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July 10, 2018

## **DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2018-10**

Re: Implementation of Act 41, Session Laws of Hawaii 2018, Relating to When a Taxpayer is Engaging in Business in the State for Purposes of Hawaii's General Excise Tax

This Announcement amends and supersedes Announcement No. 2018-10, previously issued on June 27, 2018. Taxpayers are advised that the Department will not retroactively administer Act 41, which is effective July 1, 2018.

### **Background**

The general excise tax (GET) is a privilege tax imposed on all business and other activities "in the State." Haw. Rev. Stat § 237-13. Although it is clear that a business with a physical presence in Hawaii satisfies the statutory "in the State" requirement and is therefore subject to GET, the law was previously unclear as to the circumstances under which a business that lacks a physical presence in Hawaii would satisfy the "in the State" requirement. See Travelocity.com, L.P. v. Director of Taxation, 135 Hawaii 88, 103 (2015) (rejecting argument that taxpayers must have physical presence in the State to satisfy the statutory "in the State" requirement).

Act 41, Session Laws of Hawaii 2018 (Act 41) clarifies the "in the State" requirement by creating a bright-line rule for businesses that lack a physical presence in Hawaii. Specifically, Act 41 provides that a person is engaging in business in the State, regardless of whether the person is physically present in the State, if in the current or preceding calendar year:

- (1) The person has gross income of \$100,000 or more from the sale of tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State; or
- (2) The person has entered into 200 or more separate transactions involving tangible personal property delivered in the State, services used or consumed in the State, or intangible property used in the State.

Somewhat overlapping with the statutory “in the State” requirement is the requirement imposed by the U.S. Commerce Clause that a taxpayer’s activity must have a substantial nexus with the taxing jurisdiction. See Baker & Taylor, Inc. v. Kawafuchi, 103 Hawaii 359, 365-71 (2004) (analyzing whether taxpayer was engaged in business “in the State” and whether taxpayer’s activity had a substantial nexus with the State); see also Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977) (articulating substantial nexus requirement).

In South Dakota v. Wayfair, Inc., No. 17-494, 2018 WL 3058015, at \*17 (U.S. Jun. 21, 2018), the U.S. Supreme Court held that South Dakota’s law, Senate Bill 106, which has a similar \$100,000 or 200-transaction threshold, satisfies the substantial nexus requirement imposed by the U.S. Commerce Clause, as “[t]his quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in [the state].”

In sum, the imposition of the GET on a taxpayer who lacks physical presence in Hawaii, but who has gross income of \$100,000 or more or who has entered into 200 or more transactions attributable to Hawaii, comports with the statutory “in the State” requirement as well as the U.S. Commerce Clause’s substantial nexus requirement.

A taxpayer will therefore be required to maintain a GET license, file GET returns, and remit GET to the State if *any* of the following applies:

- (1) Taxpayer has a **physical presence**<sup>1</sup> in Hawaii;
- (2) In the current or preceding calendar year, taxpayer has **gross income or gross proceeds of \$100,000 or more** from any of the following, or combination of the following, activities:
  - a. Tangible property delivered in Hawaii;
  - b. Services used or consumed in Hawaii<sup>2</sup>; or
  - c. Intangible property used in Hawaii; or
- (3) In the current or preceding calendar year, taxpayer has entered into **200 or more separate transactions** involving any of the following, or combination of the following, activities:
  - a. Tangible property delivered in Hawaii;
  - b. Services used or consumed in Hawaii; or
  - c. Intangible property used in Hawaii.

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<sup>1</sup> Physical presence includes, but is not limited to, having an office, employees or representatives, inventory, or other property in Hawaii, or providing services in Hawaii, such as installation, training, maintenance, or repair services.

<sup>2</sup> See sections 18-237-29.53-01 through 18-237-29.53-13, Hawaii Administrative Rules, and Tax Information Release No. 2018-06 for more information regarding the sourcing of income from services.

## **Implementation of Act 41 in 2018**

### **Retroactivity**

Although the U.S. Supreme Court, in South Dakota v. Wayfair, Inc., held that Senate Bill 106 satisfied the substantial nexus requirement, the Court did not rule on whether Senate Bill 106 violated other principles of the U.S. Commerce Clause. Wayfair, 2018 WL 3058015, at \*17. The Court noted, however, that South Dakota’s law contains “several features that appear designed to prevent discrimination against or undue burdens upon interstate commerce,” including a prohibition on retroactive application of Senate Bill 106. Id.

To avoid any constitutional concerns, the Department will not retroactively administer Act 41. Accordingly, taxpayers who lacked physical presence in Hawaii prior to July 1, 2018, but who met the \$100,000 or 200-transaction threshold in 2017 or 2018, will not be required to remit GET for the period from January 1, 2018 to June 30, 2018.

### **Deadline to File First Return**

Periodic returns are due on the 20<sup>th</sup> day following the close of the filing period. A taxpayer’s filing period is monthly if more than \$4,000 in GET will be paid for the year; quarterly if more than \$2,000, but \$4,000 or less in GET will be paid for the year; or semiannually if \$2,000 or less in GET will be paid for the year. Annual returns are due on the 20<sup>th</sup> day of the fourth month following the close of the tax year.

If, prior to July 1, 2018, a taxpayer lacks physical presence in Hawaii and meets the \$100,000 or 200-transaction threshold for 2017 or 2018, the taxpayer will be subject to GET beginning on July 1, 2018 and must file its first periodic return by the deadline for that period. Fiscal year taxpayers will be subject to GET beginning on July 1, 2018 or the first day of the tax year beginning after December 31, 2017, whichever is later.

If a taxpayer who lacks physical presence in Hawaii meets the \$100,000 or 200-transaction threshold between July 1, 2018 and December 31, 2018, the taxpayer will be subject to GET beginning on July 1, 2018. Fiscal year taxpayers will be subject to GET beginning on July 1, 2018 or the first day of the tax year beginning after December 31, 2017, whichever is later. The taxpayer will be given a grace period of one period for the filing of the first periodic return. Accordingly, the taxpayer must file its first periodic return by the deadline for the periodic return following the period in which the taxpayer met the \$100,000 or 200-transaction threshold.

If the taxpayer meets the threshold during the last period of the tax year, the taxpayer will not be required to file a periodic return for that period. Instead, the taxpayer’s first return will be the annual return for that tax year.

The following chart provides the first filing deadlines for calendar year taxpayers who will be filing on a monthly basis:

<b>When Threshold Was First Met</b>	<b>First Filing Deadline</b>
1/1/17 – 12/31/17	8/20/18
1/1/18 – 6/30/18	8/20/18
7/1/18 – 7/31/18	9/20/18
8/1/18 – 8/31/18	10/22/18
9/1/18 – 9/30/18	11/20/18
10/1/18 – 10/31/18	12/20/18
11/1/18 – 11/30/18	1/21/19
12/1/18 – 12/31/18	4/22/19 (annual return)

### **Catchup Income**

Because taxpayers who meet the \$100,000 or 200-transaction threshold after July 1, 2018 are given a grace period for the filing of their first return, said taxpayers will need to report “catchup income” (income recognized prior to and during the period in which the taxpayer meets the threshold) and pay GET on said income. The Department will allow taxpayers to report and pay GET on catchup income, without penalty and interest, as follows:

- (1) The taxpayer may report and pay GET on all catchup income in full on the first periodic return; or
- (2) The taxpayer may report and pay GET on catchup income by spreading the liability equally over the remaining periods in the current tax year.

If, however, the taxpayer meets the threshold during the last period of the tax year, the taxpayer must report and pay GET on all catchup income in full on the annual return.

### **Implementation of Act 41 in Subsequent Years**

In 2019 and later years, if a taxpayer lacks physical presence in Hawaii and did not meet the \$100,000 or 200-transaction threshold in the preceding calendar year, the taxpayer will be given a grace period of one period for the filing of the first periodic return. Accordingly, the taxpayer must file its first periodic return by the deadline for the periodic return following the period in which the taxpayer met the \$100,000 or 200-transaction threshold. Additionally, the Department will allow taxpayers to report and pay GET on catchup income, without penalty and interest, in the same manner described above.

## FAQs

### Engaging in Business in the State

**1. I have a physical presence in Hawaii, but I have less than \$100,000 in gross income and have entered into less than 200 transactions in 2017 and 2018. Will I be subject to GET for the tax year beginning in 2018?**

Yes, because you have a physical presence in Hawaii, you are engaging in business in the State and are subject to GET even if you do not meet the \$100,000 or 200-transaction threshold.

**2. I do not have a physical presence in Hawaii, but I have \$100,000 in gross income attributable to Hawaii in 2018. Will I be subject to GET for the tax year beginning in 2018?**

Yes, you are engaging in business in the State because you met the \$100,000 threshold in the current calendar year.

**3. I do not have a physical presence in Hawaii. My gross income attributable to Hawaii was \$100,000 in 2017 and \$50,000 in 2018. Will I be subject to GET for the tax year beginning in 2018?**

Yes, you are engaging in business in the State because you met the \$100,000 threshold in the preceding calendar year.

**4. I do not have a physical presence in Hawaii, but in 2017, I entered into 100 transactions for tangible property delivered in Hawaii and 100 transactions for intangible property used in Hawaii. Will I be subject to GET for the tax year beginning in 2018?**

Yes, you are engaging in business in the State because you have entered into 200 transactions attributable to Hawaii in the preceding calendar year. The 200-transaction threshold may be met by *any combination of* tangible property delivered in the State, services used or consumed in the State, or intangible property used in the State.

**5. I do not have a physical presence in Hawaii. If I entered into 200 transactions attributable to Hawaii in 2018, but have less than \$100,000 in gross income, will I be subject to GET for the tax year beginning in 2018?**

Yes, you are engaging in business in the State because you have entered into 200 transactions attributable to Hawaii in the current calendar year. You will be subject to GET if you meet the \$100,000 *or* the 200-transaction threshold; you do not need to meet both.

### **Filing and Payment Deadlines**

**6. I do not have a physical presence in Hawaii, but, I have \$100,000 in gross income attributable to Hawaii between January 1, 2018 and June 30, 2018. Will I be subject to GET for the \$100,000?**

You will be subject to GET for the tax year beginning in 2018, but will not be subject to GET for any periods between January 1, 2018 and June 30, 2018.

**7. I do not have a physical presence in Hawaii, but, I have \$100,000 in gross income attributable to Hawaii between January 1, 2018 and June 30, 2018. When is the deadline to file my first GET return?**

If you are a calendar year taxpayer and will be filing on a monthly basis, your first return is due on August 20, 2018; if you are a calendar year taxpayer and will be filing on a quarterly basis, your first return is due on October 22, 2018; if you are a calendar year taxpayer and will be filing on a semiannual basis, your first return is due on January 21, 2019.

**8. I do not have a physical presence in Hawaii, but I have \$100,000 in gross income attributable to Hawaii between January 1, 2018 and June 30, 2018. I have \$20,000 in gross income for July 2018. How much income should I report on my next periodic return?**

Assuming you are a calendar year taxpayer who will be filing on a monthly basis, you should report \$20,000 in gross income on the return due on August 20, 2018.

**9. I do not have a physical presence in Hawaii and do not have any gross income or transactions attributable to Hawaii in 2017. I have \$80,000 in gross income attributable to Hawaii between January 1, 2018 and June 30, 2018; \$10,000 in gross income for July 2018; \$14,000 in gross income for August 2018; and \$16,000 in gross income for September 2018. When is the deadline to file my first GET return? How much income should I report?**

Assuming you are a calendar year taxpayer who will be filing on a monthly basis, you are required to file your first return by October 22, 2018. Because you met the threshold in August 2018, you are given a grace period of one month, to October 22, 2018, to file your first periodic return. On the October 22, 2018 return, you may either: (1) report \$40,000 in gross income (catchup income of \$24,000 plus \$16,000 in income for September); or (2) report \$22,000 in gross income (catchup income of \$24,000 divided over four monthly periods, or \$6,000, plus \$16,000 in income for September).

**10. I do not have a physical presence in Hawaii and do not have any gross income or transactions attributable to Hawaii in 2017. I met the \$100,000 threshold in December 2018. My gross income between July 1, 2018 and December 31, 2018 is \$50,000. When is the deadline to file my first GET return? How much income should I report?**

Assuming you are a calendar year taxpayer, you are required to file an annual return by April 22, 2019 and report \$50,000 in gross income on that return. You are not required to file a periodic return for the 2018 tax year because you met the threshold during the last period of the tax year. Additionally, you may not pay the catchup income in installments because there are no remaining periods in the tax year.

**11. I do not have a physical presence in Hawaii and do not have any gross income or transactions attributable to Hawaii in 2017 or 2018. I have \$90,000 in gross income attributable to Hawaii in January 2019; \$80,000 in gross income in February 2019; and \$50,000 in gross income in March 2019. When is the deadline to file my first GET return? How much income should I report?**

Assuming you are a calendar year taxpayer who will be filing on a monthly basis, you are required to file your first return by April 22, 2019. Because you met the threshold in February 2019, you are given a grace period of one month, to April 22, 2019, to file your first periodic return. On the April 22, 2019 return, you may either: (1) report \$220,000 in gross income (catchup income of \$170,000 plus \$50,000 in income for March); or (2) report \$67,000 in gross income (catchup income of \$170,000 divided over 10 monthly periods, or \$17,000, plus \$50,000 in income for March).

For additional information regarding Act 41, contact the Rules Office at (808) 587-1530 or by email at [Tax.Rules.Office@hawaii.gov](mailto:Tax.Rules.Office@hawaii.gov). For general information regarding Hawaii's GET, and to obtain tax forms, instructions, and publications, visit the Department's website at [tax.hawaii.gov](http://tax.hawaii.gov).

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