

BENJAMIN J. CAYETANO  
GOVERNOR

MAZIE HIRONO  
LT. GOVERNOR



RAY K. KAMIKAWA  
DIRECTOR OF TAXATION

SUSAN K. INOUE  
DEPUTY DIRECTOR

## DEPARTMENT OF TAXATION

STATE OF HAWAII  
P.O. Box 259  
Honolulu, Hawaii 96809

December 19, 1995

# TAX INFORMATION RELEASE NO. 95-5

RE: Application of the General Excise (“GE”) and Use Taxes on Sales of Tangible Personal Property (“TPP”) by an Out-of-State Seller, Including Drop Shipments

The purpose of this Tax Information Release (“TIR”) is to provide guidance as to (1) when a sale of TPP by an out-of-state seller is subject to the GE tax or the use tax, and (2) when a sale of TPP by an out-of-state seller is subject to the GE or the use tax when the TPP is delivered to a buyer by someone other than the seller. This TIR is effective for all tax years that are open under the applicable statute of limitations.

### DEFINITIONS

The following terms and definitions are applicable with respect to the administration of this TIR.

“**Accept or Acceptance**” means the purchaser or its agent inspecting the TPP and taking physical possession of the TPP or having dominion and control over the TPP.

“**Agent**” means a person authorized by the purchaser to act on the behalf of the purchaser and includes the power to inspect and accept or reject the TPP.

“**Delivery**” means the act of transferring possession of TPP. It includes, the transfer of goods from consignor to freight forwarder or for-hire carrier, from freight forwarder to for-hire carrier, one for-hire carrier to another, or for-hire carrier to consignee.

“**Drop Shipment**”, sometimes known as direct delivery, means the delivery and acceptance of TPP by a customer in Hawaii from a manufacturer or wholesaler who is someone other than the seller with whom the customer placed the order.

“**Landed value**” means the value of imported TPP which is the fair and reasonable cash value of the TPP when it arrives in Hawaii. It includes the sales price, shipping and handling fees, insurance costs, and customs duty. It does not include sales tax paid to another state.

“**Nexus**” means the activity carried on by a seller in Hawaii which is sufficiently connected with the seller’s ability to establish or maintain a market for its products in Hawaii. It includes issues of taxability addressed under the Due Process and Commerce Clauses of the United States Constitution to support the application of the GE tax and the use tax under chapters 237 and 238, Hawaii Revised Statutes (“HRS”), respectively.

“**Place of delivery**” means the state or place where the purchaser or its agent accepts a delivery of TPP.

WHEN IS THE GE TAX IMPOSED ON A SALE OF TPP TO A CUSTOMER IN HAWAII?

Section 237-13, HRS, of our GE Tax Law imposes “privilege taxes against persons on account of their business and other activities in the State”. Section 237-2, HRS, states that “business” includes “all activities (personal, professional, or corporate), engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect”.

The act or place of passing of title is not the determinative factor for purposes of imposing the GE tax. In states imposing a retail sales tax where a sale is defined as the transfer of title or ownership, the place where title passes may be relevant. The GE tax, however, is not a sales tax imposed when title passes. Rather, the GE tax is a gross receipts tax imposed when business is transacted in Hawaii.

Section 237-13(2)(C), HRS, provides that the place of delivery determines whether goods manufactured in Hawaii are exempt from the GE tax on the business of selling such goods. Section 237-21, HRS, provides in part that the delivery of goods outside the State triggers the inquiry of whether there is a need for apportionment of the tax. These provisions evidence that the GE Tax Law looks to the place of delivery of TPP to determine whether the sale of TPP is business transacted in Hawaii.

Hawaii does not impose the GE tax on sales of TPP which originate outside of this State unless the TPP’s place of delivery is in Hawaii and the seller has nexus. We emphasize that there must be both (1) a place of delivery within Hawaii by the purchaser, or its agent, and (2) the seller must have nexus for the GE tax to apply to a particular sale. The GE tax will not be imposed if one of these elements is missing.

Delivery of TPP to a freight consolidator, freight forwarder, or for-hire carrier utilized only to arrange for and/or transport the TPP does not constitute acceptance of the TPP by the purchaser or its agent unless the freight consolidator, freight forwarder, or for-hire carrier has expressed written authority to accept the TPP as an agent for the purchaser. Simply signing the bill of lading without this expressed written authority is not sufficient.

When the TPP’s place of delivery is to a customer in Hawaii and the seller has nexus, the sale of that TPP constitutes business subject to the GE tax. Hawaii’s tax treatment of TPP with a place of delivery to a customer in Hawaii is comparable to the State of Washington’s business and occupations tax which is imposed on sales of goods delivered to customers in Washington from out-of-state sellers, and which was upheld in Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975).

In Standard Pressed Steel, the Court held that Washington’s business and occupations tax, as applied to out-of-state sellers of TPP delivered within the State, (a) did not violate due process because the measure of the tax bore a relationship to the benefits conferred on appellant by the state, and (b) was not repugnant to the Commerce Clause, because all of the activities taxed occurred within the state.

Section 237-22, HRS, states that gross income or gross proceeds of sale will be exempt if the State is prohibited from taxing the gross income under federal law or constitutional principles. If an out-of-state seller has no nexus with Hawaii, its gross income or gross proceeds of sale would be exempt under section 237-22, HRS.

WHEN IS THE USE TAX IMPOSED ON THE SALE OF TPP TO A CUSTOMER IN HAWAII?

Section 238-2, HRS, imposes use tax “on the use in this State of tangible personal property which is imported . . . for use in the State” if it is purchased from a seller that does not have a GE tax license. The general theory behind the tax is to make all TPP used or consumed in the State subject to a uniform tax burden irrespective of

December 19, 1995

whether it is acquired within or without the State. In re Hawaiian Flour Mills, Inc., 76 Haw. 1, 13 (1994) (quoting Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963)).

The use tax is levied on the importer of TPP based upon the landed value of the TPP imported. The tax rate is one-half of one percent if the TPP is intended for resale at retail, four percent if the TPP is intended for consumption or use by the importer or purchaser, or no tax if the TPP is intended for resale to a reseller licensed under the GE Tax Law.

#### WHO IS LIABLE FOR PAYING THE GE OR USE TAX?

The following is an example involving two parties and is treated as a single transaction.

S, an out-of-state seller of TPP, receives an order over the telephone or through the mail, from H, a Hawaii customer who is the ultimate consumer. H requests that the TPP be delivered to H in Hawaii. S ships the TPP for delivery to and acceptance by H in Hawaii.

There are two possible outcomes, depending on whether S has nexus with Hawaii:

- (1) If S has nexus with Hawaii, S's sale of TPP constitutes business in Hawaii for purposes of the GE Tax Law. As a result, S must obtain a GE/Use tax license. S is considered the importer for resale at retail and is subject to the use tax at one-half of one percent. S is also subject to the GE tax at four percent on the sale.
- (2) If S does not have nexus with Hawaii, pursuant to section 237-22, HRS, the GE tax is not imposed upon S. Because S is not a licensed seller and the import is for consumption by H, H is subject to the use tax at four percent.

#### WHO IS LIABLE FOR PAYING THE GE OR USE TAX ON A DROP SHIPMENT?

The following is an example involving three parties and is treated as two separate transactions.

S, an out-of-state seller of TPP, receives an order over the telephone or through the mail, from H, a Hawaii customer who is the ultimate consumer. W is an out-of-state wholesaler of TPP. S notifies W of the order and requests that W ship the TPP directly to H in Hawaii. W then ships the TPP for delivery to and acceptance by H in Hawaii.

There are four possible outcomes, depending on whether S and W have nexus with Hawaii and are properly licensed under the GE Tax Law:

- (1) If neither S nor W has nexus with Hawaii and both are unlicensed, the importation of the TPP by H is from an unlicensed seller for consumption. H is subject to the use tax at four percent.
- (2) If S has nexus with Hawaii and is licensed but W is unlicensed and has no nexus, S is considered to have imported the TPP for resale at retail and is subject to the use tax at one-half of one percent. The sale from S to H is a retail sale. S's gross income from the sale is subject to the GE tax at the rate of four percent.

December 19, 1995

- (3) If both S and W have nexus with Hawaii and are licensed, both sales would be subject to the GE tax. The sale from W to S is a wholesale sale. W's gross income is taxable at one-half of one percent. The sale from S to H is a retail sale. S's gross income is taxable at four percent. There is no use tax because W imported the TPP for resale to a licensed reseller.
- (4) If W has nexus with Hawaii and is licensed but S is unlicensed and has no nexus, the sale from W to S does not qualify as a wholesale sale under section 237-4(1), HRS, because S is not a licensed seller for GE purposes, therefore, W is subject to the GE tax at the rate of four percent. W is considered to have imported the TPP for resale at retail and is subject to the use tax at of one-half of one percent. The GE tax is not imposed on the sale from S to H because S does not have sufficient nexus with Hawaii. Since W is the importer of the TPP and H is not, H would not be subject to the use tax.

WHAT EFFECT DOES THIS TIR HAVE ON OTHER TIRs ISSUED BY THE DEPARTMENT?

TIR Nos. 88-1 and 88-2, which refer to title passage, are superseded to the extent that they are inconsistent with this TIR.



RAY K. KAMIKAWA  
Director of Taxation

HRS Sections Explained: HRS §§237-4(1), 237-13(2), 237-21, 237-22, 238-2, 238-3(c)