



**STATE OF HAWAII**  
**DEPARTMENT OF TAXATION**  
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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. 2871, Relating to Taxation

The Department of Taxation (Department) supports the intent of S.B. 2871 and offers the following comments for the Committees' consideration.

The following is a summary of key provisions in S.B. 2871, which is effective upon approval and applies to tax years beginning after December 31, 2019:

Definitions

- "Marketplace facilitator" is defined as a person who facilitates for consideration the sale of the seller's products through a marketplace and engages in certain listed activities.
- "Remote seller" is defined as any seller other than a marketplace facilitator who does not have a physical presence in the State and makes retail sales to purchasers.
- "Referrer" is defined as a person, other than a newspaper publisher, who contracts with a seller to list or advertise for sale, receives a commission or fee for the listing, transfers a purchaser to a seller or affiliated person to complete the sale, and does not collect receipts from the purchasers.

### Engaging in Business

- A remote seller with \$10,000 in gross receipts sourced to the State in the current or immediately preceding calendar year will be deemed to be engaging in business in the State.
- A marketplace facilitator with \$10,000 in gross receipts sourced to the State, whether in its own name or as an agent of a marketplace seller, in the current or immediately preceding calendar year will be deemed to be engaging in business in the State.
- A referrer with \$267,000 in gross income from referral services apportioned in the State, whether or not subject to tax and from sales sourced to the State, will be deemed to be engaging in business in the State.

### Election to Collect or Report

- Beginning January 1, 2018, remote sellers will be required to either collect and remit GET or comply with notice and reporting requirements.
- Beginning January 1, 2018, a marketplace facilitator will be required to collect and remit GET or comply with notice and reporting requirements for (1) retail sales through the marketplace on behalf of marketplace sellers who do not have a physical presence in the State and (2) its own retail sales if the marketplace facilitator does not have a physical presence in the State.
- Beginning January 1, 2018, a referrer will be required to collect and remit GET or comply with notice and reporting requirements for (1) retail sales from a referral of the purchaser to a marketplace seller who does not have a physical presence in the State and (2) its own retail sales if the referrer does not have a physical presence in the State.

### Notice and Reporting Requirements

- Sellers and referrers who do not collect GET will be required to provide notice to customers that GET is due on certain purchases, GET is not being collected or remitted, and the customer must file a GET return and remit GET directly to the Department.
- Sellers and referrers who do not collect GET will be required report on these transactions to the consumer and the Department.

### Use Tax

- Similar provisions are provided for the use tax.

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. With respect to the use tax, a buyer in Hawaii is required to pay use tax if the seller is not subject to GET (*i.e.*, if the seller does not have nexus).

Because many provisions in the bill are based on sales tax concepts, they conflict with GET law. For example, the notice and reporting requirement imposed on a "seller that does not collect the tax imposed under this chapter" is confusing because, unlike a sales tax, sellers do not collect GET. As previously explained, the GET is imposed on the seller, not the buyer. Additionally, the notice statements that purchasers must file a GET return and are required to remit GET are incorrect, as purchasers are not liable for GET.

The Department suggests, instead of imposing a collection or reporting obligation on remote sellers and marketplace facilitators, adopting language similar to that in H.B. 1655, which deems the marketplace facilitator the seller of TPP and therefore subjects the marketplace facilitator 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 2 through 4 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 facilitator 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 remote sellers for TPP delivered in the State;
- (2) A remote seller who is doing business in the State will be subject to GET at the half-percent rate if it sells TPP through a marketplace facilitator for delivery in the State; and
- (3) If a remote seller who is not doing business in the State makes a sale of TPP through a marketplace facilitator for delivery in the State, the marketplace facilitator 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, with respect to Section 5 of the bill, the Department suggests using \$100,000 as the threshold sales amount instead of \$10,000. The Department notes that a \$100,000 threshold is more consistent with amounts adopted by other states. Additionally, to promote uniform and consistent application of the GET, the Department suggests using a \$100,000 threshold amount to apply to all taxpayers, not just remote sellers, marketplace facilitators, and referrers. In lieu of the amendments in Section 5 of the bill, the Department suggests adding the following sentence to HRS section 237-2: The Department suggest the following amendments to Section 5:

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.

Finally, the Department notes that Sections 2 and 3 of the bill provide that the election to collect or report begins on January 1, 2018, but Section 10 provides that the bill applies to taxable years beginning after December 31, 2019. The Department suggests clarifying the effective date and notes that it will be able to administer the changes in the bill for 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, Define Doing Business Without Physical Presence; Reporting Requirement for Direct Sellers

BILL NUMBER: SB 2871; HB 2234 (Identical)

INTRODUCED BY: SB by KEITH-AGARAN, DELA CRUZ, Wakai; HB by NAKASHIMA

EXECUTIVE SUMMARY: This bill 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. However, it may be a tremendous administrative burden for the Department. We think that the approach of SB 2890 may accomplish the goal more simply.

SYNOPSIS: Adds a new section to HRS chapter 237 requiring that each remote seller, referrer, or marketplace facilitator shall either collect and remit GET on all taxable sales into the State or comply with the reporting section described below.

Adds a new section to HRS chapter 237 requiring any seller that does not collect the tax to comply with reporting requirements. For taxable sales made through a marketplace facilitator or other agent, the facilitator or agent shall comply with the reporting requirements.

The reporting requirements for a seller, facilitator, or other agent are that the seller, facilitator, or agent shall:

(1) Post a conspicuous notice on its marketplace, platform, website, catalog, or any other similar medium that informs Hawaii purchasers that:

- (A) General excise tax is due on certain purchases;
- (B) The State of Hawaii requires the purchaser to file a general excise tax return; and
- (C) The notice is provided under the requirements of law; and

(2) Provide a notice to each consumer at the time of each sale that includes the following information:

- (A) A statement that general excise tax is not being collected or remitted upon the sale;
- (B) A statement that the consumer may be required to remit general excise tax directly to the department of taxation; and
- (C) Instructions for obtaining additional information from the department regarding whether and how to remit general excise tax to the department of taxation.

Requires a referrer to post a conspicuous notice on its platform that informs Hawaii purchasers:

- (1) That general excise tax is due on certain purchases;
- (2) That the seller may or may not collect and remit general excise tax on a purchase;
- (3) That the State of Hawaii requires the purchaser to file a general excise tax return if tax is not assessed at the time of a taxable sale by the seller;
- (4) That the notice is provided under the requirements of this section;
- (5) Of the instructions for obtaining additional information from the department of taxation regarding whether and how to remit the general excise tax to the department; and
- (6) That if the seller to whom the purchaser is referred does not collect general excise tax on a subsequent purchase by the purchaser, the seller may be required to provide information to the purchaser and the department of taxation about the purchaser's potential general excise tax liability.

A seller shall, no later than February 28 of each year, provide a report to each Hawaii consumer including:

- (1) A statement that the seller did not collect general excise tax on the consumer's transactions with the seller and that the consumer may be required to remit such tax directly to the department of taxation;
- (2) A list, by date, generally indicating the type of product purchased or leased during the immediately preceding calendar year by the consumer from the seller sourced to this State and the price of each product;
- (3) Instructions for obtaining additional information from the department of taxation regarding whether and how to remit the sales tax to the department;
- (4) A statement that the seller is required to submit a report to the department of taxation pursuant to subsection (f) stating the total dollar amount of the consumer's purchases from the seller; and
- (5) Any information as the department of taxation may reasonably require.

Provides that the notification shall be sent to the consumer's billing address, or to the shipping address if the billing address is unknown, by first-class mail, in an envelope marked prominently with words indicating important tax information is enclosed. If no billing or shipping address is known, the report shall be sent electronically to the consumer's last known electronic mail address with a subject heading indicating important tax information is enclosed.

A referrer is also required to provide its marketplace sellers to whom the referrer transferred Hawaii customers an annual notice, due February 28, that includes:

- (1) A statement that Hawaii imposes a general excise tax on gross receipts;

(2) A statement that a seller, meeting the threshold pursuant to section 237-2, is required to either collect and remit general excise tax on all taxable gross receipts sourced to this State or to comply with this section; and

(3) Instructions for obtaining additional information from the department of taxation.

Sellers, marketplace providers, agents, and referrers are also required to provide annual reports to the department of taxation by February 28.

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.

Does not appear to provide a penalty for failing to comply.

Makes conforming amendments to chapter 238, HRS.

EFFECTIVE DATE: This Act, upon its approval, shall apply to taxable years beginning after December 31, 2019.

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.



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 IRS Form 1099 reporting requirements. Penalties are imposed against noncompliant retailers. The penalty amount is \$10 per purchaser for failing to send the purchaser statement, and \$10 per purchaser that should have been included in a report for failure to file the statement.

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*, 813 F.3d 1129 (10th Cir.), *cert. denied*, 137 S. Ct. 591 (2016).

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

The bill as drafted would appear to impose a large burden on the Department of Taxation, which is now in the midst of a gargantuan software modernization project. 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. 2871  
Hearing: February 7, 2018

#### Relating To Taxation

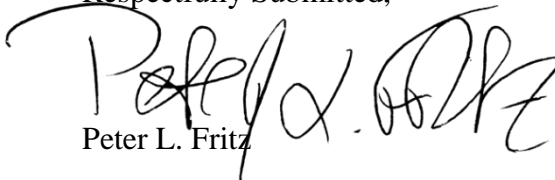
Chairs Waikai and Baker, Vice Chairs Taniguchi and Tokuda and members of the Committees. My name is Peter Fritz. I am a former Rules Specialist and a tax attorney. I am testifying today **in support** of S.B. 2282. In 2016, the United States court of appeals for the tenth circuit upheld a Colorado law 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. This allows marketplace facilitators, remote-sellers and referrers to elect whether to remit taxes or send information about purchases to the Hawaii customer and the Department of Taxation.

This bill incorporates provisions from Washington State's marketplace facilitator bill. A number of changes are necessary such as:

- Dates need to agree throughout this document.
  - The effective date for this bill should be for taxable years beginning after December 31, 2018.
  - At various locations in this bill, the collection of taxes needs to be changed years beginning after January 1, 2019.
  - The bill should refer to "sales" and not "retail sales"
  - The reference on page 3 line 16 to "tax imposed under this chapter" should refer to Chapter 237 and/or 238 as those chapters impose the General Excise Tax or the Use Tax. This change needs to be made at other locations in this bill.
- A provision should be added to require the Department of Taxation to write rules regarding mistakes in payments and marketplace facilitators ability to rely on representations or provisions such as those contained in S.B. 2282 should be written into this bill.

Thank you for the opportunity to testify.

Respectfully Submitted,



Peter L. Fritz