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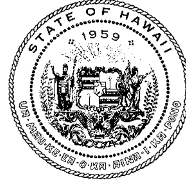

STATE OF HAWAII
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To: The Honorable David Y. Ige, Chair
and Members of the Senate Committee on Ways and Means

Date: Friday, March 28, 2014
Time: 9:15 a.m.
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: H.B. 1900, H.D. 1, S.D. 1, Relating to the Taxation of Destination Clubs

The Department of Taxation (Department) strongly **opposes** H.B. 1900, H.D. 1, S.D. 1, and offers the following concerns and comments for the Committee's consideration.

H.B. 1900, H.D. 1, S.D. 1, amends TAT law by creating a specially defined class of taxpayer known as "destination club membership plan" and imposing tax at the rate of 7.25% of the fair market rental value of occupied units in Hawaii. The Department also has concerns regarding its ability to implement this lower tax rate retroactively to January 1, 2014. The S.D. 1 has a defective effective date of July 1, 2030.

The Department has serious concerns about this measure, as it creates potentially preferential tax treatment for a specific type of business, whose operations do not vary substantively from other transient accommodations operators. As a result, this measure contains the potential to significantly erode the State's Transient Accommodations Tax (TAT) base.

Specifically, the definition of "destination club membership plan" is overly broad and would arguably apply to a broad swath of transient accommodations operators who are running business models in which the participants do not have an ownership interest in the accommodations, such as hotels. This definition would provide different tax treatment for "destination club membership plan" taxpayers, who are conducting operations that are substantially similar to other taxpayers in the State who would remain subject to the TAT rate of 9.25%.

Under chapter 237D, Hawaii Revised Statutes (HRS), the TAT is currently imposed at a rate of 9.25% on gross rental or gross rental proceeds received in exchange for furnishing a transient accommodation. Destination club membership plans, as defined in this bill, are clearly furnishing transient accommodations in exchange for gross rental proceeds. Under current law, in the case of a destination club membership plan where a member pays a membership fee and is

furnished a unit in Hawaii, the gross rental proceeds would be equal to the amount of the member's membership fee allocable to the Hawaii stay. In other words, under current law, the TAT is imposed on destination club membership plans at a rate of 9.25% on the annual destination club dues apportioned to the State. This measure instead proposes to apply the tax at a rate of 7.25% of the fair market rental value of the occupied units.

It is important to note that the imposition of the 7.25% rate is on the use of resort timeshare vacation units which are currently regulated under Hawaii's Time Sharing Plans law codified in chapter 514E, HRS. However, on April 24, 2013, the Intermediate Court of Appeals, Third Circuit, determined that the destination club at issue was not a time share plan covered under chapter 514E, HRS. S.D. 1 ignores the Intermediate Court of Appeals opinion and provides preferential tax treatment over timeshares by imposing the 7.25% rate on destination clubs even though they are not regulated under chapter 514E, HRS. In addition, S.D. 1 provides preferential treatment for destination clubs over other similar furnishers of transient accommodations which are taxed at the 9.25% rate by imposing a lower rate.

If this measure were to pass as written, any hotel could potentially begin styling itself as a "destination club membership plan" by structuring its income from certain occupants in the form of annual membership dues rather than traditional rental transactions, and immediately be subject to a 2% lower tax rate as a result. The Department has serious concerns regarding the potential impact of this measure to significantly erode the TAT base.

Finally, the Department has serious concerns about its ability to administer this new and separate tax category retroactively, due to the limitations of our current computer system. A significant amount of work would be required to modify the form and instructions. Additionally, as the Legislature is aware, the Department is ready to embark on the development of a new computer system. With much of the Department's resources focused on the development of a new computer system, the Department is unable to implement the necessary form and instruction changes for a new category of transient accommodations tax retroactively to January 1, 2014. If the Legislature were to pass this measure, the Department suggests that the measure be effective for taxable years beginning after December 31, 2014.

Thank you for the opportunity to provide comments.

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March 25, 2014

Honorable David Ige, Chair
Honorable Michelle N. Kidani, Vice Chair
Members of the Senate Committee on Ways and Means
State Senate
Twenty-Seventh Legislature
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: H.B. No. 1900, House Draft 1, Senate Draft 1, Relating to Taxation

Decision Making on March 28, 2014, 9:15 a.m.

Conference Room 211

Dear Chair Ige, Vice Chair Kidani, and Committee Members:

We represent Exclusive Resorts, a Destination Club, the owner of real property at Pauoa Beach, Mauna Lani, Hawai'i island. We respectfully submit the following written testimony in support of, but proposing amendments to, House Bill No. 1900, House Draft 1, Senate Draft 1 relating to the taxation of destination clubs, which is to be heard by your Committee on Tourism on March 28, 2014, at 9:15 a.m.

The purpose of this bill is to provide for the taxation of destination clubs. Destination clubs, like Exclusive Resorts, have a fundamentally unique business model. Destination clubs own various properties in multiple states and/or countries, including in Hawai'i. Destination clubs provide their members, who pay membership dues, with the right to use or occupy the destination club's facilities in the various locations, but members do not own any interest in those facilities, nor do they pay maintenance fees or nightly room rates.

For that and other reasons, The Hawai'i Intermediate Court of Appeals recently ruled that destination clubs are not time share plans as defined in Chapter 514E, Hawai'i Revised Statutes ("HRS"). *See Roaring Lion, LLC, et al., v. Exclusive Resorts PBLII, LLC, et al.*, No. CAAP-11-0001072, Intermediate Court of Appeals, Memorandum Opinion, April 24, 2013.

Accordingly, although destination clubs are subject to the Hawai'i general excise tax under Chapter 237, HRS, destination clubs would not be subject to the transient accommodations tax ("TAT") imposed upon time shares under Chapter 237D, HRS, because the definition of

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resort time share vacation plan in Section 237D-1, HRS, is tied to the regulation of time shares under Chapter 514E, HRS.

House Bill No. 1900, House Draft 1, Senate Draft 1, proposes that destination clubs be taxed in the same manner as time share plans, *i.e.*, based on fair rental value, as calculated on the basis of gross daily maintenance fees. However, as noted, the Hawai'i Intermediate Court of Appeals recently ruled that destination clubs are not time share plans as defined in chapter 514E, HRS. Moreover, trying to include destinations clubs within the transient accommodations tax on time share plans based on fair market rental value, which in turn is calculated on the basis of gross daily maintenance fees, simply does not work, because destination clubs do not charge their members any maintenance fees. Thus, House Bill No. 1900, House Draft 1, Senate Draft 1, could result in no transient accommodations tax being paid because gross daily maintenance fees generally are not charged by destination clubs.

For the foregoing reasons, we respectfully submit that, as proposed in the original version of House Bill No. 1900, a transient accommodations tax based on the apportioned annual membership dues would provide a reasonable basis for taxation that is consistent with the structure of destination clubs. Specifically, the proposed annual tax would be seven per cent on thirty per cent of the annual destination club dues apportioned to the State.[1]

For the foregoing reasons, we strongly support House Bill 1900, but in its original form.

We note that we are planning to meet with the Department of Taxation on March 27, 2014, and we are open to discussions with the Department on formulating an exact taxing mechanism. Thank you for your consideration of the foregoing.

Very truly yours,

McCorriston Miller Mukai MacKinnon LLP

Robert G. Klein
Peter J. Hamasaki

[1] The rationale for charging the tax only on a portion of the annual dues apportioned to the State is that destination clubs provide many other services besides accommodations to their members, such as priority access to restaurant reservations, golf clubs, spa treatments, special status with airlines and car rental agencies, travel arrangements, private jets, yachts, concierges, housekeeping and private services

L E G I S L A T I V E

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SUBJECT: TRANSIENT ACCOMMODATIONS, Taxation of destination clubs

BILL NUMBER: HB 1900, SD-1

INTRODUCED BY: Senate Committee on Tourism

EXECUTIVE SUMMARY: This measure proposes to tax "destination clubs" under the transient accommodations tax at the rate of 7.25% on their fair market rental value by imposing the tax on the destination club manager for each of its units occupied per month. To be consistent with the rest of the TAT, HRS section 237D-1 should be amended to exclude amenities that the TAT does not now tax.

BRIEF SUMMARY: Amends HRS section 237D-2 to provide that the transient accommodations tax (TAT) at the rate of 7.25% shall be imposed on the destination club plan manager for each of its Hawaii destination club units occupied each month based on their fair market rental value. Amends section 237D-1 to define fair market rental value as including services included with the unit, including but not limited to laundry, transportation, and food services.

Requires each destination club membership plan to be represented by a destination club plan manager who shall be subject to the TAT. Requires the plan manager to register and make a one-time payment of $15 for each vacation club membership plan operating within the state. Requires a plan manager for a destination club membership plan that began operating in the state prior to October 1, 2014, to register no later than December 31, 2014.

Defines "destination club membership plan" as any plan, subject to terms and conditions of a membership agreement, that is not registered under HRS chapter 514E, in which members have no ownership interest in destination club units, but in which members pay annual membership dues in exchange for club benefits including the right to use or occupy one of several destination club units, with locations inside and outside of Hawaii. Further defines "destination club membership plan manager" and "destination club unit" for purposes of the measure.

The tax on destination clubs shall take effect retroactive to January 1, 2014.

EFFECTIVE DATE: July 1, 2030 (retroactive to January 1, 2014)

STAFF COMMENTS: The Hawaii Intermediate Court of Appeals has determined that destination clubs are not considered a time share plan under HRS Chapter 514E. Therefore, they are not subject to the "transient occupancy tax" (TOT) under HRS section 237D-2(c) that is normally imposed upon time shares. It appears that this measure is proposed to subject destination clubs to the TOT. Apparently the department of taxation had been litigating with the clubs on applicability of the TOT and reached a settlement that expires this year.

It was pointed out that destination clubs have a fundamentally unique business model. Destination clubs own various properties in multiple states and countries. Membership dues allow a member the right to use or occupy the destination clubs' facilities in the various locations without any ownership interest in any of the facilities. That is why the Hawaii Intermediate Court of Appeals recently ruled that destination clubs are not time share plans in *Roaring Lion, LLC, et al., v. Exclusive Resorts PBLI1, LLC,* No. CAAP-11-0001072, Intermediate Court of Appeals, Memorandum Opinion, April 24, 2013.

Destination clubs appear to be another way in which transient residents can secure temporary lodging in Hawaii. The principal difference from timesharing is that the destination club member does not own Hawaii real estate or a temporal interest in it, but instead has either stock in or some kind of contractual arrangement with the destination club that then owns or leases the realty. The adoption of this measure would subject destination club rentals to the TAT on par with other types of transient lodging.

The measure proposes to expand the definition of "fair market rental value" to include laundry, transportation, and food services. This part is not consistent with the remainder of the TAT, as the Department of Taxation's rules have consistently provided that the TAT does not tax charges for guest amenities, including meals, beverages, telephone calls, and laundry. Hawaii Admin. Rules section 18-237D-1-03(c). Instead of the present last sentence of this definition, we recommend something like the following:

> "In addition to living accommodations, furniture, and fixtures, fair market rental value includes services included with the unit, including maid and front desk services."

Digested 3/27/14