

A REVIEW OF HAWAII'S
GENERAL EXCISE TAX ON COMMISSIONS
FOCUSING ON SALES REPRESENTATIVES

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FOREWORD

This report, *A Review of Hawaii's General Excise Tax on Commissions Focusing on Sales Representatives*, is presented in response to Senate Resolution No. 88 adopted during the 1982 legislative session.

This report studies the general excise taxation of the commissions of sales representatives, reviews the general excise taxation of the commissions of insurance agents, and discusses the findings.

Information and comments furnished by the Departments of Taxation and Commerce and Consumer Affairs, the Tax Foundation of Hawaii, as well as members of the insurance industry and sales representatives are gratefully acknowledged and appreciated.

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SUMMARY

This report contains a review of the differences between a sales tax and the general excise tax, the taxation of commissions of insurance agents and of commissions in general. It reviews in particular the activities which sales representatives engage in and the general excise taxation of the commissions they receive.

The report also finds that a number of other persons, like sales representatives, are unable to pass on the general excise tax due to contractual arrangements which cannot be modified. The report finds that the actual general excise tax burden on sales representatives, and others who are unable to pass on the tax, is 4 per cent, while for those persons who can pass the tax on to another the tax burden is .15 per cent.

The report sets forth the alternatives available in the general excise taxation of sales representatives as (1) retention of the present system, (2) eliminating the tax for sales representatives, (3) placing sales representatives in the same category as insurance agents, or (4) reducing the tax and creating a separate category. After discussing each alternative, the report makes two alternative recommendations.

The two recommendations the report makes are (1) that the general excise taxation of sales representatives not be changed or (2) that if excise tax relief be provided to sales representatives, it be provided to all others similarly situated.

Chapter 1

INTRODUCTION

This report studies the excise tax as imposed on manufacturer's sales representatives under section 237-13, Hawaii Revised Statutes.

This study is being conducted pursuant to Senate Resolution No. 88, adopted by the Eleventh Legislature of the State of Hawaii. The resolution specifies that the following topics be considered:

- (1) The present tax treatment of sales representatives and purchasing agents;
- (2) Whether any portion of the general excise tax imposed on sales representatives can legally be passed on;
- (3) Whether the present tax treatment of sales representatives and purchasing agents is equitable given the nature of their business and their legal ability to pass on the tax;
- (4) Whether and to what extent the general excise tax rate imposed on sales representatives and purchasing agents should be reduced to provide equitable treatment for such individuals under the general excise tax; and
- (5) The revenue impact of modifying the present tax treatment of sales representatives and purchasing agents.

Subsidiary issues under this study as set forth in the resolution are whether:

- (1) Under the general excise tax, sales representatives and purchasing agents should be taxed in the same manner as

insurance agents and solicitors based on their similarities and ability to pass on the general excise tax;

- (2) It is appropriate to continue maintaining the .15 per cent general excise tax rate for insurance agents and solicitors; or
- (3) Another more appropriate general excise tax rate should be applied to each group.

This study will not include purchasing agents because in Hawaii they are usually employees of companies who handle the purchasing of supplies and materials for a business. In executive positions, they are identified as directors for material management. They are salaried and not on commission.

There are special cases where a person is hired to buy certain items and is considered a purchasing agent. That person is given authority to spend a certain amount of money and negotiate for the purchase of the item. The situation arises where the commodity being purchased may be hard to find or may only be obtainable from a foreign country. These cases, however, are not common in Hawaii and there did not appear to be enough persons acting in this capacity to obtain sufficient information. Those persons who do act as purchasing agents, however, and receive commissions for performing such a function would be covered by any comments made on sales representatives.

This study confines itself to sales representatives also known as manufacturer's representatives. For the purposes of this study, sales representatives are defined as independent contractors who negotiate sales, within a manufacturer's or producer's guidelines, between the manufacturer or producer and a wholesaler or retailer of the goods or products. As independent contractors they are paid a commission, usually a percentage of the sales price, for the service they perform of bringing the manufacturer or producer together. This commission is taxed at a 4 per cent rate under the Hawaii general excise tax law.

A sales representative acts as an agent, selling the manufacturer's products to retail or wholesale outlets. The most commonly sold products are

food, paper supplies, garments, gifts, and construction supplies and tools. The legal rights and obligations between a sales representative and a manufacturer may or may not be spelled out in a written contract depending on the commodity. For example, in the garment industry contracts are not often used but they are almost always used in the food industry. Aside from listing the duties and obligations, written contracts are important in defining the sales territory. Whether the sales representative receives the entire percentage of the agreed upon commission depends on whether the sales were made within the territory.

For manufacturers who cannot afford to retain their own sales staff as employees, sales representatives may be cost effective. By using such agents, manufacturers eliminate the accounting tasks and fees and taxes associated with employees and also the problem of unproductive sales staff. Manufacturers desiring broad-based sales of their products can sell their products nationally by retaining sales representatives where they wish to sell. Manufacturers can find sales representatives through customer reference or advertisements in industry newsletters. A sales representative is contracted to show the products and solicit orders. Generally, a percentage of the sales is agreed upon as compensation for the services and is considered commission. If no orders are taken the manufacturer does not have to pay anything.

The amount of commission depends on the nature of the product being sold. For example, the percentage on food is often around five per cent, while in the garment industry, the percentage is about ten per cent. These commissions presently are subject to the general excise tax at the 4 per cent rate.

Once an order is taken and accepted by the manufacturer, the sales representative is entitled to the commission. There is no legal duty on the part of the sales representative to aid in delivery, warranty, or payment problems. Neither is there a duty to warehouse the product or to find a reliable warehouse. The contract for sale and the arrangements for delivery are between the manufacturer and the customer. As a practical matter and for the purposes of goodwill, many experienced sales representatives offer these services to their customers to keep the account and to the manufacturer

to keep the business. More often than not the manufacturer is in another state and another legal jurisdiction.

No special training is required to be a sales representative. A sales representative is given all the information about the product and its uses, the price and quantity discount, if any, the minimum quantity that must be purchased, the expected delivery date, and any other usual conditions for the particular product of the industry. Talent, experience, and contacts are then applied to make sales. Newcomers to the trade may work for an established sales representative as a subrepresentative to gain experience and exposure. The subrepresentative is compensated by receiving a percentage of the commission received by the sales representative, although the agreement is between the representative and the subrepresentative. Clientele is developed through reputation in the industry.

Sales oriented people are attracted to this business because it offers a chance to be an independent businessperson and a business in which initiative and incentive counts. Creativity and flexible working conditions are part of the working conditions. Sales representatives also enjoy working for more than one company. It would not be possible to earn a living representing one manufacturer exclusively since there would not be enough volume. Large and major manufacturers who have such volume usually have sales persons who are their employees.

As sales increase, the sales representative may then expand into a distributorship. A distributor is considered a wholesaler since the distributor buys products in bulk and resells them and is therefore, subject to a different general excise tax rate of .5 per cent. This distributorship may then lead to the actual manufacturing of products for sale. In fact large sales representative businesses offer more than one business service, combining warehousing, importing, and maintenance service besides representing, distributing, and manufacturing. As one person said, a job as a sales representative can be the building block of a profitable sales organization.

Chapter 2

APPLICABILITY OF EXCISE TAX TO COMMISSIONS

PART I. EXCISE TAX VERSUS SALES TAX

Arguments have been made that since most other states do not tax commissions, commissions should not be subject to the excise tax in Hawaii. Generally, most (37) states have a sales tax while Hawaii and a few other (10) states (including the District of Columbia) have a general excise, gross income, or similar tax. The tax applicable in 1 state is unclear, and 3 states do not have any applicable tax. The excise, gross income, or sales tax is usually complemented by a use tax.

The sales tax is a tax on the retail sale of property levied on the final consumer at the time of the sales transaction. The excise or gross income tax, on the other hand, is a tax on the privilege of doing business¹ levied on the business and payable at monthly or quarterly intervals.

The use tax, based on the use of a product within the state, is designed to apply where the sales or excise tax does not apply. For example, the sales or excise tax does not apply to a sale which occurs outside the state. The use tax is levied to tax the product if the product is brought into the state for use, less any sales or use tax paid to other states.

The Arthur D. Little report, *Hawaii's General Excise Tax: Prospects, Problems, and Prescriptions*, refuted the applicability of sales tax rationale to Hawaii's excise tax as follows:²

But the Iowa Rule, along with the other state court views on services, really deals with an essentially different problem than that which faces Hawaii. Most state courts are wrestling with statutes which are retail sales taxes (i.e., single stage sales taxes) and which do not apply to service businesses. These courts are thus caught up in the practical problem of deciding how to rationalize the levying of the retail tax on the transfers of property at some single stage in the distribution process.

Therefore, certain states have held that the tax should be levied on sales by the service business, others, that it should be levied on sales to the service business, seldom, if ever, both levels.... We offer this example to demonstrate that there is nothing particularly compelling or relevant about the application to Hawaii's tax problems of legal precedents made in other states.

The excise tax is different in scope of application from the sales tax, and the rationale of nontaxation of commissions in sales tax states does not apply to Hawaii's excise tax. The Hawaii tax is a tax on gross income no matter what type of transaction is involved - selling products or services - or where in the chain of distribution a transaction occurs - manufacturing, wholesaling, or retailing. The rate of the general excise tax in Hawaii is affected by the level in the chain of distribution at which the transaction occurs, either manufacturing or retailing, and, with the exception of insurance policies, the tax rate does not depend on the type of transaction.

A review of how other states treat sales representatives indicated the following. Forty-four states do not tax sales representatives' commission, including apparently all 37 sales tax states, 3 business privilege or gross receipts states, 3 states without taxes in this area, and 1 state whose applicable tax is unclear. Seven states with a gross receipt or similar tax to Hawaii's excise tax do tax sales representatives' commissions. The basic rationale for the nontaxation of commissions received by sales representatives in sales tax states is that the sales tax is a tax on property, and the activities of sales representatives involve that of services, not of property. Thus, the sales tax does not apply to commissions received for services. The excise tax, however, applies to the sale of services as well as to the sale of property. Those states which do tax sales representative commissions do not appear to tax them at a special rate.

PART II. GENERAL EXCISE TAX ON INSURANCE COMMISSIONS

In considering the effect of the general excise tax on commissions received by sales representatives and purchasing agents, we have also been asked to review the taxation of commissions received by insurance agents.³

The insurance field consists of:

- (1) General agents who are authorized by an insurer, among other duties, to solicit insurance applications, effectuate and countersign insurance contracts, collect premiums, and appoint subagents and solicitors.
- (2) Subagents who are appointed by the general agent or by a domestic insurer to solicit insurance applications, effectuate and countersign insurance contracts if so authorized, collect premiums, and appoint solicitors.
- (3) Solicitors appointed by a general agent, subagent, or domestic insurer to solicit insurance applications and to collect premiums.

The appointment and qualifications of general agents, subagents, and solicitors are regulated by the state insurance law.

For the purposes of this study "insurance agent" includes solicitors, agents, and subagents except as otherwise indicated.

The sale of an insurance policy, then, may involve one or more of the different types of agents described above. The insurance agent sells an insurance policy to a client who pays the premium (or part of it) to the agent. The insurance agent turns over the premium paid to the insurance company (insurer) and in turn receives a certain percentage as commission from the company.

Prior to Act 144, Session Laws of Hawaii 1978, commissions received by solicitors were taxed at a general excise tax rate of 2 per cent and general agents and subagents were taxed at a 4 per cent rate. The insurance agents are prohibited from passing on the excise tax to clients by section 431-424, Hawaii Revised Statutes.

In a 1977 study on the taxation of insurance agents, "A Study of Hawaii's General Excise Tax on Commissions", the Office of the Legislative Reference Bureau suggested two alternatives to alleviate the situation of insurance agents who could not pass on the general excise tax to their customers:

- (1) Allow the agents to pass on the tax by amending the statute;
and
- (2) Reduce the tax rate to the actual tax burden carried by those who can pass on the general excise tax to .15 per cent.

The Bureau also noted that a revenue loss of \$515,337 (\$557,121 at 2 per cent less \$41,784 at .15 per cent) would be incurred in the case of reducing the tax on solicitors from 2 per cent to .15 per cent, and an additional unknown larger amount involved in reducing the tax on general agents and subagents from 4 per cent to .15.

The legislature chose to reduce the general excise tax on general agents, subagents and solicitors to .15 per cent. To offset the loss in revenues, the premium tax paid by insurance companies for each authorized insurer, except life insurers and ocean marine insurers, was increased in the case of domestic insurers from 2.635 per cent to 2.9647 per cent and in the case of other insurers from 3.8025 per cent to 4.2824 per cent, on gross premiums. In the case of life insurers the tax on domestic insurers rose from 1.755 per cent to 1.918 per cent and on other insurers from 2.925 to 3.197 per cent, of gross premiums.

Act 144, Session Laws of Hawaii 1978, was effective on January 1, 1979. General excise tax collections for solicitors only before January 1, 1979 and for solicitors, general agents, and subagents from January 1, 1979 on a calendar year basis were:⁴

1976	\$612,975
1977	668,855
1978	728,406
1979	358,497
1980	454,920
1981	382,914

In the case of insurance premiums the following revenues were collected:⁵

<u>Year</u>	<u>Life</u>	<u>Property and Casualty</u>	<u>Total</u>
1976	\$4,116,682	\$ 8,836,621	\$12,953,303
1977	4,442,710	10,538,177	14,980,887
1978	4,766,637	12,435,714	17,202,351
1979	5,627,706	15,780,660	21,408,366
1980	5,973,805	17,535,044	23,508,849
1981	6,176,954	19,733,284	25,910,238

Due to the vagaries of the economy and the inability to estimate the revenue loss in reducing general agents and subagents from 4 per cent to .15 per cent, one cannot say specifically that the revenue loss in changing the tax on insurance agents and raising the insurance premium tax offset each other. Certainly there are notable differences in yearly revenues before and after January 1, 1979 which would appear to be partially due to Act 144, and overall, there is a revenue gain shown.

Since the situation regarding insurance agents, other than the change in tax rates has not altered since the Office of the Legislative Reference Bureau

last studied this area, it does not appear to be necessary to change the present tax rates.⁶

PART III. GENERAL EXCISE TAXATION OF COMMISSIONS

A review of the revenue figures from general excise tax collections shows that the amount of tax collected from commissions for the period 1976 to 1981 are:⁷

1976	\$ 6,778,773
1977	8,470,446*
1978	10,441,004*
1979	12,295,641
1980	11,465,336
1981	11,067,169

*Figures for 1977 and 1978 are estimated due to the unavailability of actual collections for these years.

The Department of Taxation breaks down the source of general excise tax revenue into nine categories for those paying 4 per cent excise tax. They are retailing, services, contracting, theater (amusement, radio, etc.), interest, commissions, hotel rentals, other rentals, and all others. Sales representatives report the commission earned under the general category of Commissions as do some 30 other occupations.⁸ If the sales representative offers other services such as warehousing, repair, and maintenance or engages in other business, such as manufacturing, then the income received is reported under the other categories, and if applicable, a different tax rate. No further breakdown from the department of taxation is available as to what part of the commissions are attributable to sales representatives.

If the excise tax were eliminated for all commissions then the revenue loss to the State would be approximately \$11,000,000. If the excise tax were

reduced to two per cent, the revenue would fall \$5,500,000. The sales representative industry, however, claims that not more than a couple of hundred people would be affected by a change in the excise tax, and that at the most, about \$500,000 in excise tax revenues is attributable to sales representatives.

There is no accurate estimate of how many people are sales representatives or in a similar situation. (Within the insurance industry, the number of insurance agents and solicitors is estimated to be 5,000. Unlike sales representatives, the insurance industry is heavily regulated and agents and solicitors are licensed.) Furthermore, should the excise tax be reduced or eliminated, there will be a loss of revenue which can not be readily made up by levying a tax on a related industry or part of the same industry, as in the case of the insurance agents and solicitors. Loss of revenue may have to be made up by other means unrelated to the sales representative industry.

Nevertheless as with insurance agents, the State would have to find a source of revenue to make up for any loss. Although commissions constitute only two per cent of the total excise and use tax collections, Hawaii relies more heavily on the general excise tax, than on income tax.⁹ Some other tax would have to be raised in order to make up the loss of revenues.

Chapter 3

THE REASONS SALES REPRESENTATIVES FEEL THEY SHOULD NOT PAY THE PRESENT RATE OF GENERAL EXCISE TAX

The Office of the Legislative Reference Bureau reviewed the testimony submitted regarding the Resolution under which this study is being undertaken and met with sales representatives, particularly those from the food and garment industries. The representatives presented a number of reasons which are the basis of their position that they should not pay the general excise tax at the present rate. These reasons are set forth below as the basis for discussion of this issue.

Pass On of Tax

Unlike most service businesses, e.g., doctors, restaurants, or other retail establishments, sales representatives argue that they cannot collect any part of the 4 per cent for which they are liable from the customer. Because most other businesses pass the 4 per cent general excise tax on to their customers, their sales price is 4 per cent higher, therefore, the business must in turn pay an excise tax of 4 per cent of the collected sales price (sales price plus tax passed on). Because the business has collected 4 per cent from the customer, however, this has the effect of reimbursing the merchant for most of the excise tax due. For example, where the excise tax rate is 4 per cent, the customer pays \$1.00 sales price plus the tax (4 cents). The taxpayer merchant is liable for a 4 per cent excise tax on the entire proceeds (price plus tax paid by the customer) of \$1.04, or 4.16 cents.¹ Since the customer already paid 4 cents for taxes, the taxpayer actually pays only .16 cents for every \$1.04 in income, or an actual tax burden of .15 per cent. (This is the reason that the general excise tax rate on insurance agents was set at .15 per cent.)

A sales representative can not charge the customer for the 4 per cent general excise tax because the price of the goods is set by the manufacturer

or producer. As mentioned earlier, the contract for sale is between the manufacturer and the customer, the sales representative is responsible for negotiating the contract at the price set and is paid for doing so by commission. Therefore, the sales representative complains that the entire tax must be paid out of the commission.

In terms of actual numbers, one sales representative pointed out that a person's net return is about ten per cent of gross revenue, which is considered good for a small business. The rest of the ninety per cent earned is paid out in overhead costs and normal business expenses without including the excise tax. Thus, that person indicated that the 4 per cent is taken out of the net amount reducing the net amount to 9.6 per cent. This is what makes it seem unfair, that no one else has to pay 4 per cent after net. Actually this is not a true preception of the general excise tax. In the case of a sales representative, if gross commissions are \$1,000, a general excise tax of \$40 is paid first and then all other expenses are paid out of the \$960 left.

There are other businesses who can not legally pass on the excise tax, viz. taxi drivers, travel agents, and insurance agents and solicitors. As pointed out in "A Study of Hawaii's General Excise Tax on Commissions"², these three activities cannot pass on the tax due to federal, state, or county laws preventing them from passing on the tax. On the other hand, sales representatives and others who cannot pass on the tax cannot do so due to their type of business. Sales representatives feel that although they are not statutorily prohibited from passing on the tax, insurance agents are no different than sales representatives.

Increased Commissions

The commission structure for sales representatives is fixed by the manufacturer or producer and is usually the same throughout the nation. It has been suggested that sales representatives negotiate for larger commissions to cover the cost of the excise tax. From the viewpoint of the manufacturer, commissions are not negotiable as a practical matter, if the manufacturer is to be competitive. Furthermore, the larger the commission the greater the tax

base and the tax paid. The representative's tax burden would not be changed.

Pyramiding Effect

The excise tax is easy to administer because most business transactions are taxed at the same rate of 4 per cent. Therefore, if a product or service is exchanged a number of times before being sold to the ultimate consumer, the tax tends to accumulate and pyramid. By statute, certain intermediary steps, wholesaling and other enumerated exemptions, are taxed at the rate of 0.5 per cent to alleviate the pyramid effect.

In the sales representative's case, where the subrepresentative works for a sales representative, the sales representative pays 4 per cent on gross commissions. The subrepresentative is then paid from the remainder by the representative, and the subrepresentative pays 4 per cent on what is received. Sales representatives argue that pyramiding of taxes takes place in that case as well as where the sales representative pays 4 per cent general excise tax, and then the representative reports the net from the business on an income tax return and pays personal income tax on the amount.

Here again, however, there is a misconception of the general excise tax. Pyramiding of the general excise tax only occurs when the tax on the payor is passed on. An example is the case of the general excise tax on a wholesaler being passed on to a retailer who in turn passes that tax plus the tax the retailer must pay on to the consumer. Since the sale representative does not pass on the tax no pyramiding occurs. The same is true in the case of the subrepresentative. No tax is passed on to the subrepresentative who in turn does not pass on the tax paid. Finally, no pyramiding occurs when a sales representative pays the income tax since no tax is passed on, and in fact the general excise tax paid is a deduction for purposes of income tax determination.

The sales representative might make a better argument that double taxation occurs, the representative paying both the general excise tax and the income tax on commissions. The general excise tax and the income tax,

however, are different taxes, one being a tax on the privilege of doing business³ and the other being a tax on income⁴ and double taxation does not occur.

To summarize, the sales representatives feel that the tax is a burden which cannot be alleviated by increasing the price of services nor is the representative able to pass the tax on to a customer. The representative feels that other occupations are able to pass on the tax and that since the insurance agents who could not pass on the tax received tax relief in the form of lower taxes, sales representatives should also be granted tax relief.

Chapter 4

FINDINGS, DISCUSSION, RECOMMENDATIONS, AND CONCLUSION

PART I. SUMMARY

In 1977 the Office of the Legislative Reference Bureau studied the general excise tax on commissions, particularly those of insurance agents. Senate Resolution No. 88 adopted by the State Senate in 1982 asked the Bureau to review the 1977 study and particularly to study the general excise taxation of sales representatives and purchasing agents.

In 1977 the Bureau found that insurance general agents, subagents, and solicitors, and taxicab drivers and travel agents (as to commissions on airplane tickets) were statutorily prohibited from passing on the excise tax to customers. After discussing alternatives, the Bureau's first alternative was to amend the statute and allow insurance general agents, subagents, and solicitors to pass on the tax. The second alternative was to reduce the tax such insurance agents paid and to possibly increase premium taxes to offset the revenue loss. The legislature chose the second alternative. A review of the revenues from the two taxes before and after the amendment show a loss of revenue from the general excise tax with a gain in the premium tax collections. Due to various changes in the economy from year to year, however, it is impossible to tell if the premium tax collections offset the general excise tax losses only because of the tax changes. Furthermore, there was no method in 1977 of predicting the loss of general excise tax revenues resulting in the lowering of the tax rate on insurance general agents or subagents.

In the case of our review of sales representatives, we find that the general excise tax revenues from commissions are:¹

1976	\$ 6,778,733
1977	8,470,446
1978	10,441,004
1979	12,295,641
1980	11,465,336
1981	11,067,169

Unfortunately, there is no method of determining how much of this revenue came from sales representatives, although the sales representatives themselves feel that not more than \$500,000 is involved. In reviewing their reasons for wishing a reduction or elimination of the general excise tax paid, of their three reasons presented for a reduction in or altering the tax rate--pyramiding which is found not to be true, increased commissions which does not reduce the effective rate of tax, and inability to pass on the tax to customers--only the latter is of weight. The effective excise tax rate for sale representatives who cannot pass on the tax is 4 per cent, while for those persons who can pass on the tax the effective rate is .15 per cent.

The department of taxation furnished a list of 30 occupations operating on a commission basis which includes the sales representative.² Without an in depth study of every occupation on this list it is impossible to determine which other occupations are unable to pass on the general excise tax, although the department feels that none of them are able to pass on the tax. In addition to those listed occupations, persons subject to the general excise tax on commissions who are unable to pass on the tax but not listed in the compilation furnished by the department for example are directors of corporations.

A review of the method in which other states taxed sales representative showed that 44 states do not tax sales representative commissions, (including all sales tax states, 3 business privilege or gross receipts states, 3 states with no tax in this area, and 1 state's tax which is unclear,) and 7 states with gross receipts taxes similar to the Hawaii general excise tax do tax sales

representative commissions and do not appear to give special rates. The rationale for nontaxation in the sales tax states is that a sales tax is a tax on the sale of property (a consumption tax) and the activities of a sales representative involve the furnishing of services, not property. The general excise or gross receipts tax taxes both property and services (a production tax).

PART II. ALTERNATIVES

There are several alternatives to imposing the excise tax on sales representatives. They are as follows:

- (1) Retain the present system;
- (2) Eliminate the tax for sales representatives;
- (3) Place sales representatives in the same category as insurance agents;
- (4) Reduce the tax and create a separate category.

The Present System and Excise Tax Level. The excise tax has been officially studied twice by the Office of the Legislative Reference Bureau, in 1963 and 1977.³ There is also a well recognized study done by Arthur D. Little, Inc. (1968).⁴

Although various criticisms have been levied, the Hawaii system has been described as simple and easy to administer. It taxes each business transaction without having to distinguish among the different types. The yields are relatively stable because it taxes transactions which involve services as well as goods. This point is especially significant since the Hawaii economy has been moving toward producing more services over the past decade than producing agricultural products and to a much lesser degree manufactured garments. The imposition of an excise tax is for the privilege of doing business. The basic principle is that it is related to the cost of

government services to business and regulation of business. Because revenues are collected this way, there is less of a need to have other or greater direct taxes, such as sales taxes, use taxes, ad valorem property taxes, and city income taxes. Also considered a positive feature is the fact that the tax is hidden. For example, a sales representative sells \$1,000 worth of goods and receives 10 per cent of the \$1,000, or \$100, as commission. Four per cent, or \$4, must then be paid in general excise taxes. Nowhere is it visible in the original sales transaction. The same applies to a person selling services: the bill may be for \$1,000 of service plus 4 per cent sales tax, but 4 per cent of the \$1,040 collected must be paid to the state in excise tax. There seems little reason to change a system which has worked well and which may have an impact on revenue for the State which can not be easily nor accurately assessed.

Elimination of the Excise Tax. As has been indicated, the Department of Taxation has no approximation of the amount of revenue which is attributable to sales representatives. Furthermore, this occupation is not the only occupation unable to pass on the tax. By the estimate of those who are organized in the industry, there are only a couple of hundred sales representatives in the entire State. Regardless of the number, however, they guess that the amount of business sales generated produce about \$500,000 in excise tax revenues. Accepting the proposition that this estimate is generous it would be a little under 5 per cent of the total revenues collected from commissions in 1981.

There may be legal and constitutional considerations, however, to the concept of creating a class of sales representatives who do not pay the excise tax. Under the present law, section 237-1, Hawaii Revised Statutes, representative is defined, but since representatives pay the same 4 per cent tax rate as other occupations if the definition is not legally sufficient it makes little difference. Unlike insurance agents who are licensed and in a highly regulated business, sales representative are not licensed or in a regulated business.

General principles of constitutional law prohibit passing legislation granting special privileges for individuals and corporations.⁵ While there is

no specific wording in the State Constitution, the concept is contained in the Fourteenth Amendment of the U.S. Constitution which is binding on the State. This does not mean that special laws cannot be enacted to cope with special situations. It is a constitutional mandate, however, that laws of a general nature shall have a uniform operation throughout the state.⁶

A separate class can be created by legislation comprised of sales representatives provided there are reasonable grounds for the creation of that class. There are, however, several problems associated with creating such a separate class. They are:

- (1) Defining the sales representative with specificity,
- (2) Distinguishing sales representatives from others receiving commissions, and
- (3) Relating the exemption reasonably to the purpose of the legislation.

Generally, a sales representative is one who represents and sells a product for a manufacturer or producer and receives a commission figured on a percentage of the price of goods sold. Within the industry, however, there are many variations of business arrangements. If a sales representative is to be a special case in the whole field of marketing, there must be some reasonable way to distinguish the representative from other marketing persons before a separate class can be created without violating constitutional principles.

Several characteristics have been suggested. For instance, some representatives consider themselves ~~the intermediary person who shows the products and who does not have control of the price.~~ This possible definition, however, leaves out those who represent more sophisticated and costly products such as jewelry and solar water heaters. These representatives usually offer more services, for instance in the case of the water heater where the design for installation may be a part of the sale. Dealing with the ultimate consumer has no relationship to control over the

price. The legal reason for lack of control over the price is the fact that the sales representative does not own the goods which are sold and is considered an agent. There is no logical reason to distinguish between persons who sell goods, from those who sell services, advertising space, real estate, or tickets for an event.

Another characteristic suggested is that the sales representative cannot pass on the tax to the consumer. Actually this is more of a practical matter since the sales representative is not statutorily prohibited from such pass on as are the insurance agents and solicitors, taxicab drivers, and travel agents. The sales representative cannot pass on the tax due to economic and contractual reasons. The representative does not own the goods and only solicits orders for the manufacturer or producer. The price is set by the manufacturer or producer. Because the manufacturer or producer must be competitive nationally, the price is set according to the market and is the same for all buyers across the nation and in some cases, worldwide.

This, however, is true for all persons who receive a commission as compensation. Commission is defined in the dictionary as a sum or percentage allowed to an agent for services.⁷ For instance consider the case of a person who sells securities, stock, bonds, futures, or undivided interests in real estate. The commission is figured on the amount of the gross sales, and while the brokerage house collects the taxes on the transaction the salesperson does not include it in the compensation. This is true for real estate sales and also car sales.

As pointed out by the preceding discussion sales representatives do not fit into a precise definition. Neither does there seem to be a reasonable legal distinction between any of the sales people receiving commissions.

With regard to the final problem, there have been no suggestions for the relationship of the exemption to the purpose of such legislation. Legislation normally is enacted to take care of a special situation, but here, no special situation can be easily defined other than the inability to pass on the excise tax.

The most obvious difference between a sales representative and an insurance agent is the kind of product each sells and the nature of the work. A sales representative sells tangible goods. Insurance is considered in the nature of a financial plan or investment. The insurance agent must work with a client and assess financial worth and risk, and then, recommend different plans for insuring against certain risks. In the insurance profession, the insurance policy is called the product which will fit into a client's personalized financial plan.

The reduction in the excise tax for insurance agents and solicitors was passed after many attempts over a 16 year period. Some within the insurance industry felt they were really employees since some companies participate in the Social Security program and exert extensive control over the agents. The Legislature made a determination that the excise tax could not be passed on, due to laws passed by the legislature itself, that an inequity the legislature had created existed, and that the revenues that would be lost could be gained from raising the tax on the premiums to be paid by the insurance company.⁸ The premium tax increase was probably passed on to the consumer in the form of higher premiums.

There is very little similarity between the sales representative and the insurance agent or solicitor. For one thing, the product being sold is different. The industry that each works in is totally different. The insurance industry is highly regulated, down to the price that the underwriter can charge for the coverage. The manufacture and sale of consumer products is governed by the consumer market. The product and the way the product is sold is different for the two industries. Insurance agents receive training and have a formalized agreement with the company, which often offers office space. The sales representative has less formal arrangements. Sales quotas are understood as necessary to continue as a representative, whereas, for the insurance agent, more often such quotas are stated. While both occupations have sales as a common factor, and good sales techniques are probably universal, the fact remains that in addition to the insurance industry being highly regulated the agent statutorily is not allowed to pass on the general excise tax. Sales representatives have no such legal prohibition.

Reduction of the 4 Per Cent Excise Tax. This report has already discussed the legal and constitutional problems of creating a separate class of sales representatives. If those problems can be overcome, then reducing the excise tax for sales representatives can be considered as a possible alternative.

Sales representatives claim that the 4 per cent is inequitable because it is too great a tax burden for a small business to bear. An alternative amount suggested has been .5 per cent, as the sales representatives view themselves as intermediaries and not sellers to consumers. It is submitted that to find a reasonable amount, the general excise tax structure must be considered.

The general excise tax applies to all businesses. There are three different rate categories: 4 per cent, .5 per cent, and .15 per cent. The general excise tax is simple to administer because it makes few distinctions. Everyone pays at the 4 per cent rate unless they are exempt under the statute or pay at a different rate. Manufacturing, producing, and wholesaling activities are taxed at .5 per cent rate. The rationale for their reduced rates is that transactions preceding the sale to the ultimate consumer should enjoy a lower tax rate than the 4 per cent retail rate to ameliorate the pyramiding of taxes. The .15 per cent for insurance agents and solicitors was changed by legislative act to change an inequity the legislature itself created in the application of the excise tax on the insurance industry.

As can be seen by the tax structure, sales representatives are not necessarily at the intermediate stage of the sale to the consumer, although for economic purposes sales representatives fall at the same level as wholesalers. Neither sales representatives nor wholesalers sell to the final consumer since they furnish goods for resale to a consumer. While a reduced rate can be applied, there would have to be a finding by the legislature that the reduced rate was justified to correct some inequity. Such inequity has been suggested, that the 4 per cent is too much of a burden for a small business. Except as mentioned above, all small businesses in Hawaii pay at the 4 per cent rate, although the actual tax burden may vary from 4 per cent to .15 depending on their level in the tax structure and their ability to pass on the

tax. The inequity that exists for sales representatives is that their general excise tax burden is 4 per cent due to their inability to pass on the tax to their consumer which in this case is the manufacturer.

PART III. RECOMMENDATIONS

This review of the application of the general excise tax as it applies to the commissions on sales representatives leads us to set forth the comments regarding the excise tax found in the the 1968 Arthur D. Little report concerning the major structural deficiencies in the general excise tax:⁹

- (1) It distributes tax liabilities and burdens indiscriminately and capriciously.
- (2) It bears little relationship either to the income creating potential of business or the costs of providing public services to taxpaying businesses.
- (3) It presents a de facto investment tax on both new and expanding firms, a deficiency which is further accentuated by the tax's tendency to pyramid.

Except for reducing the general excise tax on manufacturers and wholesalers, few if any of the Little report's recommendations have been implemented. Thus, the Little comments regarding Hawaii's excise tax system are still relevant.

RECOMMENDATION: Make no change.

To quote the Little report again "[s]pecial consideration begets special consideration and administration inevitably become commensurately more complex and expensive."¹⁰ In the case of relieving the inequity involving the insurance agents the legislature relieved the agents from an inequity that the legislature itself created and reinforced. That is, the legislature levied the

general excise tax and then forbade insurance agents from passing on the tax. The Bureau's preferred recommendation concerning the taxation of insurance agents, and one which was made because it foresaw other occupations approaching the legislature in this area, was to allow insurance agents to pass on the tax. The legislature chose not to adopt that recommendation and instead gave insurance agents special consideration. Now sales representatives are approaching the legislature indicating that they are in the same position as insurance agents and they should also be granted special consideration. Sales representatives and other similar business people, however, are not in the same situation as insurance agents. Their inability to pass on the excise tax is due to economic or contractual constraints as opposed to statutory constraints. Furthermore, in the case of insurance agents there was a method of recovering the revenues lost by increasing the premium tax on insurance companies when the agents were given their tax relief. In the case of sales representatives no such direct possibility exists, except to increase the tax on manufacturers or others which, in turn, may increase the price consumers will pay due to tax pyramiding. An additional problem exists due to the inability to accurately predict the revenue losses incurred if the tax on sales representatives is reduced.

While it may be possible to define sales representatives with a great deal of specificity and to legislatively justify reducing the tax imposed on sales representatives thus classed, they are not the only occupation or persons unable to pass on the general excise tax. As discussed earlier directors of corporations pay a tax on the moneys received for services rendered. Such moneys are deemed by the department of taxation to be commissions. It also appears that most occupations that receive a flat fee for services (commissions) either on a industrywide basis or on an individual basis are not able to pass on the general excise tax. For example, in many instances real estate salespersons only receive a commission on the sales they negotiate. Unless their contract allows them to pass on the general excise tax, the tax must be paid out of gross commissions just as in the case of sales representatives. It appears to the Bureau that if the sales representatives were granted excise tax relief, the door would be opened to other persons

and occupations claiming to be in same situation as sales representatives asking for similar tax relief.

Furthermore, a tax is placed on a person or transaction to collect state revenues. The State allows those taxed to pass on the tax if they can do so. If the legislature is to concern itself with the varying tax burdens resulting from the method used to collect these revenues, the legislature possibly should review the whole state tax structure, particularly that of the general excise tax and the 1968 Arthur D. Little report which pointed out many inequities that still exist.

ALTERNATIVE: If excise tax relief is provided to sales representatives, it be provided to all others similarly situated.

In performing this study the Bureau found that sales representatives had an effective general excise tax burden of 4 per cent, while other occupations which are taxed at the 4 per cent rate are able to pass on the general excise tax and have an excise tax burden of .15 per cent.

The Bureau found, however, that in addition to sales representatives other occupations are involved which apparently cannot pass on the general excise tax. For example, real estate agents receive a flat commission and without changing their contract they cannot pass on the 4 per cent tax but must pay it out of their commission just as the sales representatives. Other occupations receiving flat commission due to economic or contractual reasons are also unable to pass on the general excise tax. Some persons do not choose to pass on the tax or do not show the tax in a billing presented to the client.

Sales representatives, unlike many others whose income is taxed as commissions, do not negotiate sales to the final consumer. They arrange for the sale of a product from a manufacturer to a wholesaler or retailer for further resale to a consumer. Unlike wholesalers who take greater economic risks by purchasing the goods they resell to a retailer, sales representatives

negotiate the sales transaction without actually purchasing the goods transferred. Since wholesalers own the goods they sell they can set the price and pass on the general excise tax of the proceeds of sale to the retailer. As a result the consumer may pay a pyramiding tax, the tax on the wholesaler which is passed on to the retailer and the tax on the retailer passed on to the consumer. This is the reason that a wholesaler only pays a general excise tax of .5 per cent, because of the tax pyramiding aspect of the transaction involved.¹¹ On the other hand, the sales representative cannot pass on the tax imposed on the commission, and no tax pyramiding occurs to increase the final price to the consumer. Thus, the wholesaler pays the general excise tax at a rate of .5 per cent because of a legislative desire to reduce pyramiding and decrease the final price to the consumer, not because of any desire to grant the wholesaler tax relief.

If the general excise tax on sales representatives and others similarly situated is reduced due to a contractual inability to pass on the general excise tax, it should be clear that such action would merely be to grant tax relief to the person and not for any broader economic or social purposes.

It would appear to the Bureau that if excise tax relief is to be granted to sales representatives, tax relief should be granted to all persons similarly situated who because of contractual reasons cannot pass on the general excise tax. These persons are caught in the capriciousness of the general excise tax. It appears that there are at least two types of persons who cannot pass on the tax (1) sales representatives and those similarly situated who negotiate sales to persons who resell to consumers, and (2) others such as real estate agents who negotiate sales directly to consumers or the final purchaser.

The question arises whether these two types of economic activities should be given the same tax relief, and if so, what reduction in tax rate should be made. If the .5 per cent rate is chosen for all persons paying a tax on commissions, then revenue losses for all such persons may be approximately \$9,683,773 based on 1981 revenues of \$11,067,169 from the general excise tax on commissions. If the reduction is to .15 per cent, the revenue loss would be greater. Lost revenues could be regained if necessary by raising the tax on other transactions such as sales by manufacturers. If the tax rate for

sales representatives only is reduced to .5 per cent, then \$500,000 in revenues may be involved based on estimates made by the representatives themselves. The Department of Taxation is unable to make any estimate of the revenue lost. One of the reviewers of a preliminary version of this study suggested that the Department of Taxation could alter its general excise tax reporting form to require individual listing of occupation when paying the general excise tax in order to determine revenues from that occupation.

In addition to the revenue losses due any tax rate reduction for the commissions, the problems of administering the excise tax would possibly increase. Many persons may claim they cannot pass on the general excise tax due to contractual reasons and therefore deserve to pay the reduced rate.

PART IV. CONCLUSIONS

The discussion in this report is the latest in a number of reviews of the general excise tax in this State.¹² The most comprehensive and constantly referred to is the Arthur D. Little report, *Hawaii's General Excise Tax: Prospects, Problems, and Prescriptions*.

The Little report contained an extensive discussion regarding the general excise taxation of business, interfirm transactions, and the sales by business to business. If the sales of a business to another business were placed in a separate category, then sales representatives would possibly fall within that category also, and good legal and equitable arguments could be made for a tax reduction for all persons falling within that category. Reduction of the general excise tax rate on such transactions, as Little suggested, to .5 per cent would result in a substantial loss of revenues, around \$69,000,000.¹³

The recommendations of the Little report in this area were disregarded, but the discussion in that report and its conclusion should serve as the conclusion to this report.¹⁴

The Department of Taxation, on the other hand, has taken the position that excise tax law may be construed to mean that sales of tangible property to service businesses are for final consumption and are therefore taxable at 4 per cent, thus giving rise to another tax of 4 per cent on the same property when the service business sells to

his customers. It holds that the rendering of services constitutes an indivisible transaction which ignores the transfer of title of the parts and supplies from a service business to his customer: in other words, it recognizes only the rendering of services per se. Thus, the double application of the tax.

* * *

What opponents of the Department of Taxation's policies appear to overlook is that a community decision has been made to employ a peculiar form of taxation that guarantees business activity a liberal dose of pyramiding. Legal argumentation tends to pale before such a mandate. In the absence of a strong body of administrative rulings and court decisions, one must turn to the general philosophy of multistage taxation and the excise law itself for guidance. The underlying philosophy of the law is "tax as much as possible." The law itself is essentially silent on what constitutes a service business.

* * *

If the community believes that such treatment of the service business or any other class of business activity is unfair and unnecessarily burdensome, then the law should be changed. But they should not attempt to see in the essence of a turnover tax reasons why "widget" dealers should be accorded special treatment while "finnegan pin" dealers are not. As we have indicated, such broad accommodations will prove costly and only engender additional rounds of special accommodations.

FOOTNOTES

CHAPTER 2

1. *Hawaii Rev. Stat.*, sec. 237-13.
2. Arthur D. Little, Inc., *Hawaii's General Excise Tax: Prospects, Problems and Prescriptions*, Report to State of Hawaii, Department of Taxation (1968), pp. 23-24.
3. Discussion of insurance field taken from Lester Ishado, *A Study of Hawaii's General Excise Tax on Commissions*, Legislative Reference Bureau, Request No. 0578-A (Honolulu: 1977).
4. *Government in Hawaii, A Handbook of Financial Statistics, 1979*, Tax Foundation of Hawaii (Honolulu: 1979), p. 15; *Ibid.*, 1981, p. 17; *Ibid.*, 1982, p. 17.
5. Figures furnished by Department of Commerce and Consumer Affairs, Insurance Division, September 1982.
6. Some agents have remarked however, that the increase in the premium tax had other effects. Some insurers raised the cost of the insurance policies. Some cut the amount of commissions that the sales agents and solicitors received. Less agents are offered training to sell insurance, and offices have merged. The insurers were determined that the consumer would indirectly pay for some of the increase in the premium tax.
7. *Government in Hawaii, A Handbook of Financial Statistics, 1979*, Tax Foundation of Hawaii (Honolulu: 1979), p. 15; *Ibid.*, 1981, p.17; *Ibid.*, 1982, p. 17.
8. The Department of Taxation provided the Office of the Legislative Reference Bureau with a list of 30 occupations which operate on a commission basis and which are subject to the general excise tax: (1) Advertising agencies, (2) Appliance salespersons, (3) Art galleries, (4) Automobile salespersons, (5) Barbers, (6) Book salespersons, (7) Catalog salespersons, (8) Cemetery plot salespersons, (9) Coin operated machines, (10) Collection agencies, (11) Encyclopedia salespersons, (12) Finders fees, (13) Fishers, (14) Fuller brush salespersons, (15) Hairdressers, (16) Home products salespersons, (17) Jewelry salespersons, (18) Magazine salespersons, (19) Manufacturer's representatives (sales representatives), (20) Mortuary salespersons, (21) Mutual fund salesperson, (22) Pre-cut home salespersons, (23) Real estate brokers, (24) Securities salespersons, (25) Shoe salespersons, (26) Taxi drivers, (27) Travel agents, (28) Vacuum cleaner salespersons, (29) Vinyl siding salespersons, (30) Wig and other hair-piece salespersons.
9. *State Tax Review*, April 6, 1982, v. 43, No. 14, pp. 1 and 5.

CHAPTER 3

1. *Hawaii Rev. Stat.*, sec. 237-3.
2. Lester Ishado, *A Study of Hawaii's General Excise Tax on Commissions*, Legislative Reference Bureau, Request No. 0578-A (Honolulu: 1977).
3. *Hawaii Rev. Stat.*, sec. 237-13.
4. *Hawaii Rev. Stat.*, sec. 235-51.

CHAPTER 4

1. *Government in Hawaii, A Handbook of Financial Statistics, 1979*, Tax Foundation of Hawaii (Honolulu: 1979), p. 15; *Ibid.*, 1981, p. 17; *Ibid.*, 1982, p. 17.
2. The Department of Taxation provided the Office of the Legislative Reference Bureau with a list of 30 occupations which operate on a commission basis and which are subject to the general excise tax: (1) Advertising agencies, (2) Appliance salespersons, (3) Art galleries, (4) Automobile salespersons, (5) Barbers, (6) Book salespersons, (7) Catalog salespersons, (8) Cemetery plot salespersons, (9) Coin operated machines, (10) Collection agencies, (11) Encyclopedia salespersons, (12) Finders fees, (13) Fishers, (14) Fuller brush salespersons, (15) Hairdressers, (16) Home products salespersons, (17) Jewelry salespersons, (18) Magazine salespersons, (19) Manufacturer's representatives (sales representatives), (20) Mortuary salespersons, (21) Mutual fund salesperson, (22) Pre-cut home salespersons, (23) Real estate brokers, (24) Securities salespersons, (25) Shoe salespersons, (26) Taxi drivers, (27) Travel agents, (28) Vacuum cleaner salespersons, (29) Vinyl siding salespersons, (30) Wig and other hair-piece salespersons.
3. Robert M. Kamins and Y. S. Leong, *Hawaii's General Excise Tax*, University of Hawaii, Legislative Reference Bureau, Report No. 2 (Honolulu: 1963) and Lester Ishado, *A Study of Hawaii's General Excise Tax on Commissions*, Legislative Reference Bureau, Request No. 0578-A (Honolulu: 1977).
4. Arthur D. Little, Inc., *Hawaii's General Excise Tax: Prospects, Problems and Prescriptions*, Report to State of Hawaii, Department of Taxation (1968).
5. 73 Am Jur. 2d, *Statutes*, sec. 38 et seq. (1974) The best illustration is from a case which was decided in Hawaii regarding Section 55 of the Organic Act, specifically prohibiting the granting of special or exclusive privileges, immunities, or franchises. While the Organic Act no longer governs the State, the case

explains the concept which is still legally sound:

Prohibition similar to that of Section 55 of the Organic Act is provided in most state constitutions in varied form. In some cases, the provision is in the form of a prohibition against special or local laws where a general law can be made applicable, or as sometimes expressed, where a general law could have been enacted, or that the operation of a general law shall not be suspended by the legislature for the benefit of individuals. Many state constitutions require that general laws have a uniform operation. [citations omitted]

It is also stated that such a constitutional prohibition supplements the equal protection clause of the Fourteenth Amendment; prohibits class legislation which does not operate equally and uniformly on all members of the class brought within its operation, or on all persons coming naturally within the class; and prevents enlargement of the rights of one person or more in discrimination against the rights of others. [citations omitted]

* * *

"In construing the meaning of the word 'privilege', as used in the constitution, the maxim, *noscitur a sociis*, is applicable. The prohibition is against granting special or exclusive 'privileges, immunities, or franchises.' The three terms are evidently all intended to refer to things of the same or similar general nature. An 'immunity' has been defined as an exemption from any charge, duty, office, tax, or imposition;...."

Koike et al. v. Board of Water Supply, 44 H. 100, 109-110, 352 P.2d 835 (1960).

6. Constitutional uniformity is secured where the law operates alike on all who come within the scope of its provisions, or upon every person, subject, or object within the relation or circumstances provided for, or upon all persons or things within a legitimate class to which, alone, the statute is addressed, or upon all the individuals of a class for which the legislature is authorized to make specific laws, or, in general, where the statute makes a reasonable classification....However, to be of a uniform operation, the law must be applied equally to like conditions and subjects, or to all classes similarly situated. A classification made by a statutory provision meets the constitutional requirement only where based upon something which distinguishes one class

from another in such a way as to suggest the reasonable necessity for legislation based upon such classification. (footnotes omitted) 73 Am Jur. 2d, *Statutes*, sec. 43 (1974).

7. *The Random House Dictionary of the English Language, College Edition*, (New York: 1969) p. 270.
8. 1978 *Hawaii Session Laws*, Act 144.
9. Little, p. 4.
10. Little, p. 21.
11. Kamins and Leong, p. 11.
12. Kamins and Leong; Little; and Lester Ishado, *A Study of Hawaii's General Excise Tax on Commission*, Legislative Reference Bureau, Request No. 0578-A (Honolulu: 1977).
13. See Tax Foundation of Hawaii testimony on S.B. No. 2165-82.
14. Little, pp. 23 to 24.

(To be made one and seven copies)

THE SENATE

ELEVENTH LEGISLATURE, 19 82

STATE OF HAWAII

S.R. NO. 88

SENATE RESOLUTION

REQUESTING A STUDY OF THE GENERAL EXCISE TAX ON SALES REPRESENTATIVES AND PURCHASING AGENTS.

WHEREAS, a general excise tax is a tax imposed on the gross proceeds of the seller and the tax is presently passed on to the buyer by some sellers and not by others; and

WHEREAS, under Hawaii's general excise tax law, sales representatives and purchasing agents are required to pay a four per cent general excise tax on their commissions and other compensation; and

WHEREAS, sales representatives and purchasing agents are individuals engaged in procuring orders for the sale of property between unlicensed sellers and retail establishments in the State; and

WHEREAS, these individuals act as liaisons between unlicensed sellers and retail establishments in the State, receive commissions and other compensation for their services, and are not involved in the retail sale of property in the State; and

WHEREAS, since sales representatives and purchasing agents are not directly involved in the retail sale of property in the State, it appears that the present application of a four per cent general excise tax (which is the rate applied to retailers) on their commissions and other compensation may be inequitable; and

WHEREAS, furthermore, it appears that sales representatives and purchasing agents, unlike all other individuals except insurance solicitors and agents subject to the general excise tax, are unable to pass on any portion of the general excise tax levied on their commissions and other compensation; and

WHEREAS, since the livelihood of these individuals depends entirely on commissions and other compensation and since it appears that these individuals are unable to pass on any portion of the general excise tax, many sales representatives and purchasing agents in the State have maintained that the application of a four per cent general excise tax on their sole

source of income is not only inequitable but also imposes a heavy tax burden on such individuals; and

WHEREAS, although sales representatives and purchasing agents have maintained that they are similar to insurance agents and solicitors (in that they both receive their incomes in the form of commissions and are also unable to effectively pass on the general excise tax) and therefore should be taxed at the 0.15 per cent general excise tax rate currently applied to insurance agents and solicitors, it is both timely and necessary that serious consideration be given to such matters as whether:

- (1) Under the general excise tax, sales representatives and purchasing agents should be taxed in the same manner as insurance agents and solicitors based on their similarities and ability to pass on the general excise tax;
- (2) It is appropriate to continue maintaining the 0.15 per cent general excise tax rate for insurance agents and solicitors; or
- (3) Another more appropriate general excise tax rate should be applied to each group;

and

WHEREAS, this body therefore finds that a study is urgently needed to ascertain the present treatment of sales representatives and purchasing agents under the general excise tax, including such concerns as whether such individuals are equitably treated under the general excise tax, whether and to what extent the present general excise tax rate should be reduced to promote the equitable tax treatment of these individuals, and if in fact such individuals are similar to insurance agents; now, therefore,

BE IT RESOLVED by the Senate of the Eleventh Legislature of the State of Hawaii, Regular Session of 1982, that the Office of the Legislative Reference Bureau with the cooperation and assistance of the Department of Taxation and sales representatives and purchasing agent industry officials is requested to conduct a study of the general excise tax on sales representatives and purchasing agents; and

BE IT FURTHER RESOLVED that the study include, but not be limited to, a discussion of the following topics:

- (1) The present tax treatment of sales representatives and purchasing agents under the general excise tax;
- (2) Whether any portion of the general excise tax imposed on sales representatives can legally be passed on;
- (3) Whether the present tax treatment of sales representatives and purchasing agents is equitable given the nature of their business and their legal ability to pass on the tax;
- (4) Whether and to what extent the general excise tax rate imposed on sales representatives and purchasing agents should be reduced to provide equitable treatment for such individuals under the general excise tax; and
- (5) The revenue impact of modifying the present tax treatment of sales representatives and purchasing agents;

and

BE IT FURTHER RESOLVED that the Director of the Office of the Legislative Reference Bureau report findings and recommendations to the legislature twenty days prior to the convening of the Regular Session of 1983; and

BE IT FURTHER RESOLVED that certified copies of this Resolution be transmitted to the Directors of the Office of the Legislative Reference Bureau and Taxation.

4/8/82

OFFERED BY:

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