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To: The Honorable Gilbert Kahele, Chair
and Members of the Senate Committee on Tourism

Date: Monday, March 17, 2014
Time: 2:45 P.M.
Place: Conference Room 229, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

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

The Department of Taxation (Department) appreciates the intent of H.B. 1900, H.D. 1, 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. The Department also has concerns regarding its ability to implement the new and separate tax treatment retroactively to January 1, 2014.

H.B. 1900, H.D. 1, amends TAT law by carving out a specially defined class of taxpayer known as "destination clubs" and imposing the tax at an unspecified rate 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 different tax treatment for this group of 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 clubs, 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 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 in Hawaii. This measure, as written, applies the tax at an unspecified rate on only 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 in addition to annual dues.

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 create a new and separate category for destination club businesses, the Department proposes the following alternative formula for taxing such entities, to ensure that the tax treatment of destination clubs is consistent with other transient accommodations operators. Proposed section 237D-2(e) should be amended to read 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.

The Department notes that 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.

Finally, the Department has serious concerns about its ability to administer the a new and separate 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.

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, HD-1

INTRODUCED BY: House Committee on Finance

EXECUTIVE SUMMARY: This measure proposes to tax "destination clubs" under the transient accommodations tax at a now unspecified percentage of apportioned destination club dues. Because the method of apportionment remains a mystery, we think it may be proper to consider an alternative approach such as amending HRS section 237D-2© to include destination clubs as well as time shares, as 237D-2© imposes the tax based on occupancy of a transient unit.

BRIEF SUMMARY: Amends HRS section 237D-2 to provide for the imposition of an annual tax of ___% 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: 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© 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 a percentage of destination club dues apportioned to Hawaii. However, there is no standard proposed as to how such dues are to be apportioned. For income tax purposes, apportionment is accomplished by determining property, payroll, and sales ratios and multiplying overall net income by the average of those three. General excise tax apportionment is generally done by cost ratio under HRS section 237-21. The bill does not specify which of these four methodologies, if any, would be appropriately applied to the dues.

Perhaps the transient occupancy tax in 237D-2(c) should be revisited. 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 3/16/14

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March 14, 2014

Honorable Gilbert Kahele, Chair
Honorable Gilbert Keith-Agaran, Vice Chair
Members of the Senate Committee on Tourism
State Senate
Twenty-Seventh Legislature
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: H.B. No. 1900

Hearing on March 17, 2014, 2:45 p.m.

Conference Room 229

Dear Chair Kahele, Vice Chair Agaran, 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 House Bill No. 1900, relating to the taxation of destination clubs, which is to be heard by your Committee on Tourism on March 17, 2014, at 2:45 p.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.

This bill will ensure that destination clubs that own facilities in Hawai'i will be subject to the transient accommodations tax under Chapter 237D, HRS, in a fair and equitable manner based on members' dues apportioned to the State of Hawai'i. Specifically, this bill creates a separate category for destination clubs under Chapter 237D, HRS, and imposes the transient accommodations tax upon destination clubs in an equitable manner that takes into account destination clubs' unique business model and extra-jurisdictional operations.

For the foregoing reasons, we strongly support House Bill 1900, but are open to discussions with the DOT on formulating an exact taxing mechanism. Thank you for your consideration of the foregoing.

Very truly yours,

MCCORRISTON MILLER MUKAI MACKINNON LLP

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