

SB2774

Measure Title: RELATING TO THE TAXATION OF DESTINATION CLUBS.
Report Title: Destination Club Membership Plan; Taxation
Description: Establishes a tax on annual destination club dues apportioned to the State. Requires destination club membership plan managers to register with the department of taxation and keep records of annual destination club dues apportioned to the State.

TESTIFIERS LIST

- Fred Pablo, Dept. of Taxation, *COMMENTS*
- Thomas Yamachika, Tax Foundation of HI, *COMMENTS*
- Robert G. Klein, Exclusive Resorts, *SUPPORT*

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

Date: Monday, February 10, 2014
Time: 3:00 P.M.
Place: Conference Room 229, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. 2774, Relating to the Taxation of Destination Clubs

The Department of Taxation (Department) appreciates the intent of S.B. 2774 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.

S.B. 2774 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.

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 then pays an additional fee to rent a unit in Hawaii, the gross rental proceeds would be equal to the amount paid for the unit plus 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 unit is occupied plus fees specific to renting the unit in Hawaii. The measure, as written, applies the tax to only 7% of thirty percent of the annual destination club dues and no tax on the amount paid specifically for the Hawaii unit.

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 clubs 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 in exchange for furnishing the accommodation.

If this measure were to pass as written, many hotels and timeshares could potentially begin styling themselves as "destination clubs" 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.

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SUBJECT: TRANSIENT ACCOMMODATIONS, Taxation of destination clubs

BILL NUMBER: SB 2774; HB 1900 (Identical)

INTRODUCED BY: SB by Dela Cruz, Kahele, Kidani, Solomon; HB 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: This measure apparently is being proposed because there is concern that the existing transient occupancy tax imposed by HRS section 237D-2(e) does not produce a fair result for this type of accommodation. The existing tax is imposed at 7.25% (not 9.25%) on “fair market rental value,” which generally is half of the gross daily maintenance fees that are paid by the owner, “unless the taxpayer proves or the director determines that the gross daily maintenance fees do not fairly represent fair market rental value taking into account comparable transient accommodation rentals or other appraisal methods.”

Although destination clubs are not technically timeshare properties in that club members do not acquire an interest in Hawaii realty or a right to use Hawaii realty, the transient occupancy tax should apply because, however the club is organized, there still are transient vacation rental units in Hawaii, they are being occupied by people, and the units are owned by some person or entity who thereby has nexus with

the state and should pay the tax. If one or more of these clubs is trying to hide behind some technicality to say that the tax doesn't apply, then the technicality is what needs to be addressed. If the issue can be solved with an administrative fix, such as by promulgating some methodology to value such units other than the half of daily maintenance fee system, then no new tax needs to be enacted. If there are other real impediments to applying the tax to destination clubs, then the proper solution is to address those impediments or technicalities, and not enact a new tax that is imposed on top of the existing ones.

Digested 1/30/14

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February 10, 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: **S.B. No. 2774**

Hearing on February 10, 2014, 3:00 p.m.

Conference Room 229

Dear Chair Kahele, Vice Chair Agaran, and Committee Members:

I represent Exclusive Resorts, a Destination Club, the owner of real property in Hawai'i. I respectfully submit the following written testimony in support of Senate Bill No. 2774, relating to the taxation of destination clubs, which is to be heard by your Committee on Tourism on February 10, 2014, at 3:00 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.

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 imposed upon time shares under Chapter 237D, HRS, because the definition of resort time

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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. 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 Senate Bill 2774. Thank you for your consideration of the foregoing.

Very truly yours,

MCCORRISTON MILLER MUKAI MACKINNON LLP

Robert G. Klein