 398 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.

PETER L. FRITZ

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HOUSE OF REPRESENTATIVES
THE TWENTY-NINTH LEGISLATURE
REGULAR SESSION OF 2017

COMMITTEE ON ECONOMIC DEVELOPMENT & BUSINESS

Testimony on H.B. 398
Hearing: February 1, 2017

Relating To Taxation

Chair Nakashima, Vice Chair Keohokalole and members of the Committee. My name is Peter Fritz. I am testifying in **strong support** of H.B. 398.

There has been an explosive growth in online commerce. Last year online sales increased by approximately 15%. Online sales place Hawaii retailers at a significant disadvantage because online retailers may not collect tax at the point of sale and Hawaii in-state retailers impose tax at the point of sale. This is a serious, continuing injustice faced by Hawaii in-state retailers.

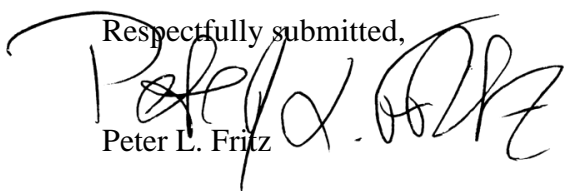
When the United States Supreme Court let a Colorado law that imposes reporting requirements for online sellers to notify customers and the state of how much a customer purchased so that the customer can pay use tax, stand it opened an opportunity for Hawaii to enact a similar law and this bill follows the structure of the Colorado law.

This bill imposes three obligations on retailers that do not pay general excise or non-collecting retailers: (1) to send a transactional notice to purchasers informing them that they may be subject to Hawaii's use tax, (2) to send Hawaii purchasers who buy goods from the retailer an annual purchase summary reminding them of their obligation to pay use taxes on those purchases, and (3) to send the Department of Taxation an annual customer information report listing their customers' names, addresses, and total amounts spent.

Hawaii relies on purchasers themselves to calculate and pay a use tax on their purchases from out-of-state retailers that do not collect the general excise tax. But few in Hawaii pay the use tax despite their legal obligation to do so.¹ A reason for low compliance could be the difficulty in calculating the amount of online purchases. Receiving statements from an online retailer would facilitate payment of the use tax. The statements would be similar to statements that taxpayers already receive for interest, tax refunds or dividends that are used to prepare their taxes.

Thank you for the opportunity to testify.

Respectfully submitted,


Peter L. Fritz

¹ Chapter 238, HRS imposes a use tax on items imported into Hawaii. The compliance rate on remote retail sales with no collection obligation has been estimated to be only 4%. *See Direct Mktg. Ass'n v. Brohl* ("Brohl II"), 135 S.Ct. 1124, 1135 (2015) (Kennedy, J., concurring); *see also* Brief of National Governors Ass'n et al. as Amici Curiae in Support of Defendant-Appellant Supporting Reversal at 10, *Direct Mktg. Ass'n v. Brohl*, No. 12-1175 (10th Cir. argued Sept. 29, 2015) estimating household use-tax compliance at 0-5%, excluding motor vehicle purchases. .

LATE



Hawaii Association of Public Accountants

P.O. Box 61043
Honolulu, HI 96839

Before the House Committee on Economic Development and Business

**Wednesday, February 1, 2017 at 9:00 a.m.
Conference Room 309**

Re: Support for HB398 Relating to Taxation

Chair Nakashima, Vice Chair Keohokalole and Committee Members:

Hawaii Association of Public Accountants (HAPA) is a statewide organization of over 550 tax and public accounting practitioners who are primarily small to mid-sized Hawaii CPA firm owners, managers, and staff located throughout the State of Hawaii.

HAPA is in strong support of HB398 since it will encourage compliance with Hawaii General Excise/Use taxes by those retailers who do not have taxable “nexus” (or physical presence) in the State of Hawaii. Where a retailer has no nexus, the state cannot directly impose the Hawaii General Excise tax on the retailer even though the retailer sells products to purchasers in Hawaii. Instead, the obligation to pay tax falls on the purchaser of goods, who is supposed to pay a corresponding “use” tax. Unfortunately, except for some businesses, the use tax is not paid by most purchasers of goods from out-of-state vendors because the purchasers are not informed or aware of their Hawaii use tax obligations, and for other reasons.

Hawaii General Excise/Use tax receipts currently constitute over 50% of Hawaii’s General Fund tax revenues and are the largest single category of tax collections for the State of Hawaii. Nationwide, consumers have been resorting more and more to purchasing goods online, and the growth rate for online shopping recently has been in the double digits, while the growth rate of sales from brick and mortar stores has been in the low single digits. This means that without action taken to shore up tax compliance for purchases made from online retailers, Hawaii will lose more and more of its retail tax revenues.

HB398 is crafted similar to a Colorado statute with notice provisions, and HB398 provides that online vendors not already paying or collecting Hawaii General Excise or Use tax shall provide notice to purchasers and the Hawaii Department of Taxation of amounts subject to Hawaii’s use tax. After Colorado's statute withstood legal

challenges, giant retailer Amazon agreed to collect sales taxes for Colorado and for states with similar statutes rather deal with the paperwork of providing notices to purchasers or the various states. As of February 1, 2017, Hawaii will be only one of six states remaining where Amazon has not agreed to collect sales/use taxes for a state imposing such taxes.

Unfair playing field for Hawaii Brick and Mortar Stores compared to Online Retailers with no Hawaii physical presence

With the increased growth rate of online sales and the offer of free shipping by out-of-state retailers, much of the retail sales to Hawaii purchasers have not been taxed. Where online sales have not been taxed, it creates an unfair playing field for Hawaii brick and mortar stores, who have to pay not only Hawaii General Excise taxes, but also payroll taxes and either taxes related to lease rent or property taxes.

In addition, it is not fair or equitable to raise taxes to provide for Hawaii's needs when reasonable efforts have not already been made to collect taxes that are already required to be paid under existing Hawaii tax laws.

Please support HB398. Thank you for considering the above.

Respectfully submitted,

Brian M. Iwata, CPA

State President, Hawaii Association of Public Accountants

and

Marilyn M. Niwao, J.D., CPA, ATA, CGMA

Legislative Committee Chairperson, Hawaii Association of Public Accountants



January 31, 2017

The Honorable Isaac Choy
Hawaii House of Representatives
State Capitol, Room 404
Honolulu, HI 96813

**RE: HB 398 (Choy) - Online Sales Tax Notification and Reporting
Set for hearing February 1, 2017
Notice of OPPOSITION**

Dear Representative Choy,

The Internet Association respectfully must **OPPOSE HB 398**, which requires remote sellers to provide their customers located in Hawaii an annual statement of their total purchases and a notice that they may owe use tax to the state. Every single business selling products or services into Hawaii would be required to track, compile and provide these notices to their customers, regardless of whether they are the most casual online sellers, mom and pop small businesses, or one of the country's largest retailers. We believe this approach is flawed and that Hawaii should leave online sales tax issues for Congress to pass a uniform law, thereby avoiding a patchwork of state tax laws.

The Internet Association is a nonprofit trade organization representing the interests of America's leading internet companies and their global community of users. The Internet Association is dedicated to advancing public policy solutions that strengthen and protect internet freedom, foster innovation and economic growth, and empower users.

The tax notice and reporting provisions in HB 398 are similar to flawed Colorado law. Those laws also proposed to require remote sellers to turn over lists of online purchases made by in-state residents. The Colorado law was challenged in court. To date, its provisions have not been imposed on retailers as it is still under an injunction. It is important to note that the Colorado law recognizes the impact of the law on small businesses and requires only those retailers selling more than \$100,000 in total gross sales in prior calendar year to report. HB 398 contains no small business threshold of any kind and would likely be challenged. Hawaii should not expose its consumers to risk by adopting controversial tax provisions. These tax and reporting provisions will be expensive for the state and invasive of consumer privacy.

HB 398 sets the tone of over-broad taxation which will fall hardest on individuals who must pay the tax and the small businesses that may have to comply with a patchwork of state tax collection, reporting, and notice laws that may differ on tax rate, the information to report, but also on which products are taxable and which are not. It is not cost-effective policy for the Department to pursue very small sellers. That's one of the reasons why Colorado included a threshold. The cost to implement and



Internet Association

enforce such a law with no threshold would be much more expensive with dubious benefits to the state.

Also, if HB 398 is enacted, in-state companies will be put at risk of new burdensome rules when other states look to follow Hawaii's example. If states enact similar laws, it could ultimately hurt Hawaii small businesses that could suddenly find themselves subject to costly reporting requirements and audits from state and local jurisdictions around the country – from states in which Hawaii companies likely have no physical presence.

While we recognize the need to balance state budgets, the notice requirements in HB 398 are a prime example of a law which will not produce a windfall of new revenue but instead result in costly and unsuccessful litigation, all funded by Hawaii taxpayers.

For these reasons and more, the Internet Association respectfully **OPPOSES HB 398**. Should you have any questions or concerns, please contact me at (916) 836-8983. Thank you.

Sincerely,

Robert Callahan
State Government Affairs, West

cc: Members, House Committee on Economic Development & Business