



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

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**ON THE FOLLOWING MEASURE:**  
S.B. NO. 2514, RELATING TO TAXATION.

**BEFORE THE:**  
SENATE COMMITTEE ON WAYS AND MEANS

**DATE:** Tuesday, February 13, 2018      **TIME:** 10:15 a.m.

**LOCATION:** State Capitol, Room 211

**TESTIFIER(S):** Russell A. Suzuki, Acting Attorney General, or  
Nathan S.C. Chee, Deputy Attorney General

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Chair Dela Cruz and Members of the Committee:

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.

The purpose of this bill is to amend chapter 231, Hawaii Revised Statutes (HRS), by adding a new section that would make any person without a physical presence in the State that is selling tangible personal products or services to customers in this State subject to Title 14, HRS, specifically, the general excise tax if:

- (1) Gross proceeds of goods or services entering the State exceeds \$5,000; or
- (2) The total number of transactions involving goods or services entering the State is equal to or exceeds 200.

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.

Today's proliferation of online commerce reveals that the physical presence requirement affirmed by Quill 25 years ago may be inadequate in today's market. For example, New York's highest court recently said that "[t]he world has changed dramatically in the last two decades, and it may be that the physical presence test is outdated." Overstock.com, Inc. v. New York Department of Taxation and Finance, 20 N.Y.3d 586, 595 (2013). Despite this statement, the New York court maintained that the taxpayer must have some type of physical presence in the state.

It may be important to note that many of the authoritative cases, including Quill, interpret the substantial nexus requirement to involve a state sales and use tax, not a general excise tax, which is at issue here in Hawaii. It is unknown whether the tests under Quill will be applied to a general excise tax and whether the imposition of such a tax without a requirement of a 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 Inc., 901 N.W.2d 754 (S.D. 2017), cert. granted, 2018 WL 386568 (U.S. Jan. 12, 2018) (No. 17-494), later this year.

Because the main purpose of this bill is to apply the state general excise tax to the activity of certain taxpayers with no physical presence in Hawaii, if this bill becomes law, a taxpayer may cite to the United States Supreme Court decisions of Quill and Bellas Hess to challenge the State 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.

Thank you for the opportunity to provide comments.

DAVID Y. IGE  
GOVERNOR

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

Date: Tuesday, February 13, 2018

Time: 10:15 A.M.

Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

Re: S.B. 2514, Relating to Taxation

The Department of Taxation (Department) offers the following comments on S.B. 2514 for the Committees' consideration.

S.B. 2514 adds a new section in chapter 231 of the Hawaii Revised Statutes (HRS), which provides that any person selling tangible personal property, products transferred electronically, or services for delivery into the State and who does not have physical presence in the State shall be subject to title 14, shall remit the general excise tax (GET), and shall follow all requirements of law as if the person has physical presence in the State if the person has more than \$5,000 in revenue in the State or 200 or more transactions in the State in the previous or current calendar year. The bill is effective upon approval and applies to tax years beginning after December 31, 2017.

First, the Department notes that 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 GET.

Second, the Department notes that the bill would evaluate transactions for electronic products transferred into the State and services delivered into the State to determine whether the taxpayer is subject to tax. For purposes of GET, however, income from intangible property is sourced to where the property is used and income from services is sourced to where the service is used or consumed. Stated differently, if an intangible property or service is used outside the State, it is not subject to GET even if it was delivered in the State. The Department therefore suggests amending the bill to correctly reflect the sourcing rules.

Third, in lieu of the \$5,000 threshold, 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.

Fourth, to avoid ambiguity, the Department suggests amending the bill to state that a person without physical presence who meets the threshold is engaging in business in the State, instead of stating that the person must follow all procedures and requirements of law.

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

**§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 in the current or immediately preceding calendar year:**

- (1) The person's gross income or gross proceeds of sale from the sale of tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State is \$100,000 or more; or
- (2) The person sold tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State in two hundred or more separate transactions.

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.