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

Date: Friday, February 23, 2018  
Time: 9:55 A.M.  
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: S.B. 2508, Relating to Taxation

The Department of Taxation (Department) offers the following comments on S.B. 2508 for the Committees' consideration.

S.B. 2508 adds a new section in chapter 231 of the Hawaii Revised Statutes (HRS), which creates a presumption that a person conducting business in the State that has its commercial domicile in another state is presumed to be systematically and regularly engaging in business in the State and taxable under HRS title 14 if the person engages in or solicits an unspecified number of business transactions with persons in the State and the sum of the person's income or gross proceeds equals an unspecified amount. The bill further provides that a person taxable under this new section may petition the Director of Taxation to allow the remitting of tax on a basis other than monthly for good cause. The bill is effective on July 1, 2018.

First, the Department notes that HRS title 14 contains many different types of taxes and they do not all follow the same legal standard with respect to nexus. Accordingly, the Department suggests limiting application of this bill to the general excise tax (GET).

Second, the Department notes that a person with a commercial domicile outside the State will be engaged in business in the State if the person has a physical presence in the State. Accordingly, a presumption is unnecessary for said persons. The Department therefore suggests amending the bill to specify that the presumption applies to persons that lack physical presence in the State (as opposed to persons who merely have their commercial domicile outside the State).

Third, the Department notes that the presumption would apply if the person meets the threshold “during any year,” which could result in a person being subject to tax based on transactions occurring 10 years prior. The Department therefore suggests replacing the phrase “during any year” with “during the current or preceding calendar year.”

Fourth, the Department suggests deleting subsections (b) and (c) regarding the ability to petition the Director to allow the remitting of tax on a basis other than monthly for good cause, as HRS section 237-30 already grants the Director the authority to permit a taxpayer to file returns on a quarterly or semiannual basis for good cause.

Fifth, the Department suggests adopting a \$100,000 threshold, similar to that adopted by a large number of states, including South Dakota, whose statute will be reviewed by the U.S. Supreme Court in the case South Dakota v. Wayfair, Inc.

Sixth, the Department suggests deleting the word “entity” from the bill, as the term “person” includes entities.

Based on the foregoing, the Department proposes the following language:

**§237-\_\_ Persons lacking physical presence in the State; nexus presumption.** A person that lacks physical presence in the State is presumed to be systematically and regularly engaging in business in the State and taxable under this chapter if, during the current or preceding calendar year:

- (1) The person engages in or solicits \_\_ or more business transactions with persons within the State; and
- (2) The sum of the value of the person's gross income attributable to sources in this State equals or exceeds \$100,000.

Finally, the Department notes that it will be able to administer the changes in this bill with the current effective date.

Thank you for the opportunity to provide comments.

# TAX FOUNDATION OF HAWAII

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SUBJECT: GENERAL EXCISE, Sellers Without Physical Presence; Economic Nexus

BILL NUMBER: SB 2508

INTRODUCED BY: DELA CRUZ

EXECUTIVE SUMMARY: States that the seller with more than \$\_\_\_\_\_ in sales or \_\_\_\_\_ transactions into the state is presumed to have nexus with the state.

SYNOPSIS: Adds a new section to chapter 231, HRS, providing that notwithstanding any other law to the contrary, any person is presumed to be systematically and regularly engaging in business in the State and taxable under chapter 14, HRS, if, during any year, the person or entity engages in or solicits \_\_\_ or more business transactions with persons within the State, and the sum of the value of income, gross proceeds, gross rental, or gross rental proceeds attributable to sources in the State equals or exceeds \$\_\_\_\_\_.

Provides that a person taxable under this provision may petition the director of taxation to allow the remitting of tax on a basis other than monthly, for good cause. Good cause includes compliance with the federal or Hawaii constitution.

EFFECTIVE DATE: July 1, 2018.

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.

This bill adopts unspecified thresholds.

Digested 2/19/2018



**TESTIMONY OF TINA YAMAKI  
PRESIDENT  
RETAIL MERCHANTS OF HAWAII  
February 23, 2018**

**SB 2508 Relating to Taxation**

Good morning Chair Dela Cruz and Chair Taniguchi and members of the Senate Committee on Commerce, Consumer Protection and Health and the Senate Committee on Judiciary. 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 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 SB 2508 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. 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.

Currently under the existing state law, consumers are required to pay the General Excise Tax on the goods they purchase in the brick and mortar stores physically located in the state of Hawaii. However, if local consumers shop on line, sellers are not required to collect a tax in the same way our 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.

Although news last year that Amazon will begin charging tax on Hawaii purchases was a step in the right direction, they are only a 1% tax and NOT the 4% on neighbor islands and 4.5% for Oahu customers that our local brick and mortar stores have to charge. Furthermore, third party sellers on Amazon do not charge the tax. There are so many more online retailers like Wayfair, Overstock, Ebay, Vista Print, Etsy and Shoe Dazzle to name a few that are also not collecting taxes. Because of this, Hawaii is missing out on millions of dollars on uncollected use tax from remote sales. And every year online sales has been increasing substantially.

We urge you to support SB 2508.

Again mahalo for this opportunity to testify.