

TAX FOUNDATION OF HAWAII

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TECHNICAL SECTION

Rules Office
Hawaii Department of Taxation
830 Punchbowl Street, Room 221
Honolulu, HI 96813

Re: **Comments on Proposed Rules Relating to Exported Services**

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Ladies and Gentlemen:

The Foundation is strongly in support of the Department's efforts to add clarity to the sourcing of services and commissions for Hawaii General Excise Tax ("GET") purposes.

A. **Some Rules Need to be Classified Under Other Statutory Sections, Or At Least Cross-Referenced.**

The proposed rules relating to exported services represent a clear and thoughtful attempt to unravel some of the issues that have been plaguing tax practitioners and the Department for years. Trying to tackle these disparate issues under one statutory section, however, may be problematic because practitioners, especially those normally practicing in other jurisdictions, need to be able to locate the proper rules in a quick and logical manner and probably would not intuitively look under this section.

1. **Commission Agent.**

Rules defining a "commission agent" are sorely needed. The definition of the term in proposed § 18-237-29.53-01 and Examples 1 and 2 thereunder represent a common-sense approach to the issue, but may be difficult for practitioners to locate because they do not immediately relate to exported services. We suggest that these rules be classified under a different statutory section, such as HRS § 237-13(5) (imposing tax on commission activity).

If the Department is not open to renumbering or reclassifying the rules, we strongly urge that an appropriate cross-reference be added under section 237-13(5) such as:

§ 18-237-13-04 [~~to~~05] (Reserved.)

§ 18-237-13-05 Tax upon commissions. For rules defining a "commissioned agent" subject to HRS section 237-13(5), see section 18-237-29.53-01.

[Eff _____] (Auth: HRS §231-3(9), 237-8) (Imp: HRS §237-13(5))

2. Noncommissioned Negotiated Contract Rate.

Rules defining a “noncommissioned negotiated contract rate” in proposed § 18-237-29.53-01 and Examples 3-5 thereunder, and the rules in § 18-237-29.53-06, also are useful and flow directly from *In re Travelocity.com, L.P.*, 135 Haw. 88, 346 P.3d 157 (Haw. 2015), but may be difficult for practitioners to locate. We suggest that these rules be classified under HRS § 237-18, which the Hawaii Supreme Court was construing in that decision.

If the Department is not open to renumbering or reclassifying the rules, we strongly urge that an appropriate cross-reference be added under section 237-18(g) such as:

~~[§ 18-237-17 to 19 (Reserved.)]~~

§ 18-237-18-07 Transient accommodations furnished through arrangements made by a travel agency or tour packager. For rules defining “noncommissioned negotiated contract rates” for purposes of section 237-18(g), HRS, see sections 18-237-29.53-01 and 18-237-29.53-06. [Eff] (Auth: HRS §231-3(9), 237-8) (Imp: HRS §237-18)

B. The Substantive Treatment of Cancellation Fees Is Questionable.

Section 18-237-29.53-12: The rule as presented suggests that the Department would seek to tax cancellation fees regardless of whether the services were performed in Hawaii or whether the services, if performed, would have been consumed in Hawaii. Such a rule is not internally consistent and would fail *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). We recommend that the Department instead adopt a rule stating that cancellation charges are considered service fees and are sourced according to the rules applicable to services. In the example given, we suggest that the services are properly sourced outside of Hawaii because the consumer would be ABC Company under section 18-237-29.53-11(a)(2) and (b) Example 2.

C. The Concept of “Bad Faith” Is Undefined.

Section 18-237-29.53-02(a): The standard begins with “Absent bad faith,” but there is no attempt to define what bad faith is or what consequences ensue if it is present. This language, furthermore, appears nowhere else in the proposed rules. We recommend that this language be deleted to prevent confusion. Actual bad faith or fraud can be dealt with under other statutes or case law.

D. Stylistic Comments.

Section 18-237-29.53-03: The first sentence does not seem to be grammatically correct. We suggest, “Contracting is used or consumed where the real property to which the contracting activity pertains is located.” This would account for activity taking place in a different location from the project, such as under the fact pattern in Example 1.

Examples Cross-Referencing the Same Section: Several examples cross-reference the same section in which they are located. For example, section 18-237-29.53-07 Example 4 ends, “Because the complaint was not filed, section 18-237-29.53-07 does not apply. Instead, section 18-237-29.53-11 will apply.” To be consistent with the Hawaii Administrative Rules Drafting Manual (2006) at page 65, we suggest, “Because the complaint was not filed, this section does not apply....” This comment also applies to section 18-237-29.53-09 Example 4. In addition, references to a different subdivision in the same section need not state the section number in full. For example, section 18-237-29.53-11(b) Example 1 ends with “pursuant to section 18-237-29.53-11(a)(3),” where it should say “pursuant to subsection (a)(3).” The same comment applies to the other examples in section 18-237-29.53-11.

Section 237-29.53-11(b) Example 5: The example as presented is confusing because the referenced rule, subsection (a)(3), states that if the customer is an individual, the service is used or consumed where the individual resides, but the example shows two places of residence. Language should be added clarifying when the test is applied, such as:

Arnold Accountant, an accountant located in Hawaii, is hired by Mary Mover, a California resident, to prepare her 2016 federal and state tax returns. Mary Mover must file state tax returns in California, where she resided for the first half of 2016, and Hawaii, where she currently resides. Arnold Accountant performs his services in 2017, when Mary Mover is a resident of Hawaii. Thus, all of the value or gross income that Arnold Accountant receives from Mary Mover is not exempt under section 237-29.53, HRS, because Arnold Accountant's services are used or consumed in Hawaii, where Mary Mover resides, pursuant to subsection (a)(3).

Thank you for the opportunity to submit comments.

Very truly yours,


Thomas Yamachika
President