myStateTaxOffice

A Washington National Tax Services (WNTS) Publication

July 20, 2012

Follow @twitter

Hawaii Department of Taxation rules that in-state affiliate's activities create nexus for out-of-state internet seller

Authored by: Kate Thurber

In brief

An in-state affiliate's activities created nexus in Hawaii for an out-of-state Internet retailer for Gross Excise Tax purposes. [Hawaii Department of Taxation, Letter Ruling 2012-10 (7/10/12)]

In detail

Background

Taxpayer is an Internet retailer with no physical presence in Hawaii. Taxpayer's affiliate operates eight retail stores in the state. Taxpayer and its in-state affiliate jointly promote a loyalty points program whereby the customers of each company receive points for purchases made either on the taxpayer's Internet site or at the affiliate's retail stores. The in-state affiliate also accepts returns of merchandise purchased on taxpayer's Internet site.

Sufficient Minimum Contacts Established Under Due Process Clause

Hawaii law imposes its general excise tax on sales of tangible personal property that originate outside the state where the place of delivery is in Hawaii and the seller has nexus. A retailer has nexus when its activity in Hawaii is sufficiently connected with the ability to establish or maintain a market for products in the state. In addition, under the Due Process Clause of the U.S. Constitution there must be "some definite link, some minimum connection between a state [Hawaii] and the person, property, or transaction."

In interpreting the minimum connection required under the Due Process Clause, the U.S. Supreme Court held that "the in-state presence of a representative of an out-of-state seller who conducts regular or systematic activities in furtherance of the seller's business, such as solicitation of sales or provision of services, creates nexus." *See Scripto, Inc. v. Carson,* 362 U.S. 207 (1960), et.al. In this ruling, the Department finds that the in-state activities of the taxpayer's affiliate, including the operation of the mutual merchandise exchange and loyalty points programs, were in furtherance of the taxpayer's business in the state and thus create nexus. In addition, while the Taxpayer itself does not have physical presence in Hawaii, the affiliate's brick and mortar stores establish physical presence through which the taxpayer has nexus.

The Department expressly adopts the position taken in the Multistate Tax Commission Nexus Program Bulletin No. 95-1 through Hawaii Tax Information Release 96-1. In this ruling, the "Affiliate's service of accepting returns and exchanges of merchandise purchased from Taxpayer's website, as well as the loyalty points program, benefits Taxpayer and aids in Taxpayer's establishment and maintenance of a Hawaii market."

The Department also cites the California Court of Appeals decision in *Borders Online, LLC v. State Board of Equalization,* 29 Cal. Rptr. 3d 176 (2005), in support of its ruling. In *Borders*, the court held that an affiliate's in-state physical presence and the online seller's return policy of allowing customers to make returns of online purchases to the affiliated brick-and-mortar retailers was sufficient to establish nexus.

Based on the above analysis, the Department concluded that "Affiliate, which has physical presence in Hawaii, is Taxpayer's in-state representative due to the mutual merchandise return program and loyalty points program. Because Taxpayer has an in-state, physically present representative, Taxpayer has nexus with the State." Consequently, taxpayer is subject to the gross excise tax on its Hawaii gross receipts.

Let's talk

If you have questions about nexus in Hawaii for out-of-state Internet retailers, please contact:

Joseph Motola
Director
(602) 364-8131
joseph.m.motola@us.pwc.com

For more information on PricewaterhouseCoopers' state legislative tracking service, click here.