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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Tuesday, February 25, 2014
Time: 11:15 A.M.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

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

The Department of Taxation (Department) appreciates the intent of H.B1900 to clarify that certain taxpayers owe transient accommodations tax. However, the Department has serious concerns about this measure, as it creates new and separate tax treatment for a specific business model and contains the potential to significantly erode the State's Transient Accommodations Tax (TAT) base.

H.B. 1900 amends TAT law by carving out a specially defined class of taxpayer known as "destination clubs" and imposing the tax at a rate of 7.0% on thirty percent of annual destination club dues apportioned to the State. The Department offers the following concerns and comments for the Committee's consideration.

First, the definition of "destination club" 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. Further, this definition would provide preferential tax treatment for this group of taxpayers who are conducting substantially similar operations as compared to other taxpayers in the State who would remain subject to the tax at the 9.25% rate.

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 clubs are clearly furnishing transient accommodations in exchange for gross rental proceeds. Under current law, in the case of a destination club 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 clubs at a rate of 9.25% on one hundred percent of the sum of annual destination club dues apportioned to the State for the nights the Hawaii. The measure, as written, applies the tax to only 7% of thirty percent of the annual destination club dues. The measure arguably also exempts any gross rental proceeds a destination club receives in transactions separate from the receipt of membership fees, such as a nightly fee specific to the Hawaii unit, should a destination club choose to impose such a fee.

The Department does, however, note that this measure's language would provide a more reliable and easily determinable stream of income to the State in that it would impose the tax once yearly on an allocated portion of membership dues. Under current law the TAT is imposed only on the gross rental proceeds received in exchange for furnishing units on night-to-night basis, so TAT is not collected on nights where units are not rented out.

If the Committee wishes to move forward with this measure, the Department proposes the following alternative formula for taxing such entities. To ensure that the tax treatment of destination is consistent with other transient accommodations operators, proposed section 237D-2(e) should be amended as follows:

> (e) There is levied and shall be assessed and collected each month a tax of 9.25 per cent on the amount resulting from the following operation: 100 per cent of the annual destination club dues apportioned to the unit located in the State, divided by 365, the result of which is then multiplied by the number of nights the accommodation is occupied. The tax of 9.25 per cent shall also be levied and assessed on any additional amounts received by the destination club related to occupancy of the accommodation.

If this measure were to pass as written, any hotel or timeshare could potentially begin styling itself as a "destination club" to avoid the imposition of TAT. The Department has serious concerns regarding the potential to significantly erode the TAT base.

Thank you for the opportunity to provide comments.

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

INTRODUCED BY: Tsuji, Choy, Creagan, Nakashima, Yamashita

BRIEF SUMMARY: Amends HRS section 237D-2 to provide for the imposition of an annual tax of 7% on 30% of the annual destination club dues apportioned to the state. Requires each destination club membership plan to be represented by a destination club plan manager who shall be responsible to pay the tax imposed by this section. Requires the vacation club plan manager to register and make a one-time payment of $15 for each vacation club membership plan operating within the state. Requires a destination club membership 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 "annual destination club dues apportioned to the state" as the gross receipts, cash or accrued, of the taxpayer received in the form of annual membership dues collected under a destination club membership plan as reasonably apportioned to the state on the taxpayer's Hawaii income tax return. Defines "destination club membership plan" as any plan, subject to terms and conditions of a membership agreement, 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. Amends the definitions of "resort time share vacation plan" and "transient accommodations" to exclude a vacation club unit.

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

EFFECTIVE DATE: October 1, 2014 (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.

This measure proposes a new set of provisions within HRS Chapter 237D, that deal exclusively with destination clubs. The tax proposed is 7% of 30% of destination club dues apportioned to Hawaii. However, destination clubs appear to be another way in which transient residents can secure temporary lodging in Hawaii, the principal difference from timesharing being 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. That being the case, it may be better to amend the existing TOT HRS section 237D-2(c), to pick up destination clubs rather than inventing an entirely new methodology applicable only to destination clubs. For example:

(c) There is levied and shall be assessed and collected each month on the occupant of a resort time share vacation unit, and upon the destination club plan manager for each Hawaii unit occupied during the month, a transient accommodations tax of 7.25 per cent on the fair market rental value.

It would then be up to the destination clubs and the department to agree upon acceptable valuation methodologies using the "fair market value" definition in HRS section 237D-1.

Digested 2/23/14