



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

ON THE FOLLOWING MEASURE:
S.B. NO. 2890, S.D. 1, RELATING TO TAXATION.

BEFORE THE:
SENATE COMMITTEE ON WAYS AND MEANS

DATE: Wednesday, February 28, 2018 **TIME:** 11:00 a.m.

LOCATION: State Capitol, Room 211

TESTIFIER(S): **WRITTEN TESTIMONY ONLY.**
(For more information, contact Kathryn-Jean T. Kanemori,
Deputy Attorney General, at 586-1480)

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 the definitions in chapter 237, Hawaii Revised Statutes (HRS), relating to general excise tax by (1) adding the term "marketplace provider" and (2) amending the definition of "business". "Marketplace provider" is defined as "any 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." Under the proposed amendment to the term "business", a taxpayer would be engaging in "business" and subject to the general excise tax regardless of whether it has a physical presence in Hawaii. A person without physical presence in Hawaii is deemed to be engaging in "business" in the State if the person has gross receipts attributable to transactions in Hawaii totaling \$100,000 or more. Gross receipts attributable to sales in the State include sales by a person without physical presence in the State and that are facilitated by a marketplace provider.

The amendments proposed in this bill may withstand a challenge in the State court under the current Hawaii Supreme Court jurisprudence; however, 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.

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.

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GOVERNOR

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

Date: Wednesday, February 28, 2018
Time: 11:00 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2890, S.D. 1, Relating to Taxation

The Department of Taxation (Department) supports the intent of S.B. 2890, S.D. 1, and offers the following comments for the Committee's consideration.

S.B. 2890, S.D. 1 amends the definition of "business" in Hawaii Revised Statutes (HRS) section 237-2 by clarifying that a person with no physical presence in the State is engaged in business if the person has gross receipts attributable to transactions in this State totaling \$100,000 or more in the current or preceding calendar year. The bill further provides that gross receipts attributable to transactions in the State include gross receipts from sales that are facilitated by a marketplace provider that is engaged in business in the State. The term "marketplace provider" is defined as any person who sells or assists in the sale of tangible personal property (TPP) on behalf of another seller and who provides customer services, processes payments, and controls the fulfillment process. The bill has a defective effective date of July 1, 2035.

The Department appreciates that its proposed amendment regarding the period of time during which the \$100,000 threshold will be evaluated was adopted by the joint Committees on Judiciary and Commerce, Consumer Protection, and Health.

With respect to sales facilitated by a marketplace provider, the Department notes that the purpose of the last sentence in the definition of "business" is unclear. The last sentence provides: "Gross receipts attributable to transactions in this State include gross receipts from sales that, but for the seller's lack of physical presence, would be taxable under this chapter and are facilitated by a marketplace provider that is engaged in business in this State." Under current law, a seller's gross receipts include sales made through a marketplace provider engaged in business in the State. The provision therefore does not change the current state of the law. The

provision is incomplete, however, in that a seller's gross receipts also include sales facilitated by a marketplace provider who is not engaged in business in the State, as well as direct sales made by the seller.

If the intent of this bill is to maximize collection of the general excise tax (GET) on sales made by remote sellers through marketplace providers, the Department suggests adopting the language in Sections 1 and 2 of 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. Specifically, the Department proposes the following amendments:

First, the Department suggests amending 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.

Second, the Department suggests amending 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, combined with the \$100,000 threshold in this bill, would result in the following:

- (1) 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;
- (2) 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 third-party sellers for TPP delivered in the State;
- (3) A third-party 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 provider for delivery in the State; and
- (4) If a third-party seller 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).

This proposal is the most efficient method of imposing and collecting GET on third-party sales made through a marketplace provider because instead of having to collect the retail rate of GET from numerous individual third-party sellers, the Department would only need to collect from one seller—the marketplace provider. Additionally, even if a third-party seller who lacks physical presence has less than \$100,000 in sales in the State, all of the third-party seller's sales made through a marketplace provider who is engaged in business in the State will be subject to GET.

Thank you for the opportunity to provide comments.



Chamber of Commerce HAWAII

The Voice of Business

**Testimony to the Senate Committee on Ways and Means
Wednesday, February 28, 2018 at 11:00 A.M.
Conference Room 211, State Capitol**

RE: SENATE BILL 2890 SD1 RELATING TO TAXATION

Chair Dela Cruz, Vice Chair Keith-Agaran, and Members of the Committee:

The Chamber of Commerce Hawaii ("The Chamber") **supports the intent of SB 2890 SD1**, which amends the general excise tax law by adding a definition for “marketplace provider.” Provides that a person with no physical presence in the State shall be considered to be engaged in business in the State if, in the current or immediately preceding calendar year, the person has gross receipts attributable to transactions in the State totaling \$100,000 or more.

The Chamber is Hawaii’s leading statewide business advocacy organization, representing about 2,000+ 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.

We support the intent of this bill to help ensure that local stores with bricks-and-mortar locations in Hawaii will be on a level playing field with internet sellers as internet sellers would be subject to the same taxes as the in-state businesses.

From a legal standpoint, it is our understanding that this bill may be premature as technically, this statute would violate existing US Supreme Court precedent, which continues to state that a physical presence is necessary in a state before you can be taxed. The case that makes this statement, the “Quill” decision, is currently being challenged at the US Supreme Court. If enacted before the Supreme Court decision is announced, it could potentially be contrary to existing law.

Thank you for the opportunity to testify.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Define Doing Business Without Physical Presence; Attribution from Marketplace Provider

BILL NUMBER: SB 2890, SD-1

INTRODUCED BY: Senate Committee on Judiciary, Senate Committee on Commerce, Consumer Protection, & Health

EXECUTIVE SUMMARY: This is an attempt to adopt a form of “factor presence nexus,” namely a statement that substantial sales in a state give rise to a sufficient connection between the state and the seller to enable that state to impose sales tax or use tax collection obligations. While the measure may be subject to constitutional challenge, 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 also provides for attribution of nexus from a “marketplace provider,” which is on firmer constitutional footing.

SYNOPSIS: Adds a definition of “marketplace provider” in HRS section 237-1 as “any 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.”

Amends the definition of “business” or “engaging” in business in HRS section 237-2 to provide that a person with no physical presence in the State is engaged in “business” in this State if, in the current or immediately preceding calendar year, the person has gross receipts attributable to this State of \$100,000 or more. Also provides that gross receipts attributable to this State include gross receipts from sales that would be taxable under chapter 237 but for the physical presence of the seller, and are facilitated by a marketplace provider that is engaged in business in this State.

EFFECTIVE DATE: July 1, 2035.

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 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.

Amazon, the online retailer, registered for a Hawaii general excise tax license and started collecting and remitting Hawaii tax on online purchases effective April 1, 2017. We understand, however, that it is collecting and remitting tax on its own sales but is not doing so on “Amazon Marketplace” sales, where the company acts as a sales agent and a fulfillment agent for other, unrelated companies.

For marketplace sales, *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 can be established through an independently contracted sales agent who acts in a state on behalf of another. Thus, whether or not “economic nexus” is ultimately found to be constitutional, nexus can be attributed from a marketplace provider as stated in this bill.

Digested 2/22/2018