

JAN 24 2019

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# A BILL FOR AN ACT

RELATING TO MARKET-BASED SOURCING.

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:**

1           SECTION 1. The purpose of this Act is to adopt market-  
2 based sourcing for purposes of apportioning income under the  
3 Uniform Division of Income for Tax Purposes Act (UDITPA), part  
4 II of chapter 235, Hawaii Revised Statutes. UDITPA governs the  
5 imposition of the Hawaii net income tax to taxpayers that carry  
6 on business both within and without the state. Historically,  
7 UDITPA has sourced intangibles and services to the place where  
8 the income-producing activity is performed or where most of the  
9 costs of performance are incurred.

10           As intangible property and services have become a greater  
11 part of the economy, states have transitioned to market-based  
12 sourcing for intangibles and services. Market-based sourcing  
13 imposes tax in the place where taxpayers' markets are located  
14 rather than only the location of taxpayers' activities. Today,  
15 more than half of all states have made the transition to market-  
16 based sourcing. This Act will amend UDITPA to transition to  
17 market-based sourcing for income from intangibles and services.  
18 Specifically, this Act will change the sourcing rules for the

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1 Hawaii sales factor for sales of services or intangibles to  
2 market-based sourcing.

3 This transition will ensure that Hawaii's income tax is  
4 keeping up with the changing economy and will foster uniformity  
5 with states that have also transitioned to market-based  
6 sourcing. This will reduce inter-state complexity and simplify  
7 inter-state compliance.

8 In addition, Hawaii's general excise tax utilizes a version  
9 of market-based sourcing. Therefore, transitioning the net  
10 income tax to market-based sourcing will increase consistency  
11 and efficiency between the two taxes.

12 SECTION 2. Section 235-37, Hawaii Revised Statutes, is  
13 amended to read as follows:

14 "§235-37 Apportionment; sales factor; nontangible  
15 personalty. Sales, other than sales of tangible personal  
16 property, are in this State [if]:

17 (1) ~~[The income producing activity is performed in this~~  
18 ~~State; or]~~ In the case of intangible property, to the  
19 extent the intangible property is used in this State;  
20 or

21 (2) ~~[The income producing activity is performed both in~~  
22 ~~and outside this State and a greater proportion of the~~

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1 ~~income producing activity is performed in this State~~  
2 ~~than in any other state, based on costs of~~  
3 ~~performance.] In the case of a service, to the extent~~  
4 ~~the service is used or consumed in this State."~~

5 SECTION 3. Statutory material to be repealed is bracketed  
6 and stricken. New statutory material is underscored.

7 SECTION 4. This Act shall take effect upon its approval  
8 and shall apply to taxable years beginning after December 31,  
9 2018.

INTRODUCED BY: 

BY REQUEST

# S.B. NO. 1270

**Report Title:**

Net Income Tax; Sales Factor; Market-based Sourcing.

**Description:**

Amends the rules for sourcing the sales factor for net income tax to impose market sourcing for sales of other than tangible personal property. Provides specific rules for intangibles and services.

*The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.*

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## JUSTIFICATION SHEET

DEPARTMENT: Taxation.

TITLE: A BILL FOR AN ACT RELATING TO MARKET-BASED SOURCING.

PURPOSE: To amend Hawaii's net income tax law to transition to market-based sourcing under the Uniform Division of Income for Tax Purposes Act (UDITPA).

MEANS: Amend section 235-37, Hawaii Revised Statutes.

JUSTIFICATION: UDITPA sources services and intangibles to where the income-producing activity is performed or where most of the costs of performance are incurred. UDITPA sources tangible personal property to where the markets for the products are located. Services and intangibles are a growing part of the economy. Increasingly, products that have traditionally been tangible personal property are becoming consumable in intangible form, and services that previously were only performable "in-person" are performable remotely. As this transition has happened, the tax base has become distorted because the sourcing rules no longer reflect the nature of the economy. To combat this, many states have transitioned to market-based sourcing for sales of services and intangibles.

Impact on the public: There will be minimal impact on the general public. Multi-state businesses will need to comply with different sourcing rules. Multi-state businesses will get the benefit of consistent sourcing between the general excise tax and the income tax. This will reduce complexity and ease compliance.

Impact on the department and other agencies:  
The State will benefit from consistency with other states' income taxes. The State will benefit from consistency between the general excise tax and the net income tax laws.

GENERAL FUND: Pending.

OTHER FUNDS: None.

PPBS PROGRAM  
DESIGNATION: None.

OTHER AFFECTED  
AGENCIES: None.

EFFECTIVE DATE: Upon approval, applies to taxable years beginning after December 31, 2018.