



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-NINTH LEGISLATURE, 2018**

ON THE FOLLOWING MEASURE:

S.B. NO. 2282, RELATING TO TAXATION.

BEFORE THE:

SENATE COMMITTEES ON
ECONOMIC DEVELOPMENT, TOURISM, AND TECHNOLOGY, AND ON
COMMERCE, CONSUMER PROTECTION, AND HEALTH

DATE: Wednesday, February 7, 2018 **TIME:** 1:15 p.m.

LOCATION: State Capitol, Room 414

TESTIFIER(S): Russell A. Suzuki, Acting Attorney General, or
Stacie M. Nakamura, Deputy Attorney General

Chairs Wakai and Baker and Members of the Committees:

The Department of the Attorney General has concerns about this bill because it may be challenged as violating the Commerce Clause of the United States Constitution to the extent that it is intended to assess Hawaii general excise tax on businesses with no physical presence in the state.

This bill would require marketplace providers that facilitate over \$100,000 in taxable retail sales to collect and remit Hawaii general excise tax and use tax on behalf of marketplace participants that may not be paying general excise tax and use tax. The bill would also allow marketplace providers to claim a credit against the general excise taxes and use taxes required to be collected and remitted on behalf of marketplace participants.

Any amendments that are intended to assess Hawaii general excise tax on businesses with no physical presence in the state may withstand a challenge in the State court under the current Hawaii Supreme Court jurisprudence, but the amendments may still be subject to federal constitutional challenge.

The Commerce Clause of United States Constitution explicitly grants power to Congress to regulate interstate commerce, and in doing so, also implicitly restricts states from enacting laws that unduly burden interstate commerce. The United States Supreme Court stated that a state tax will survive a Commerce Clause challenge if the tax "is applied to an activity with a substantial nexus with the taxing State, is fairly

apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.” Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977). Furthermore, the United States Supreme Court in Quill Corp. v. North Dakota, 504 U.S. 298 (1992), appeared to affirm the need for some type of physical presence, as originally established in National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967), in order to meet the substantial nexus requirement.

If the purpose of this bill is to impose the state general excise tax to the activity of certain taxpayers with no physical presence in Hawaii and this bill becomes law, a taxpayer may cite to the United States Supreme Court decisions of Quill and Bellas Hess to challenge the State on the grounds that the application of the general excise tax to a taxpayer with no physical presence in Hawaii violates the Commerce Clause of the United States Constitution.

It is an open question as to whether the tests under Quill, which involved a sales tax, will be applied to Hawaii’s general excise tax and whether the imposition of such a tax without a requirement of physical presence in the state would ultimately be sustained under a Commerce Clause challenge. Furthermore, it may be important to note that the United States Supreme Court will be reevaluating the physical presence requirement under Quill when it reviews the arguments from South Dakota v. Wayfair, 901 N.W.2d 754 (S.D. 2017), cert. granted, 2018 WL 386568 (U.S. Jan. 12, 2018) (No. 17-494), later this year.

Thank you for the opportunity to provide comments.



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To: The Honorable Glenn Wakai, Chair
and Members of the Senate Committee on Economic Development, Tourism, and
Technology

The Honorable Rosalyn H. Baker, Chair
and Members of the Senate Committee on Commerce, Consumer Protection and
Health

Date: Wednesday, February 7, 2018
Time: 1:15 P.M.
Place: Conference Room 414, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2282, Relating to Taxation

The Department of Taxation (Department) supports the intent of S.B. 2282 and offers the following comments for the Committees' consideration.

The following is a summary of key provisions in S.B. 2282, which applies to tax years beginning after December 31, 2017:

Definitions

- "Marketplace provider" is defined as any person who facilitates sales for marketplace participants by providing a forum for the listing for sale of tangible personal property (TPP) or services for sale by the marketplace participant and collects receipts from the customer and transmits those receipts to the marketplace participant.
- "Marketplace participant" is defined as any person that sells TPP or services via the forum provided by a marketplace provider.

Collection Threshold

- Marketplace providers that facilitated over \$100,000 in retail sales to customers in the State will be required to begin collecting and remitting the general excise tax (GET) on all sales they facilitate for marketplace participants to customers in the State.
- Once a marketplace provider is required to collect GET, it must do so for at least 12 months. If, after 12 months, the marketplace provider can demonstrate that it

facilitated less than \$100,000 in sales in the previous 12 months, the marketplace provider will no longer be required to collect GET.

Exceptions and Safe Harbor

- Marketplace providers will not be required to collect GET on sales for which the marketplace participant is registered to collect GET.
- Marketplace providers will not be subject to audit for retail sales for which they are required to collect and remit GET.
- Marketplace providers will not be liable for failure to collect and remit GET if the error was due to incorrect information given by the marketplace participant or the marketplace participant or customer has remitted the GET.
- Marketplace providers will be allowed a credit against GET required to be collected and remitted on behalf of marketplace participants in an amount determined by the Department.

Use Tax

- Similar provisions are provided for the use tax.

First, the Department notes that this bill appears to be based on principles of sales tax law and is not consistent with the manner in which the GET operates. In most states, liability of the sales tax is imposed on the *buyer*, but a duty to collect the sales tax is imposed on the seller if the seller has nexus. Unlike a sales tax, the GET is a gross receipts tax imposed on the *seller* for the privilege of doing business in Hawaii. Tax Appeal of Baker & Taylor, Inc. v. Kawafuchi, 103 Hawaii 359, 364-65 (2004). The seller may, but is not required to, pass on the GET to the customer.

Because many provisions in the bill are based on sales tax concepts, they conflict with GET law. For example, subsection (j) refers to a consumer's obligation to remit GET, but consumers are not liable for GET, nor do they have an obligation to file returns or remit the GET. Additionally, subsection (d) refers to a marketplace participant's registration to collect GET, however, the Department does not register sellers for collection accounts. Instead, sellers are issued GE licenses to pay GET for which they are liable.

Second, the Department notes that the bill would not require a marketplace provider to remit GET on marketplace sales if the marketplace provider facilitated less than \$100,000 in sales but has a physical presence in the State.

Third, the Department notes that subsection (f) in Sections 1 and 2 of the bill would preclude the Department from auditing the marketplace provider, thereby requiring the Department to audit the marketplace participants. The marketplace participants, however, may not have nexus and may not be subject to audit.

Fourth, subsection (h) in Sections 1 and 2 of the bill provides marketplace providers with a GET and use tax credit in an amount determined by the Department. Chapters 237 and 238 of the HRS, however, do not currently provide for any credits against tax. Further, it is ambiguous

what the purpose of the credit is and what the amount should be based on.

Based on the foregoing, the Department suggests, instead of imposing a collection obligation on marketplace providers, adopting language similar to that in H.B. 1655, which deems the marketplace provider the seller of TPP and therefore subjects the marketplace provider to GET at the four-percent rate. This approach is similar to that taken by Arizona, which like Hawaii, has a privilege tax.

Specifically, the Department suggests deleting Sections 1 through 3 of this bill and replacing them with the following amendments:

1. Amend the definitions of "person" and "representative" in HRS section 237-1 as follows:

"Person" or "company" includes every individual, partnership, society, unincorporated association, joint adventure, group, hui, joint stock company, corporation, trustee, personal representative, trust estate, decedent's estate, trust, trustee in bankruptcy, or other entity, whether such persons are doing business for themselves or in a fiduciary capacity, and whether the individuals are residents or nonresidents of the State, and whether the corporation or other association is created or organized under the laws of the State or of another jurisdiction. Any person who ~~[has in the person's possession, for sale in the State, the property of a nonresident owner, other than as an employee of such owner,]~~ sells or assists in the sale of tangible personal property on behalf of another seller by providing customer service, processing payments, and controlling the fulfillment process shall be deemed the seller of the property, when sold[-], and the seller on whose behalf the sale is made shall be deemed to have made a sale at wholesale pursuant to section 237-4.

"Representative" means any salesperson, commission agent, manufacturer's representative, broker or other person who is authorized or employed by ~~[an unlicensed]~~ a seller to assist such seller in selling property for use in the State, by procuring orders for such sales or otherwise, and who carries on such activities in the State, it being immaterial whether such activities are regular or intermittent[+]

~~but the~~]. The term "representative" does not include
[a]:

- (1) A manufacturer's representative whose functions are wholly promotional and to act as liaison between an unlicensed seller and a seller or sellers, and which do not include the procuring, soliciting or accepting of orders for property or the making of deliveries of property, or the collecting of payment for deliveries of property, or the keeping of books of account concerning property orders, deliveries or collections transpiring between an unlicensed seller and a seller or sellers~~[- Any unlicensed seller who in person carries on any such activity in the State shall also be classed as a representative.]~~; and
- (2) A person who sells or assists in the sale of tangible personal property on behalf of another seller and who provides customer service, processes payments, and controls the fulfillment process.

2. Amend the definition of "import" in HRS section 238-1 as follows:

- "Import" (or any nounal, verbal, adverbial, adjective, or other equivalent of the term) includes:
- (1) The importation into the State of tangible property, services, or contracting owned, purchased from an unlicensed seller, or however acquired, from any other part of the United States or its possessions or from any foreign country, whether in interstate or foreign commerce, or both; ~~and~~
 - (2) The sale and delivery of tangible personal property owned, purchased from an unlicensed seller, or however acquired, by a seller who is or should be licensed under the general excise tax law from an out-of-state location to an in-state purchaser, regardless of the free on board point or the place where title to the property transfers to the purchaser~~[-]~~; and
 - (3) The sale of tangible personal property by, or assisted by, a licensed seller who provides customer service, processes

payments, and controls the fulfillment process on behalf of an unlicensed seller for delivery to a purchaser in the State.

The foregoing amendments would result in the following:

- (1) A marketplace provider doing business in the State will be subject to GET at the rate of four percent for its own sales as well as sales made on behalf of marketplace participants for TPP delivered in the State;
- (2) A marketplace participant who is doing business in the State will be subject to GET at the half-percent rate if it sells TPP through a marketplace provider for delivery in the State; and
- (3) If a marketplace participant who is not doing business in the State makes a sale of TPP through a marketplace provider for delivery in the State, the marketplace provider will be subject to use tax at the rate of half a percent for the import of the TPP (in addition to being subject to GET at the rate of four percent for the sale of the TPP).

Additionally, to promote uniform and consistent application of the GET, the Department suggests expanding the \$100,000 threshold to apply to all taxpayers, not just marketplace providers, by adding a new section to read as follows:

§237-___ Engaging in business in the State. A person is engaging in business in the State, whether or not the person has a physical presence in the State, if the person has gross income or gross proceeds of sale of \$100,000 or more from tangible personal property delivered in the State or services used or consumed in the State during the current or immediately preceding calendar year.

As a result of this amendment, a marketplace provider who lacks physical presence in the State will be subject to GET if a combination of its own sales and its marketplace sales (*i.e.*, sales for which it assisted or facilitated on behalf of another seller) for TPP delivered in the State total \$100,000 or more.

Finally, the Department notes that the changes in this bill will require form and computer system changes and therefore requests that the bill is amended to apply to tax years beginning after December 31, 2018.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: GENERAL EXCISE, Require Marketplace Providers to Collect on Retail Sales

BILL NUMBER: SB 2282

INTRODUCED BY: S. CHANG, INOUYE, Galuteria, Kidani, Shimabukuro

EXECUTIVE SUMMARY: Requires any marketplace provider that facilitated over \$100,000 in taxable retail sales for one or more marketplace participants to collect and remit GET on all taxable retail sales. The bill as currently drafted applies only to one year, and focuses on the marketplace provider while ignoring the broader issue of derivative nexus. We think that the approach of SB 2890 may accomplish the goal more simply.

SYNOPSIS: Adds a new section to chapter 237, HRS, requiring any marketplace provider to collect and remit GET on all taxable retail sales that the marketplace provider facilitates for marketplace participants to customers in Hawaii, if the provider facilitated over \$100,000 in taxable retail sales for taxable year 2018.

Provides that the marketplace provider shall not be subject to audit by the department with respect to the retail sales for which it is required to collect and remit taxes. Nothing in this subsection shall preclude the department from auditing marketplace participants with respect to sales facilitated by marketplace providers.

Contains the following definitions:

"Marketplace participant" means any person that sells tangible personal property or services via the forum provided by a marketplace provider.

"Marketplace provider" means any person who, pursuant to an agreement with one or more marketplace participants, facilitates sales for marketplace participants; provided that a marketplace provider facilitates a sale for a marketplace participant if the marketplace provider:

(1) Provides a forum for the listing for sale of tangible personal property or taxable services for sale by the marketplace participant, including a catalog or internet website; and

(2) Either directly or indirectly, through agreements or arrangements with marketplace participants, collects receipts from the customer and transmits those receipts to the marketplace participant, regardless of whether the marketplace provider receives compensation or other consideration in exchange for its services.

"Taxable retail sales" means any sales of tangible personal property or services that are subject to general excise taxes under this chapter.

Makes corresponding amendments to chapter 238, HRS.

EFFECTIVE DATE: This Act shall apply to taxable years beginning after December 31, 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 trying to address 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.

Some companies have held themselves out to sellers as a "marketplace facilitator," which has the potential to provide even a small seller with a very large market to which to offer products and services. Typically, such companies offer e-commerce and fulfillment services such that the remote seller can easily offer products or services for sale through the facilitator's Internet portal.

Existing law, namely *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), and *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987), hold that substantial nexus necessary for a jurisdiction to impose tax can be established through an independently contracted sales agent who acts in a state on behalf of another. Thus, a seller using such an agent in Hawaii does not need to have physical presence in Hawaii because nexus can be attributed from a marketplace provider as stated in this bill.

The bill, however, needs some work.

- As drafted, it only applies to taxable year 2018.
- It defines taxable sales using the word "retail," which makes sense in a sales tax state but does not make sense when dealing with the GET.
- It provides that the marketplace provider shall not be subject to audit by the department with respect to the retail sales for which it is required to collect and remit use taxes, and

Re: SB 2282
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appears not to impose any other penalties or confer incentives, so what would motivate a marketplace provider to comply with the requirements imposed by this bill?

Lawmakers may instead wish to consider the simpler approach in SB 2890 / HB 2417.

Digested 2/5/2018

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THE SENATE THE TWENTY-NINTH LEGISLATURE REGULAR SESSION OF 2018

COMMITTEE ON ECONOMIC DEVELOPMENT, TOURISM, AND TECHNOLOGY and COMMITTEE ON CONSUMER PROTECTION AND HEALTH

Testimony on S.B. 2282
Hearing: February 7, 2018

Relating To Taxation

Chairs Waikai and Baker, Vice Chairs Taniguchi and Tokuda and members of the Committees. My name is Peter Fritz. I am a former Rules Specialist and a tax attorney. I am testifying today **in support** of S.B. 2282. Other states have introduced or enacted marketplace provider or facilitator legislation. In 2016, the United States court of appeals for the tenth circuit upheld a Colorado law requiring out-of-state retailers that do not collect Colorado's state sales tax to report tax-related information to their Colorado customers and the Colorado department of revenue. I suggest that this bill be amended to include provisions allowing a marketplace provider to elect whether to remit taxes for third-party marketplace sellers or send information about purchases to the Hawaii customer and the Department of Taxation.

This bill would expand tax collection responsibilities to online marketplace providers. This bill is effective for taxable years beginning after December 31, 2017.

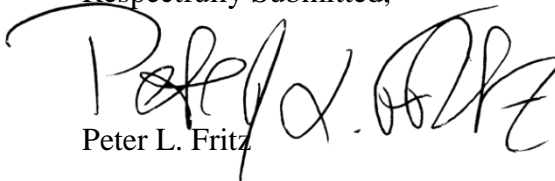
- This proposal does not increase taxes.
 - The taxes that would be collected by the online marketplace are legally owed by the purchasers. The proposal is a necessary, proactive response to the rapidly changing retail Internet economy.
- Amazon Marketplace, eBay, Etsy and other online marketplaces such as, represent a large and growing share of online retail sales.
 - 2016, ecommerce sales totaled \$5.71 trillion¹.
 - Retail sales on marketplaces grew in at nearly a 20% annual pace.
 - Over 2 million third party sellers operate on Amazon's marketplace. eBay hosts 25 million sellers, and Etsy 1.6 million.
- Under the typical online marketplace business model, the marketplace provider 1) provides a forum in which third-party sellers are able to display their products and transact sales; and 2) facilitates the collection and processing of payments for these third-party sellers. As a general rule, however, online marketplaces do not collect tax as part of their service.

¹ William F. Fox "Inability to Collect Sales Tax on Remote Sales Still Harms the Economy" State Tax Notes, Nov. 6, 2017, p. 576.

- Amazon generally does not collect tax on sales for third-party sellers. It only remits tax on items “sold by Amazon.”
- In the third quarter of 2017, Amazon reported that approximately 50% of its sales were on behalf of third-party sellers for which Amazon does not collect any tax
- This dichotomy between the payment collector and the actual seller undermines a central feature of tax administration – collection of the tax by the seller from the purchaser on behalf of the state at the time of sale. In the online marketplace model, sellers receive their money from the online marketplace sometime after the sales transaction has occurred. By this time, the opportunity for the seller to collect the tax simultaneously with the sale has passed. Given this major breakdown in the tax collection structure, there is reason to believe noncompliance by third-party sellers is widespread.
- Under this bill, tax would be collected and remitted by the marketplace provider on sales to Hawaii by all third-party sellers, including those that do not have a presence (nexus) in the State. This helps to level the playing field for Hawaii’s “Main Street” stores.
- Hawaii is not the only state to pursue this type of legislation. Washington has enacted marketplace legislation that went into effect on January 1, 2018. Amazon announced that it would collect taxes on sales sourced to Washington by third-party marketplace sellers. Several other states have enacted marketplace legislation. A chart of states that have enacted different types of legislation to tax online sales is attached.
- The Committee should consider adding provisions that require marketplace providers that facilitate remote sales by third-party sellers into Hawaii to have the option to collect general excise or use tax on taxable sales into the Hawaii or comply with certain general excise and use tax notice and reporting provisions. Colorado adopted a law requiring out-of-state retailers that do not collect Colorado's state sales tax to report tax-related information to their Colorado customers and the Colorado department of revenue. In 2016, the United States court of appeals for the tenth circuit upheld that law.

Thank you for the opportunity to testify.

Respectfully Submitted,


Peter L. Fritz

Remote Seller Nexus Chart

This chart lists the states that have passed one or more of the following types of legislation, along with the effective date for that type of legislation: Click-Through Nexus, Affiliate Nexus, Economic Nexus, Marketplace Nexus, and Use Tax Notice and Reporting Requirements.

Click-Through Nexus: If a retailer or service provider contracts with an individual or company located in-state who directly or indirectly refers potential customers to the retailer through a web link for a commission/other consideration upon sale, the retailer is considered to maintain a place of business in that state. Thresholds apply and vary by state. Pay-per-click, banner and other advertising do not qualify if payment is not contingent upon a sale.

Affiliate Nexus: If an affiliated person of the retailer with a physical presence, or employees or agents in state, has sufficient nexus in state to require the retailer to collect and remit sales and use taxes on taxable retail sales of tangible personal property or services. Some states have expanded these provisions to include activities by unrelated parties performed on the seller's behalf.

Economic Nexus: Generally, correlates with a set level of sales or gross receipts activity within the state. No physical presence is required.

Marketplace Nexus: If an online marketplace operates its business in a state and provides e-commerce infrastructure as well as customer service, payment processing services and marketing, the marketplace facilitator is required to register and collect tax as the retailer rather than the individual sellers. This could also impose reporting requirements on the marketplace facilitator.

Reporting Requirements: Retailer must notify buyers that they must pay and report state use tax on their purchases. Retailer may be required to send purchasers an annual statement of all of their purchases from the retailer.

State	Click-Through Nexus	Affiliate Nexus	Reporting Requirements	Economic Nexus	Marketplace Nexus
Alabama		8/24/2012	7/1/2017	1/1/2016	
Arizona					Ruling issued 9/20/2016
Arkansas	10/27/2011	10/27/2011			
California	9/15/2012	9/15/2012			
Colorado	7/1/2014	7/1/2014	7/1/2017		
Connecticut	5/4/2011				
Georgia	7/18/2012	10/1/2012			
Illinois	1/1/2015	7/1/2011			
Indiana				7/1/2017 - Challenged	
Iowa		6/11/2013			

Kansas	10/1/2013	7/1/2013			
Kentucky			7/1/2013		
Louisiana	4/1/2016	4/1/2016	7/1/2017		
Maine	10/9/2013	10/9/2013		10/1/17	
Massachusetts				Pending 10/1/17	
Michigan	10/1/2015	10/1/2015			
Minnesota	7/1/2013	Delayed			Delayed
Missouri	8/28/2013	8/28/2013			
Nevada	10/1/2015	7/1/2015			
New Jersey	7/1/2014				
New York	5/8/2008	6/1/2009			
North Carolina	8/7/2009				
North Dakota				Delayed	
Ohio	7/1/2015	7/1/2015		1/1/2018	
Oklahoma		6/9/2010 and 11/1/2016	6/9/2010 and 11/1/2016		
Pennsylvania	12/1/2011	12/1/2011			
Rhode Island	7/1/2009 and 8/17/2017	8/17/2017	8/17/2017	8/17/2017	8/17/2017
South Dakota		7/1/2011	7/1/2011	Appealed	
Tennessee	7/1/2015	1/1/2014	3/26/2012	Delayed	
Texas		1/1/2012			
Utah		7/1/2012			
Vermont	12/1/2015		5/24/2011 and July 1, 2017	Effective date pending SD legislation	
Virginia		9/1/2013			
Washington	9/1/2015		1/1/2018	B&O Tax only 9/1/2015 and expanded 7/1/2017	1/1/2018
West Virginia		1/1/2014			
Wyoming				Delayed	