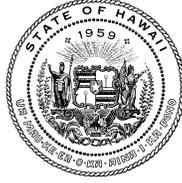


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DEPARTMENT OF TAXATION
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September 16, 2002

TAX INFORMATION RELEASE 2002-4

RE: Act 98, Session Laws of Hawaii 2002, Relating to the Conformity of the State Tax Laws to the United States Constitution (Act 98)

I. Introduction

Act 98 provides a general excise tax (GET) offset for taxes paid to another state. This GET offset is similar to the credit for use taxes paid to another state offered under § 238-3(i), Hawaii Revised Statutes (HRS), which was first enacted in 1967. This Act became effective on June 4, 2002, and applies to all open tax years and for tax years for which an appeal is pending at the time the Act became effective.

The offset provided by this Act ensures that our taxes do not offend the Commerce Clause of the United States Constitution. The Commerce Clause, article I, § 8, cl. 3, prohibits states from discriminating against interstate commerce by “tax[ing] a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.” *Id.* at 642. The test for constitutionality is not whether a transaction was in fact subject to multiple taxation, but whether it is possible that the transaction could be subject to multiple taxation. *Armco Inc. v. Hardesty*, 467 U.S. 638, 644 (1983). However, the Commerce Clause does not prohibit states from receiving their fair share of taxes from interstate commerce.

A taxpayer who has paid sales and use taxes to another state on an import, which is resold in the State,¹ may first offset the use tax due under chapter 238, HRS, using the use tax credit provided by §238-3(i), HRS. The taxpayer may then use the offset provided by Act 98 to offset any GET due on the gross receipts from the subsequent sale of the imported tangible personal property, services or contracting.² Any remaining balance of sales and use taxes actually paid to another state, which has not already been used to offset the Hawaii use tax due with respect to the same import, may be used to offset the GET liability on the subsequent sale of that import.

¹ The GET offset will not apply when the import is for consumption (the landed value of which is reported on line 18 of the GET/Use Tax return). The GET offset applies only when there is a subsequent resale of the import, thus generating gross receipts and a GET liability.

² The Hawaii use tax applies to imports of tangible personal property, services, and contracting. §238-3(i), HRS (2001 Supp.).

II. Examples

The following examples illustrate how this offset might be used to avoid multiple taxation of transactions that are subject to taxation by two states:

Example 1. A Hawaii contractor uses a Washington traffic-flow consultant to draw plans for a Hawaii commercial construction project. The Hawaii contractor is considered the importer of these services, and the ½% use tax would apply to the value of the imported services under §238-2.3(2)(C), HRS, as an import for resale at retail.³ Assume that the sale of the services was subject to tax in Washington (i.e., the Washington Business and Occupations Tax is levied when a service is performed in the State of Washington). The contractor may offset its Hawaii use tax on the importation of the services into the State by way of the use tax credit provided under §238-3(i), HRS. In addition, the contractor may use the credit provided under Act 98 to offset its GET liability due with the actual amount of sales tax paid to Washington (less any amounts used to offset the use tax) with respect to the same services.

Example 2. A Hawaii business hires a consulting firm to perform a management efficiency study. Sixty percent of the work is performed by the firm's New Mexico office and 40% is performed by the firm's Hawaii office. The consulting firm (Hawaii office) is considered to be the importer of the work done by the New Mexico office. The consulting firm is, therefore, subject to the ½% use tax under §238-2.3(a)(2), HRS, as an import of a service for resale at retail.⁴ Assume that

³ Here, the ½% use tax would apply. If the consultant had been subject to the GET (e.g., the transaction took place between two parties in Hawaii), the subcontract deduction under §237-13(3)(B), HRS, would not be available because the traffic-flow consultant is not a "contractor" as defined by §237-6, HRS.

⁴ HRS § 238-1 defines "use" as:

any use, whether the use is of such nature as to cause the property, services, or contracting to be appreciably consumed or not, or the keeping of the property or services for such use or for sale, and shall include the exercise of any right or power over tangible or intangible personal property incident to the ownership of that property.

In holding that the taxpayer was liable for the use tax, the Hawaii Supreme Court in In the Matter of the Tax Appeal of Habilitat, Inc., 65 Haw. 199 (1982), made the following statement in interpreting the term "use":

The statutory term thus covers the exercise of any right or power incident to the ownership of personal property. Habilitat exercised such right or power over the "advertising specialty items" when it directed the unlicensed sellers to transmit the purchased goods to persons who had ordered them from its residents. The transactions were clearly within the reach of the use tax. Id. at 210.

the New Mexico office reports and pays a 5% sales tax on the gross receipts received from performing 60% of the work in the New Mexico. Under §238-3(a), HRS, the director has the authority to exclude the imposition of the use tax to avoid discrimination against imports, thus eliminating the ½% use tax in this instance.⁵ Upon the retail sale of the imported services to the client, the Hawaii office may use the credit provided by Act 98 to offset its GET liability due with the actual amount of sales tax already paid to New Mexico with respect to the same services.

Example 3. A Taxpayer with retail stores in both California and Hawaii purchases a large quantity of widgets to use as promotional gifts in its California stores. Because the purchases are for the Taxpayer's consumption and not for resale, the Taxpayer pays a 7% sales tax to California. A change in marketing strategy compels the Taxpayer to try to sell the widgets in its Hawaii stores. The ½% Hawaii use tax applies to the landed value of the widgets upon importation into the State, and the 4% GET applies when the widgets are sold at retail. Taxpayer may offset its Hawaii use tax on the importation of the property into the State by way of the use tax credit provided under §238-3(i), HRS. Upon the retail sale of the widgets in Hawaii, the Taxpayer may use the credit provided by Act 98 to offset its GET liability due with the actual amount of sales tax already paid to California (less any amounts used to offset the use tax) with respect to the same widgets.

III. The Deduction Method

The Department will administer the GET offset by implementing a deduction method to claim the offset on Forms G-45 (GET/Use Tax Periodic Return), G-49 (GET/Use Tax Annual & Reconciliation), G-54 (GET/Use Tax Amended Periodic) and G-55 (GET/Use Tax Amended Annual & Reconciliation). This method is currently used to claim the use tax credit.

The following is a step-by-step instructional guide on how the use tax credit and GET offset shall be claimed and an example that illustrates these steps:

While this case was decided before the enactment of Act 70, SLH 1999, which amended the law to impose the use tax on imported services and contracting (in addition to tangible personal property), the general rule that the exercise of any right or power incident to ownership of property should also be applied in the context of imported services and contracting when determining whether the use tax applies.

⁵ In this case, the director has authorized taxpayers to exclude the value of the imported services from the landed value of imports subject to the use tax. If the firm's Hawaii office performed 100% of the work in Hawaii, no use tax or GET at the ½% rate would have been imposed. See Tax Information Release 2001-2.

Part A – Offset the Use Tax:

- Step 1: Enter the value of the imported property in Column A⁶ of line 17, as applicable,⁷ and determine the exact amount of use tax due on that property.
- Step 2: Compare the use tax due (Step 1) with the sales or use tax paid to another state on that property. Divide the LESSER of the two amounts by 0.005, and enter the result in Column B.⁸
- Step 3: Subtract Column B from Column A, and enter the result in Column C.⁹
- Step 4: Multiply Column C by the applicable tax rate, and enter the result in Column D.¹⁰

Part B – Offset the GET:

- Step 5: Enter the gross income from the sale of the imported property in Column A of the applicable line, and determine the exact amount of GET due on that property.
- Step 6: Subtract the use tax due on that property (Step 1) from the sales or use tax paid to another state on that item.
- Step 7: Compare the GET due (Step 5) with the remaining sales or use tax paid (Step 6). Divide the LESSER of the two amounts by 0.005 or 0.04, as applicable, and enter the result in Column B.
- Step 8: Subtract Column B from Column A, and enter the result in Column C.
- Step 9: Multiply Column C by the applicable tax rate, and enter the result in Column D.

Example 4: Taxpayer A purchases widgets in State X on which \$125 of sales tax is paid, and imports the widgets into Hawaii for resale at retail. The landed value of the widgets is \$1,500, and they are sold at retail for \$2,700.

⁶ Column A on GET/use tax returns is used to report values, gross proceeds, or gross income.

⁷ The GET offset is not likely to apply when the import is for consumption (which is reported on line 18 of the GET/use tax returns) because the GET offset applies when there is a subsequent resale of the import, generating gross receipts and a GET liability.

⁸ Column B on GET/use tax returns is used to claim exemptions and deductions from gross income.

⁹ Column C on GET/use tax returns is used to calculate and report taxable income.

¹⁰ Column D on GET/use tax returns is used to calculate and report the tax due.

PART A – USE TAX CREDIT DEDUCTION

SCHEDULE A — ACTIVITIES UNDER CHAPTER 237, HRS — GENERAL EXCISE TAX LAW									
BUSINESS ACTIVITIES	BUS. ACT. CODE	VALUES, GROSS PROCEEDS OR GROSS INCOME a	EXEMPTIONS/DEDUCTIONS (EXPLAIN ON REVERSE SIDE) b	TAXABLE INCOME c (column a minus column b)	RATE	TAXES d			
RETAILING	8				.04				8
SCHEDULE B — ACTIVITIES UNDER CHAPTER 238, HRS — USE TAX LAW									
IMPORTS FOR RESALE AT RETAIL	17	1,500.00	1,500.00	0.00	.005	0.00			17
IMPORTS FOR CONSUMPTION	18				.04				18

Step 1: $\$1,500 \times 0.005 = \7.50

Step 2: $\$7.50 \div 0.005 = \$1,500$

Step 3: $\$1,500 - \$1,500 = \$0$

Step 4: $\$0 \times .005 = \0.00

PART B – GET CREDIT DEDUCTION

SCHEDULE A — ACTIVITIES UNDER CHAPTER 237, HRS — GENERAL EXCISE TAX LAW									
BUSINESS ACTIVITIES	BUS. ACT. CODE	VALUES, GROSS PROCEEDS OR GROSS INCOME a	EXEMPTIONS/DEDUCTIONS (EXPLAIN ON REVERSE SIDE) b	TAXABLE INCOME c (column a minus column b)	RATE	TAXES d			
RETAILING	8	2,700.00	2,700.00	0.00	.04	0.00			8
SCHEDULE B — ACTIVITIES UNDER CHAPTER 238, HRS — USE TAX LAW									
IMPORTS FOR RESALE AT RETAIL	17	1,500.00	1,500.00	0.00	.005	0.00			17
IMPORTS FOR CONSUMPTION	18				.04				18

Step 5: $\$2,700 \times 0.04 = \108

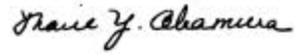
Step 6: $\$125 - 7.50 = \117.50

Step 7: $\$108 \div 0.04 = \$2,700$

Step 8: $\$2,700 - \$2,700 = \$0$

Step 9: $\$0 \times .04 = \0.00

Forms and other tax information may be downloaded from the Department’s website at www.state.hi.us/tax. On Oahu, forms may be ordered by calling the Department’s Forms Request Line at 587-7572. Persons who are not calling from Oahu may call 1-800-222-7572 to receive forms by mail or fax.



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Director of Taxation

HRS Section Explained: HRS §237-22

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