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September 29, 2021

DEPARTMENT OF TAXATION INFORMATION RELEASE NO. 2021-07

RE: Exemption from Taxes in a Foreign Trade Zone

The purpose of this Tax Information Release (TIR) is to clarify the exemption from state taxes in a Foreign Trade Zone (FTZ). Specifically, this TIR is intended to address the imposition of Hawaii taxes on certain services and contracting in an FTZ.

Background

The Federal Foreign Trade Zones Act¹ (FTZA), authorizes the establishment of FTZs: designated geographic areas that, for purposes of customs and tariff laws, are treated as if they were located outside of the United States. Businesses importing foreign goods or remanufacturing foreign-made goods may operate within an FTZ to realize substantial tax and duty benefits, including deferral or elimination of duties, inverted tariffs, and exemption from state and local property taxes.

Federal and State Statutory Tax Exemptions

Both federal and Hawaii law contain codified exemptions from the imposition of State taxes. These statutory exemptions are very limited in that they apply only to the sale of specific categories of tangible personal property or merchandise that are directed into interstate or foreign commerce through a common carrier. Services and contracting are not expressly exempted, or even mentioned in the statutes discussed below.

These provisions are unambiguous, and do not appear to be the source of the confusion which this TIR is intended to clarify. However, for the purpose of comprehensively addressing the exemption from taxes in an FTZ, the federal and Hawaii statutory exemptions have been included in this TIR.

Section 810(e) of the FTZA is the relevant federal provision, and provides:

Tangible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or

¹ 19 U.S.C. §81a, *et seq.*

processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the above processes, shall be exempt from State and local ad valorem taxation.

The Hawaii-specific exemption from taxes in an FTZ is codified at Hawaii Revised Statutes (HRS) section 212-8, and provides:

Notwithstanding any law to the contrary, sales of all products which are categorized as privileged foreign merchandise, nonprivileged foreign merchandise, domestic merchandise, or zone-restricted merchandise, and which are admitted into a foreign-trade zone, as more specifically set forth in the Act of Congress, and any rules and regulations promulgated thereunder, made directly to any common carrier in interstate or foreign commerce, or both, whether ocean-going or air, for consumption out-of-state by the crew or passengers on the shipper's vessels or airplanes, or for use out-of-state by the vessels or airplanes, shall be exempt from those taxes imposed under chapters 237, 238, 243, 244D, and 245.

Attorney General Opinions

In Attorney General Opinion (AG Op.) No. 64-52, dated November 5, 1964, and in subsequent opinions and other legal advice, the Department of the Attorney General (AG) generally opined that the imposition of all state taxes were preempted in an FTZ. The Department of Taxation also previously issued written guidance consistent with AG Op. No. 64-52. However, on September 22, 2021, the AG issued AG Op. No. 21-01 which concluded that, “to the extent Opinion No. 64-52 assumed that Congress intended to occupy the entire field with respect to FTZs such that all state taxation would be preempted, we advise that Opinion No. 64-52 has been superseded” by Section 810(e), which was an amendment to the FTZA in 1984, and by subsequent case law.

AG Op. No. 21-01 also concluded that Hawaii’s General Excise Tax (GET) and Use Tax were not expressly preempted by the FTZA, and that Congress did not assume exclusive regulatory power over FTZs such that state taxation was preempted. Moreover, AG Op. No 21-01 explicitly states, “to determine whether the application of a particular state tax on a particular activity in an FTZ conflicts with or frustrates Congress’s intent in passing the [FTZA], a conflict preemption analysis must be performed.”

Therefore, based on the foregoing, all prior guidance by the Department of Taxation that is inconsistent with AG Op. No, 21-01 is no longer valid and is not to be relied upon going forward.

Conflict Preemption

Conflict preemption exists if the application of Hawaii taxes, including GET, to a particular activity within an FTZ “stands as an obstacle to the accomplishment and execution of

the full purposes and objectives of² the federal law. A discussion of the purpose of the FTZA is contained in Section II.C. of AG Op. 21-01 (please see attached).

Aside from the activities expressly exempted by the FTZA and HRS section 212-8, the Department is unable to conceive of a situation where the imposition of a Hawaii tax would stand as an obstacle to accomplishing the “full purpose and objectives” of the FTZA. As such, the Department provides the following guidance regarding the imposition of Hawaii taxes on business activities that have been frequently asked about.

Imposition of GET in an FTZ

Unless expressly exempted by section 81o(e) of the FTZA or HRS 212-8, the following is a list of business activities that are not preempted and are thus subject to GET in an FTZ:

- Sale of tangible personal property delivered in an FTZ for consumption in an FTZ;
- Sale of tangible personal property delivered in an FTZ for consumption outside the FTZ, but in Hawaii;
- Sale or import of machinery, vehicles, and other equipment for use within an FTZ;
- Services related to machinery, vehicles, and other equipment used in an FTZ;
- Engaging in business of “contracting” for real property located in an FTZ;
- Services relating to real property located in an FTZ that are not considered “contracting” for GET purposes;
- Other Services that are used and consumed in an FTZ; and
- Lease rents received for the letting of real property located in an FTZ.

The foregoing is not intended, nor shall it be interpreted, to be an exclusive list of Hawaii tax impositions.

Taxpayers who filed returns and paid taxes in a manner not consistent with the guidance contained in this TIR are encouraged to apply to the Department’s Voluntary Disclosure Program. Program details can be found in TIR 2020-03.

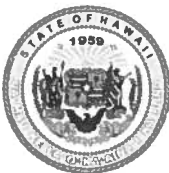
If you have any questions, you may contact the Department of Taxation Rules Office at tax.rules.office@hawaii.gov, or call (808) 587-1530.

ISAAC W. CHOY
Director of Taxation

Attachment: Attorney General Opinion 21-01 (September 22, 2021)

² *Williamson v. Mazda Motor of Am., Inc.*, 562 U.S. 330 (2011).

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September 22, 2021

The Honorable Isaac W. Choy
Director of Taxation
State of Hawaii
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Honolulu, Hawaii 96813-5094

Dear Director Choy:

RE: Hawaii General Excise Tax and Use Tax on
Activities Occurring Within the Hawaii
Foreign-Trade Zone and Sub-zones.

This opinion responds to your request for clarification as to whether the Foreign-Trade Zones Act of 1934, codified as amended at 19 U.S.C. §§ 81a-81u (2016) (FTZA), preempts the State from imposing general excise and use tax on activity conducted within a foreign-trade zone (FTZ).

I. ISSUE PRESENTED AND SHORT ANSWER

Your request concerns the conclusions reached in Attorney General Opinion No. 64-52, dated November 5, 1964, and in subsequent opinions and other legal advice, including, but not limited to, the memorandum designated "OP:85:812-1," dated October 23, 1985.

Specifically, Opinion No. 64-52 concluded that "Congress has assumed exclusive regulatory powers within the zone, and no local regulation may interfere with these powers." Based on the facts and assumptions identified therein, and based on the foregoing conclusion as to the law at the time, the opinion further concluded that: "neither the general excise tax nor the consumption tax would apply on account of sales made within the zone or on account of goods imported into the zone." In the years since Opinion No. 64-52 was issued, the law changed and it is now clear that not all state taxes are preempted by the FTZA.

More specifically, in 1984, Congress amended the FTZA to specify that only state and local ad valorem taxes on imported and domestic goods held for export are preempted. 19 U.S.C. § 810(e). The fact that Congress expressly preempted ad valorem taxes on certain tangible personal property, and did not expressly preempt any other taxes, establishes that Congress did not intend to occupy the entire field of taxation and regulation within FTZs. Additionally, subsequent case law affirms that the FTZA does not expressly preempt or otherwise occupy the field to the exclusion of state laws. See *United States v. 4,432 Mastercases of Cigarettes, More Or Less*, 448 F.3d 1168 (9th Cir. 2006). Therefore, to the extent Opinion No. 64-52 assumed that Congress intended to occupy the entire field with respect to FTZs such that all state taxation would be preempted, we advise that Opinion No. 64-52 has been superseded.

Instead, to determine whether the application of a particular state tax on a particular activity in an FTZ conflicts with or frustrates Congress's intent in passing the FTZA, a conflict preemption analysis must be performed. See *id.* To the extent Opinion No. 64-52, or any subsequent opinion or other legal advice, ignores the change in the law or otherwise conflicts with the legal analysis herein, those subsequent opinions or other legal advice are superseded.

II. DISCUSSION

Federal preemption of state law can occur in three ways: (1) express preemption by statute; (2) occupation of the field to the exclusion of state law; or (3) a conflict between state and federal regulation. *4,432 Mastercases of Cigarettes*, 448 F.3d at 1189.

A. Hawaii's General Excise Tax and Use Tax Are Not Expressly Preempted by the Foreign Trade Zones Act.

"Express preemption occurs when Congress enacts a statute that expressly commands that state law on the particular subject is displaced." *Id.* (quoting *Gadda v. Ashcroft*, 377 F.3d 934, 944 (9th Cir. 2004)).

In 1984, the FTZA was amended to add that imported goods held in an FTZ and domestic goods held in an FTZ for export are

exempt from state and local ad valorem taxes. The amendment reads as follows:

Tangible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the above processes, shall be exempt from State and local ad valorem taxation.

Trade and Tariff Act of 1984, Pub. L. No. 98-573, § 231, 19 U.S.C. § 810(e). An ad valorem tax is based on the value of an item and may be imposed annually. *4,432 Mastercases of Cigarettes*, 448 F.3d at 1184-85. "The most common example of an ad valorem tax is the local property tax." *Id.* at 1185. In contrast, an excise tax is imposed on the performance of an act or the enjoyment of a privilege and can be imposed only once per act. *Id.* Thus, an excise tax is "not expressly precluded by the FTZ Act." *Id.* at 1184.

Hawaii's general excise tax is not an ad valorem tax, as it is imposed once on a transaction and is measured "by the income realized by the particular activity engaged in by the taxpayer within the state." *Matter of Grayco Land Escrow, Ltd.*, 57 Haw. 436, 449 (1977). Similarly, Hawaii's use tax, which is complementary to the general excise tax, is not an ad valorem tax, as it is imposed once upon the import of the tangible personal property into the State. HRS § 238-2. Accordingly, Hawaii's general excise tax and use tax are not expressly preempted by the FTZA.

B. Congress Has Not Assumed Exclusive Regulatory Powers With Respect to FTZs Such That All State Taxation is Preempted.

Field preemption occurs "when the scope of a [federal] statute indicates that Congress intended federal law to occupy a field exclusively." *Kurns v. R.R. Friction Prod. Corp.*, 565 U.S. 625, 630-31 (2012) (quoting *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995)); see also *Murphy v. Nat'l Collegiate*

Athletic Ass'n, 138 S. Ct. 1461, 1480 (2018) ("Field preemption occurs when federal law occupies a 'field' of regulation 'so comprehensively that it has left no room for supplementary state legislation.'").

As previously discussed, in 1984, the FTZA was amended to add that state and local ad valorem taxes on imported and domestic goods held in an FTZ for export are expressly preempted. 19 U.S.C. § 810(e). The fact that Congress expressly preempted ad valorem taxes on certain tangible personal property, and did not expressly preempt any other taxes, indicates that Congress did not intend to occupy the entire field of taxation and regulation within FTZs. See *Cipollone v. Liggett Grp., Inc.*, 505 U.S. 504, 517 (1992) ("Congress' enactment of a provision defining the pre-emptive reach of a statute implies that matters beyond that reach are not pre-empted").

Moreover, in *4,432 Mastercases of Cigarettes*, the Ninth Circuit Court of Appeals considered the precise question of whether Congress "expressed an intent to occupy the entire field of activity around FTZs, such that state law should be preempted." *4,432 Mastercases of Cigarettes*, 448 F.3d at 1190. The Ninth Circuit held that Congress did not. *Id.*

Accordingly, Congress has not assumed exclusive regulatory powers in FTZs such that the State is preempted from imposing taxes on all activity within an FTZ.

C. Conflict Preemption Applies as a Barrier to Certain, But Not All, State Taxes on Activities in an FTZ.

"Under ordinary conflict pre-emption principles a state law that 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives' of a federal law is pre-empted." *Williamson v. Mazda Motor of Am., Inc.*, 562 U.S. 323, 330 (2011) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). There must be "clear evidence" of a conflict to invalidate the state law. *Geier v. American Honda Motor Co., Inc.*, 529 U.S. 861, 885 (2000).

FTZs were created by the FTZA. The purpose of the FTZA was "to provide for the establishment, operation, and maintenance of foreign trade zones in ports of entry of the United States, to

expedite and encourage foreign commerce, and for other purposes." *3M Health Care, Ltd. v. Grant*, 908 F.2d 918, 919 (11th Cir. 1990) (quoting Foreign Trade Zones Act, ch. 590, 48 stat. 998 (1934) (internal quotation marks and brackets omitted)). "Foreign and domestic merchandise of every description . . . may, without being subject to the customs laws of the United States . . . be brought into a zone and may be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured" 19 U.S.C. § 81c(a).

"Congress's twin aims in passing the FTZ Act, further encouraging use of United States ports in the flow of interstate commerce and enabling manipulation of foreign goods before they are imported, are apparent from the face of the statute." *4,432 Mastercases of Cigarettes*, 448 F.3d at 1193. The zones are designated geographic areas "through which goods can pass without being subject to United States customs duties" as an incentive to use the zones. *3M Healthcare, Ltd.*, 908 F.2d at 919. The use of U.S. ports for the warehousing of goods in international trade was considered an endeavor worthwhile enough to exempt such goods from customs duties and thus make the use of the ports as easy as possible for transshipment. *Id.* at 921. Thus, "the goal of the Foreign Trade Zones Act is straightforward—to facilitate the use of U.S. ports for the transshipment of goods in foreign commerce." *Id.*

In *4,432 Mastercases of Cigarettes*, the Ninth Circuit Court of Appeals conducted a conflict preemption analysis to determine whether the imposition of California's cigarette tax would "create an irreconcilable conflict with the FTZ laws, at least when the goods are already duty-paid and bound for domestic consumption." *Id.* at 1194.¹ The Ninth Circuit determined that express preemption and field preemption did not apply, but that a conflict preemption analysis must be applied to determine whether a state or local tax can be imposed on activity within an FTZ. This determination establishes that whether a state tax can be applied to a particular activity within an FTZ depends on

¹ The Ninth Circuit stated, "[w]e do not reach the question of whether a state or local tax imposed on domestic bound goods that have not yet been 'entered into' the United States would conflict with the purpose of the FTZ Act." *Id.* at n.10.

the specific facts of that activity, and whether the tax, if applied to the activity "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of" the federal law. *Williamson*, 562 U.S. at 330.

III. CONCLUSION

As set forth above, the FTZA does not expressly preempt the State from imposing general excise and use tax on activities conducted within an FTZ. Moreover, Congress has clarified, by way of an amendment in 1984, that it did not intend to occupy the entire field with respect to FTZs such that all state taxation would be preempted. Ultimately, whether a state tax can be applied to a particular activity within an FTZ depends on whether the tax conflicts with the purposes and objectives of the FTZA.

Because Opinion No. 64-52 did not include the legally required conflict preemption analysis, it has been superseded.² To the extent this opinion conflicts with any prior opinions or other legal advice concerning the ability of the State to impose and collect general excise and/or use tax in an FTZ, this opinion supersedes those opinions and other legal advice, and clarifies that a conflict preemption analysis must be performed to determine whether a state tax conflicts with or frustrates the objectives of the FTZA.

Very truly yours,


Gary S. Sukanuma
Deputy Attorney General

APPROVED:


Clare E. Connors
Attorney General

² Although Opinion No. 64-52 has been superseded, the answers to the specific questions posed therein may still be valid if the answers would be the same upon completion of a conflict preemption analysis.