IN THE TAX APPEAL COURT OF THE

STATE OF HAWAII

In the Matter of the Tax Appeal of AMERICAN EXPRESS RELATED SERVICES COMPANY, INC., Appellant.	Case Nos. 3055 and 3089 FINAL JUDGMENT ORDER

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FINAL JUDGMENT ORDER

In accordance with the foregoing Findings of Fact and Conclusions of Law and pursuant to Jenkins v. Cades, 76 Haw. 115 (1994);

IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

1. American Express Travel Related Services, Inc.'s ("Taxpayer") Motion for Summary Judgment iS denied;

2. Director of Taxation, Ray K. Kamikawa's, ("Director") Motion for Summary Judgment is granted on the ground that the assessments under appeal are valid and legal;

3. Hawaii's use tax applies to Taxpayer's distribution, through direct mail to Hawaii residents, of promotional materials and merchandise catalogs to sell its products and services in Hawaii because that activity is a taxable use of those materials in this State: and

4. Judgement is hereby entered for the Director and against Taxpayer in the sum of $39,135.12 paid by Taxpayer in Tax Appeal No. 3055 and in the sum of $53,797.32 paid by the Taxpayer in Tax Appeal No. 3089, together with accrued interest thereon. These payments are hereby adjudged to be proper government realizations and shall immediately be released to the general fund.

DATED: Honolulu, Hawaii, MAY 12 1995.

Wendell K. Huddy

TAX APPEAL COURT SEAL STATE OF HAWAII

JUDGE OF THE ABOVE-ENTITLED COURT

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In the Matter of the Tax Appeal of AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.; Case Nos. 3055 and 3089 (Consolidated); FINAL JUDGMENT ORDER

IN THE TAX APPEAL COURT OF THE

STATE OF HAWAII

In the Matter of the Tax Appeal of AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC., Appellant.	)	Case Nos. 3055 and 3089 FINDINGS OF FACT AND CONCLUSIONS OF LAW

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FINDINGS OF FACT AND CONCLUSIONS OF LAW

This Tax Appeal came on for hearing before the Court on March 24, 1995, the Honorable Wendell K. Huddy presiding. Pursuant to this Court's order, the parties' Stipulation of Facts was filed herein on November 3, 1994. Cross-motions for summary judgment, with supporting memoranda, were filed concurrently on February 10, 1995. At oral argument before the Honorable Wendell K. Huddy on March 24, 1995, Walter Hellerstein, Arthur R. Rosen, Michael A. Shea and David W. Lonborg represented the Appellant American Express Travel Related Services, Inc. ("Taxpayer") and Mark A. Winer represented the Appellee Director of Taxation ("Director"). The Court, having heard argument and considered the Stipulation of Facts and being fully advised in the premises, finds and concludes as follows:

FINDINGS OF FACT

1. The Court finds and adopts the facts contained in the Stipulation of Facts filed herein on November 3, 1994.

2. The tax issue in this case is whether the Taxpayer's distribution of promotional materials and merchandise catalogs by direct mail from the mainland to Hawaii residents for the purpose of selling Taxpayer's products and services in Hawaii is a taxable use of such materials and catalogs in this State under Hawaii Revised Statutes ("HRS") § 238–2 (1985).

3. Taxpayer contends that the Hawaii use tax does not apply to its distribution through direct mail of promotional materials and catalogs to Hawaii residents from the mainland because the definition of the word "use" in HRS § 238-1 (1985) does not contain the word "distribution." Taxpayer concedes that its direct mail activity would be a taxable use under Hawaii's use tax if the definition of the term "use" contained the word "distribution." Taxpayer also contends that the Hawaii use tax does not apply to the promotional materials and merchandise catalogs used in its direct mail advertising to Hawaii residents because: (1) Taxpayer never took possession of those materials and catalogs in the State of Hawaii; and (2) Other examples of Taxpayer's power and control over these materials, including design, editing, purchase and determination of who would receive these materials, were exercised by Taxpayer outside the State of Hawaii.

4. The Director contends that the term "use" is broadly defined in HRS § 238-1 to mean "any use" and therefore, the Taxpayer's distribution of its promotional materials and merchandise catalogs to sell its products and services in Hawaii

through direct mail to Hawaii residents is a taxable use of those materials and catalogs under HRS § 238-2. The Director's position is that distribution is one of many uses subject to the Hawaii use tax under the broad definition of "use" in HRS § 238-1 and that no laundry list of all possible uses is required under Hawaii law.

In addition, the Director contends that Taxpayer's two secondary arguments are without merit because: (1) physical possession of property by the Taxpayer in Hawaii is not a prerequisite to the imposition of the use tax under HRS § 238-2: and (2) Taxpayer's other examples of its exercise of power and control over the promotional materials and merchandise catalogs, through design, editing, purchase and determination of who would receive these materials from outside the State of Hawaii are irrelevant because there is a taxable use of Taxpayer's promotional materials and merchandise catalogs within the State of Hawaii by the Taxpayer. That taxable use of Taxpayer's materials and catalogs is the distribution to Hawaii residents of those materials and catalogs advertising Taxpayer's products and services by direct mail from out-of-state.

CONCLUSIONS OF LAW

1. As defined in HRS § 238-1, "use" means "any use, whether the use is of such nature as to cause the property to be appreciably consumed or not . . . and shall include the exercise of any right or power over tangible personal property incident to the ownership of that property . . . ."

2. Taxpayer concedes, as it must under D.H. Holmes v. NcNamara, 486 U.S. 24 (1988), that Taxpayer's importation of catalogs and promotional materials into the State would be a taxable use under the Hawaii use tax law, if the statutory definition of use in HRS § 238–1 contained the word "distribution."[1] Taxpayer must make this concession because the United States Supreme Court, in D.H. Holmes, approved the imposition of the Louisiana use tax on the distribution by direct mail of merchandise catalogs from out-of-state where the use tax was imposed by statute on, inter alia, "distribution" of personal property in the state. See LA. REV. STAT. ANN. § 47:321 (West 1970 and Supp. 1988). That is the same activity as the Taxpayer's activity in this case.

3. The Court concludes that the definition of "use" in HRS § 238-1 is broad and includes "any use." The legislature did not need to enumerate every possible use of property that was

[1] The Taxpayer also concedes that there is no federal or state constitutional bar to the imposition of the Hawaii use tax in this case based on the United States Supreme Court's holding in D.H. Holmes v. McNamara. In D.H. Holmes, the Court held that states have the constitutional authority under the Commerce Clause of the United States Constitution, Article I, § 8, clause 3, to impose a use tax on promotional materials and catalogs that are sent directly to residents of the taxing state by printers from out-of-state as long as there is: (1) nexus; (2) fair apportionment of the tax; (3) no discrimination against interstate commerce; and (4) the tax is fairly related to the benefits provided by the state. D.H. Holmes, 486 U.S. at 30. This four part test was originally set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). The parties have stipulated and this Court concludes that the imposition of Hawaii's use tax meets these requirements in this case and therefore satisfies the requirements of the United States and Hawaii Constitutions.

now, or could be hereafter, conceived.[2] The definition is sufficiently broad and unambiguous to include the distribution, by direct mail, from out-of-state, of Taxpayer's promotional materials and merchandise catalogs in Hawaii to sell its products and services in Hawaii.[3]

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[2] Courts have opined, in several states since D.H. Holmes was decided, that the state's use tax applied where the definition of "use" contained in the statute did not contain the word "distribution." See Comfortably Yours, Inc. v. Director, Div. of Taxation, 12 N.J. Tax 570 (Tax Ct. 1992), aff'd, 640 A.2d 862 (N.J. Super. Ct. App. Div. 1994); Sharper Image v. Comptroller, (1993 Md. Tax Ct.), aff'd, Md. Cir. Ct. Montgomery County (1993); Sharper Image Corp. v. Michigan, Mich. Ct. Cl. (1994); cf. J.C. Penney Co., Inc. v. Olsen, 796 S.W.2d 943, 946 (Tenn. 1990) (while the Tennessee use tax statute contains the word "distribution" the court did not rely on that fact in its decision; instead, the court stated that the use tax applied because the taxpayer utilized the property for profit-making purposes in the state). In these cases the courts determined that the economic utilization of the advertising materials in state was a proper basis for imposition of the use tax. This view is also supported by two leading authorities on state and local taxes who contend that:

> The economic utilization of the promotional materials lies in getting them to the prospective customers in the State. The advertiser, which had the articles produced, delivered them to its prospects through its agents -- the printer, the Post Office, the common carrier, or the private trucker. Such delivery in the State and such exploitation of the State's market by the taxpayer or its agents on its behalf ought to be treated as a taxable use of the catalogs or advertising supplements in the market State.

J. Hellerstein & W. Hellerstein, State Taxation: Sales and Use, Personal and Death and Gift Taxes, ¶ 16.03[3][a][i] at 16-16-16-17 (2d ed. 1993)

[3] Where state courts have found that their states' use tax does not apply to distribution activities, like Taxpayer's activities here, the statutes do not contain definitions of use as broad as HRS § 238-1's "any use." See, CONN. GEN. STAT. § 12-407(5) (1995); D.C. CODE ANN. § 47-2201(f) (1995); GA. CODE ANN.

4. Hawaii's use tax complements Hawaii's broad general excise tax.[4] See In re Hawaiian Flour Mills, Inc., 76 Haw. 1, 13, 868 P.2d 419, 431 (1994); In re Habilitat, Inc., 65 Haw. 199, 209, 649 P.2d 1126, 1133-34 (1982). The primary purpose of the Hawaii use tax is to insure that out-of-state vendors are not at a competitive advantage over Hawaii vendors who must pay the general excise tax on sales of similar property. In re Habilitat, 65 Haw. at 209, 649 P.2d at 1134; Stewarts' Pharmacies v. Tax Com'n Fase, 43 Haw. 131, 134 (1959).

5. In the absence of a use tax that complements the general excise tax, out-of-state sellers of products would enjoy a competitive advantage over in-state sellers of products. Not being subject to the general excise tax, products purchased out–

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§ 48-8-2(12) (Michie Supp. 1994); KY. REV. STAT. ANN. § 139.190 (Michie/Bobbs-Merrill 1991); ME. REV. STAT. ANN. tit. 36, § 1752-21 [West 1990); MO. REV. STAT. § 144.605(10) (Vernon 1976); N.Y. TAX LAW § ll0l(subd. [b], par. 7) (McKinney 1987); OHIO REV. CODE ANN. § 5741.01 (Baldwin 1991); R.I. GEN. LAWS § 44-18-10 (1988); S.D. CODIFIED LAWS ANN. § 10-46-1(12) (Michie Supp. 1994); VA. CODE ANN. § 58.1 602 (Michie 1991); WASH. REV. CODE ANN. § 82.12.010(2) (West 1991).

[4] Hawaii's general excise tax, in plain and unmistakable language, taxes "any business, trade, activity, occupation or calling." H.R.S. § 237-13(10). "Business" is defined by the statute as "all business engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, but does not include casual sales." H.R.S. § 237-2. This language demonstrates the legislative intent to tax every form of business that may be taxed by the State of Hawaii, unless a specific exemption applies. In re Grayco Land Escrow, Ltd., 57 Haw. 436, 443, 559 P.2d 264, 270 (1977). Similarly, Hawaii's use tax, in plain and unmistakable language, demonstrates by defining the term "use" as "any use" the legislative intent to tax every form of use that may be taxed by the State of Hawaii, unless a specific exemption applies. The choice of the all inclusive word "any" by the legislature is consistent with the legislative intent that the use tax compliment the broad general excise tax.

of-state would be less expensive than products purchased in Hawaii because the prices of in-state purchases would presumably reflect some pass-on of the general excise tax. In re Hawaii Flour Mills, Inc., 76 Haw. 1 at 13, 868 P.2d 419 at 431.

6. The Court concludes that the purpose of the Hawaii use tax is fulfilled by imposing the Hawaii use tax on the distribution of Taxpayer's promotional materials and catalogs in Hawaii. Taxpayer orders its catalogs and promotional materials from mainland printers who are not subject to any sales or other excise taxes on these materials. If Taxpayer, instead, purchased these materials from Hawaii printers, the general excise tax would apply. Thus, the imposition of the use tax on Taxpayer's distribution of promotional materials and catalogs in Hawaii is consistent with the purpose of the use tax which is to remove the competitive advantage the mainland printers enjoy because they are not subject to the general excise tax.

7. The Hawaii Supreme Court, in In re Habilitat, held that in-state physical possession by the taxpayer of the tangible personal property imported to Hawaii for use in the State is not required for the imposition of the use tax. The Supreme Court stated that: "the language of HRS Chapter 238 leaves no doubt that the import of the articles was subject to the use tax, notwithstanding that the transactions were structured to effect direct delivery of the purchased items." In re Habilitat, 65 Haw. at 210, 649 P.2d at 1134. In other words, the fact that the

taxpayer in In re Habilitat never took physical possession of the purchased items in Hawaii was irrelevant for Hawaii use tax purposes.

8. In this case, the fact that the Taxpayer never took physical control or possession of the property it purchased and used to sell its products and services in Hawaii is also irrelevant for purposes of the Hawaii use tax. [5] Taxpayer used the promotional materials and catalogs in Hawaii, for purposes of HRS Chapter 238, by distributing those materials in the State to promote sales of its products and services.

9. Cases relied upon by the Taxpayer, from other states, have limited the use tax to instances where the property used in the state is physically possessed by the taxpayer in the

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[5] The modern trend of decisions from other states supports Hawaii's view that possession is not required for the imposition of the use tax. Instead, what is required, simply, is use. See, K Mart Corp. v. Idaho State Tax Com'n, 727 P.2d 1147 (Idaho 1986); Sharper Image v. Comptroller, (1993 Md. Tax Ct.), aff'd, Md. Cir. Ct. Montgomery County (1993); Sharper Image Corp. v. Michigan, Mich. Ct. Cl. (1994). Comfortably Yours, Inc. v. Director, Div. of Taxation, 12 N.J. Tax 570 (Tax Ct. 1992), aff'd, 640 A.2d 862 (N.J. Super. Ct. App. Div. 1994). In addition Professors Jerome Hellerstein and Walter Hellerstein express the view that:

> [P]hysical control or possession of the catalogs or preprints . . . are inappropriate measuring rods for determining whether a taxable use of the promotional materials in the State by the vendors took place. Use ought to be judged by economic standards.

J. Hellerstein & W. Hellerstein, State Taxation: Sales and Use, Personal and Death and Gift Taxes, 1603[3][a][i] at 16-16 (2d ed. 1993).

state.[6] These cases do not persuade this Court to ignore the clear mandate of In re Habilitat, and require physical possession by the taxpayer as a prerequisite to the application of the Hawaii use tax.[7]

10. Although Taxpayer does substantial business in Hawaii and maintains retail travel offices throughout the State, Taxpayer also contends that the Hawaii use tax does not apply in this case because Taxpayer designed, edited, and purchased the promotional materials and catalogs from its offices on the

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[6] See e.g., District of Columbia v. W. Bell & Co. Inc., 420 A.2d 1208 (D.C. 1980); J.C. Penney Co. v. Collins, Ga. Super. Ct., No. E-4106 (Sept. 15, 1994); May Dept. Stores v. Director of Revenue, 748 S.W.2d 174 (Mo. 1988); Service Merchandise v. Director of Revenue, 748 S.W.2d 177 (Mo. 1988); Automobile Club of Missouri v. Director of Revenue, 748 S.W.2d 179 (Mo. 1988); Bennett Bros., Inc. v. State Tax Comm'n, 405 N.Y.S.2d 803 (N.Y. App. Div. 1978); Hoffman-LaRoche, Inc. v. Porterfield, 243 N.E. 2d 72 (Ohio 1968); Mart Realty, Inc. v. Norberg, 303 A.2d 361 (R.I. 1973); Modern Merchandising v. Dept. of Revenue, 397 S.W.2d 470 (S.D. 1986); Sears, Roebuck & Co. v. State, Etc., 643 P.2d 884, app. dis., 459 U.S. 803 (1982); Wis. Dep't. of Revenue v. J.C. Penney Co., 323 N.W.2d 168 (Wis. Ct. App. 1982).

[7] Two Missouri cases decided on the same day, a few months before the United States Supreme Court decision in D.H. Holmes v. McNamara, 486 U.S. 24 (1988), illustrate this distinction. In May Dept. Stores v. Director of Revenue, 748 S.W.2d 174, 175 (Mo. 1988), the Missouri Supreme Court held that a Missouri department store chain was not liable for use tax on catalogs produced and mailed outside the state by the taxpayer's printer to prospective customers in state because the taxpayer was not in physical possession "even for an instant" of the catalogs in Missouri. In contrast, in R&M Enters., Inc. v. Director of Revenue, 748 S.W.2d 171 (Mo. 1988), the same court held that the use tax applied to a Missouri textile manufacturer's sample books of textiles that were produced outside Missouri and delivered to the manufacturer's office in Missouri and then delivered to prospects by mail or common carrier. The critical fact in the court's decision sustaining the tax was that during the period the sample books were at its office in Missouri the taxpayer had physical possession of them.

mainland. Taxpayer equates these activities with out-of-state power and control, which, along with its lack of possession in-state, it asserts, bar the imposition of the use tax by the Director. Taxpayer points out that the taxpayer in In re Habilitat submitted purchase orders for the items purchased from its office in Hawaii.

11. This Court rejects Taxpayer's attempt to create a distinction for use tax purposes based on the location from which a purchase order is placed. This would allow any taxpayer with an out-of-state office to avoid the Hawaii use tax by making purchases of property to be used in Hawaii from an out-of-state office. The Court recognizes that the Taxpayer maintains offices in Hawaii and distributes the promotional materials and catalogs in Hawaii to promote its business in-state. Therefore, the Court concludes that In re Habilitat is controlling. [8]

12. It is immaterial, under the Hawaii use tax, that Taxpayer executed purchase orders and engaged in other activities relating to these promotional materials and catalogs from offices on the mainland. [9]

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[8] The Idaho, Maryland and Michigan cases cited in footnote 5, above, each involve taxpayers, K-Mart and Sharper Image, who ordered materials for distribution in the taxing state from offices outside those states. In each case, the Court found a taxable use, even though the orders were placed from out-of-state.

[9] In re Grayco Land Escrow, Ltd., 57 Haw. 436, 443, 559 P.2d 264, 270 (1977), the Court held that a taxpayer with no place of business or any employees in Hawaii was subject to the general excise tax on the interest it was paid out-of-state on the sale of property in Hawaii. In Grayco, it was the sale of property situated in Hawaii that made the interest paid on the

13. Hawaii law does not require that the activity subject to the State's use tax involve property purchased, designed or edited within the State anymore than it requires possession by the taxpayer of the property within the State. Simply stated, what is required is use, which is broadly defined as "any use" in HRS § 238-1 and includes the distribution by the Taxpayer of its promotional materials and catalogs to sell its products and services in Hawaii.

14. The assessments under appeal are therefore valid and legal, and judgment is entered in favor of the Director for the total amount in dispute.

DATED: Honolulu, Hawaii, MAY 12 1995.

TAX APPEAL COURT SEAL

Wendell K. Huddy

JUDGE OF THE ABOVE-ENTITLED COURT

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In the Matter of the Tax Appeal of AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC.; Case Nos. 3055 and 3089 (Consolidated); FINDINGS OF FACT AND CONCLUSIONS OF LAW

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sales contract subject to the general excise tax, notwithstanding the fact the sale was consummated out-of-state and the interest was paid to the taxpayer out-of-state. By analogy, in this case, the use tax applies because the Taxpayer uses its promotional materials and catalogs in Hawaii regardless of where it purchased these materials.