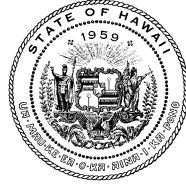


DAVID Y. IGE
GOVERNOR

JOSH GREEN M.D.
LT. GOVERNOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
Phone: (808) 587-1540 / Fax: (808) 587-1560
Email: Tax.Directors.Office@hawaii.gov

RONA M. SUZUKI
DIRECTOR OF TAXATION

DAMIEN A. ELEFANTE
DEPUTY DIRECTOR

To: The Honorable Donovan M. Dela Cruz, Chair;
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair;
and Members of the Senate Committee on Ways and Means

From: Rona M. Suzuki, Director
Department of Taxation

Re: S.B. 2084, Relating to Taxation

Date: Wednesday, January 29, 2020

Time: 10:10 A.M.

Place: Conference Room 211, State Capitol

The Department of Taxation (Department) appreciates the intent of this measure and provides the following comments regarding S.B. 2084. The measure removes from the definition of "resident person" under the Hawaii Real Property Tax Act all foreign partnerships, foreign limited liability partnerships, foreign limited liability companies, or foreign limited liability companies. The measure is effective on January 1, 2021 and applies to taxable years beginning after December 31, 2020.

The Department appreciates that the measure is effective on January 1, 2021, and respectfully requests that the provision applying the measure to taxable years beginning after December 31, 2020 be deleted. The Department suggests amending Section 3 of the measure to read:

SECTION 3. This Act shall take effect upon its approval and shall apply to real estate dispositions that occur on or after January 1, 2021.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Remove Foreign Entities from HARPTA Resident Definition

BILL NUMBER: SB 2084

INTRODUCED BY: DELA CRUZ, KANUHA, KIDANI, Keith-Agaran, Nishihara, Shimabukuro

EXECUTIVE SUMMARY: This measure removes foreign entities from the definition of “resident” under Hawaii’s law requiring nonresident sellers to withhold a percentage of the gross proceeds of a real estate transaction. Thus, foreign entities would be required to withhold even if they are owned and operated in Hawaii. This measure undoes changes to the law that were made in 1991 and may raise constitutional concerns under the Commerce Clause and Foreign Commerce Clause.

SYNOPSIS: Amends HRS section 235-68 to delete from the definition of “resident person” foreign entities that are registered with the DCCA to do business in Hawaii.

EFFECTIVE DATE: July 1, 2021.

STAFF COMMENTS: The withholding provision at issue, HRS section 235-68, commonly known as HARPTA, was enacted as Act 213, SLH 1990. At the time, HARPTA excused from withholding only to domestically organized corporations, partnerships, and similar business entities.

In the very next legislative session, the Department of Taxation introduced an administration measure, TAX-17 (1991), to add to the definition of resident person any business entities that were lawfully registered with the DCCA. That measure became Act 279, SLH 1991. In its testimony before the Legislature, the Department explained:

The bill adds any foreign corporation certified or authorized to transact business in Hawaii to the definition of a resident person. Since these corporations are registered with the department of commerce and consumer affairs, they should be treated in a manner similar to resident corporations.

Testimony of Richard F. Kahle, Jr., Director of Taxation (Mar. 27, 1991); Testimony of Richard F. Kahle, Jr., Director of Taxation (Feb. 19, 1991).

The Foundation’s testimony in 1991 also highlighted another reason:

Finally, it should be noted that the amendment to the definition of a resident person recognizes that there are companies which while not incorporated under Hawaii law, nevertheless make Hawaii their home.

Testimony of Tax Foundation of Hawaii (Mar. 25, 1991); Testimony of Tax Foundation of Hawaii (Feb. 7, 1991).

In addition, the Commerce Clause of the U.S. Constitution informs analysis of taxes affecting business such as the General Excise Tax, *In re Hawaiian Flour Mills, Inc.*, 76 Haw. 1, 868 P.2d 419 (1994), and the Liquor Tax, *Bacchus Imports, Ltd v. Dias*, 468 U.S. 263 (1984).

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), which the Hawaii Supreme Court also follows when evaluating Commerce Clause tax issues, *In re Baker & Taylor, Inc.*, 103 Haw. 359, 82 P.3d 804 (2004), establishes that a state tax must pass a four-part test to survive scrutiny under the Commerce Clause:

1. The taxed activity has a substantial nexus to the taxing state;
2. The tax is fairly apportioned to activity in the state;
3. The tax does not discriminate against interstate commerce; and
4. The tax is fairly related to services provided by the state.

Bacchus Imports, Ltd v. Dias, 468 U.S. 263 (1984), called it a “cardinal rule of Commerce Clause jurisprudence” that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce ... by providing a direct commercial advantage to local business.’” *Id.* at 268 (quoting *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 320 (1977)).

The U.S. Constitution similarly restricts or forbids discrimination against foreign commerce. *Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 505 U.S. 71 (1992); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

In *Bacchus*, the taxing statute facially discriminated against interstate commerce. *Bacchus* invalidated an exemption from Hawaii Liquor Tax on sales of locally produced okolehao and fruit wine. The bill before this Committee imposes a withholding requirement when an entity organized outside of Hawaii sells real property but does not impose the requirement when an entity organized in Hawaii sells real property. That would be a burden on business being conducted by an entity solely because it is organized outside of Hawaii, which could be seen as facial discrimination against interstate commerce. For that reason, the bill should be carefully analyzed for compliance with this constitutional provision if it is to move forward.

Instead, the Committee may wish to consider nondiscriminatory criteria, such as whether the seller has filed a Hawaii income tax return within the 12-month period preceding the transaction, to trigger HARPTA withholding.