LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

LATE TESTIMONY

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

HOUSE COMMITTEE ON TOURISM & CULTURE
TESTIMONY REGARDING HB 1585
RELATING TO THE TAXATION OF ONLINE TRAVEL COMPANIES

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 9, 2009
TIME: 8:30AM
ROOM: 312

This measure assesses the transient accommodations tax (TAT) and the general excise tax (GET) on online travel companies that facilitate hotel stays in Hawaii over the internet, to the extent of the online travel company's "markup" or portion of proceeds received.

The Department of Taxation (Department) takes **no position** on this measure.

I. ACTIVE LITIGATION THROUGHOUT THE COUNTRY ON ONLINE TRAVEL COMPANY MARKUPS.

Throughout the country, there is active litigation being pursued by local governments seeking to collect unassessed and unpaid hotel or "bed" taxes by companies that facilitate hotel or other transient accommodations online. Online travel companies dispute being liable for hotel or bed taxes based upon the theory that the online travel company does not provide the actual hotel room, but rather the hotel itself provides the room and is therefore liable for any commensurate taxes.

Based upon a review of current cases and literature in the area, the arguments from online travel companies stem mainly from plain readings of various hotel or bed tax statutes, which were written before the advent of online travel facilitation. Hence, many of the local statutes being litigated appear unclear whether they rightfully apply in certain online travel company cases. The dispute about taxes stems from the taxation of the "markup," or the difference between what a hotel charges the online travel company for the resale of a room and what the online travel company charges a customer at retail. The difference or "markup," apparently goes untaxed in many states because the laws were not equipped to handle third-party reselling, such as through online travel companies.

II. HAWAII'S TAXATION OF HOTELS.

The purpose of Hawaii's taxation of the hotel industry was to levy a tax on the amount of money for which a room is rented. Where third parties become involved in facilitating the rental of the room, depending upon the means by which the room is rented through the third party, the state may be losing out on taxing the retail rate of the hotel room rented in the State. Hawaii law assesses the TAT on the person "actually furnishing" transient accommodations. Whether an online travel company is actually furnishing a hotel room is disputable.

This measure would clarify the definition of "furnish" to include the online facilitating through whatever means. This expanded definition would reach online travel companies.

III. CAUTION MUST BE CONSIDERED WITH CURRENT STATE OF TOURISM INDUSTRY.

As a state whose economy is greatly dependent upon the tourism industry and the taxes on that industry to sustain tourism-related and state funded advertising, entertainment, and other tourism programs, Hawaii should be cautious when considering policies to extend its taxes to the online travel industry. The concern relates to possibly making Hawaii a more expensive destination during a time when tourism has slowed. However, simultaneously, as defenders of the general fund, the Department should ensure that it is not being undercut on what it should rightfully collect due to outdated laws and other developments in the industry.

IV. IMPORTANT NEXUS STANDARD

Currently, the state of the law with regard to taxing out-of-state entities has expanded greatly to include the concept of economic nexus. In short, before a state can constitutionally tax an out-of-state entity, the entity must have certain minimum contacts (substantial nexus) with the taxing entity. Substantial nexus used to only include physical presence. However, two state tax law cases in recent years upheld the concept of "economic nexus," which allowed taxation based upon a certain number of customers or sales. One of the important features of economic nexus was that the administrative burden of paying the taxes had to be relatively low, such as annual filing versus monthly filing.

This legislation adopts a nexus standard proved constitutional in other states when applied to other taxes. Also, this measure allows online travel companies with little nexus to Hawaii to petition the Director of Taxation to make a return and remit taxes on a basis that will meet constitutional thresholds for good cause. The Department supports these provisions.

V. **REVENUE IMPACT**

The bill results in the following revenue gains—

General Fund: $6.4 million per year.

Tourism Special Fund: $3.7 million per year

Convention Center Special Fund: $1.9 million per year.