

**ACT 96**

S.B. NO. 394

A Bill for an Act Relating to Taxation.

*Be It Enacted by the Legislature of the State of Hawaii:*

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

As intangible property and services have become a greater part of the economy, states have transitioned to market-based sourcing for intangibles and services. Market-based sourcing imposes tax in the place where taxpayers' markets are located rather than only the location of taxpayers' activities. Today, more than half of all states have made the transition to market-based sourcing. This Act amends UDITPA to transition to market-based sourcing for income from intangibles and services. Specifically, this Act changes the sourcing rules for the Hawaii sales factor for sales of services or intangibles to market-based sourcing.

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

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

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

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

- (1) [~~The income producing activity is performed in this State; or~~] In the case of intangible property, to the extent the intangible property is used in this State; or
- (2) [~~The income producing activity is performed both in and outside this State and a greater proportion of the income producing activity is performed in this State than in any other state, based on costs of performance.~~] In the case of a service, to the extent the service is used or consumed in this State.”

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

SECTION 4. This Act shall take effect upon its approval, and shall apply to taxable years beginning after December 31, 2019.

(Approved June 7, 2019.)