



**STATE OF HAWAII
DEPARTMENT OF TAXATION**

830 PUNCHBOWL STREET, ROOM 221

HONOLULU, HAWAII 96813

<http://tax.hawaii.gov/>

Phone: (808) 587-1540 / Fax: (808) 587-1560

Email: Tax.Directors.Office@hawaii.gov

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

Date: Friday, February 23, 2018

Time: 12:00 P.M.

Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2008, H.D. 1, Relating to Taxation

The Department of Taxation (Department) supports the intent of H.B. 2008, H.D. 1, and offers the following comments for the Committee's consideration.

H.B. 2008, H.D. 1, requires travel agencies and tour packagers to obtain a certificate of registration under chapter 237D of the Hawaii Revised Statutes (HRS) if they enter into arrangements to furnish transient accommodations at noncommissioned negotiated contract rates. Additionally, the bill imposes the transient accommodations tax (TAT) on all travel agencies and tour packagers licensed under chapter 237D and specifies that when transient accommodations are booked at noncommissioned negotiated contract rates, the TAT will be imposed on each person's share of the proceeds. The bill is effective on July 1, 2018 and applies to taxable years beginning after December 31, 2018.

Background

Under current law, the imposition of the TAT on transient accommodations sold through a travel agency or tour packager varies depending on whether the transaction was on a commissioned or noncommissioned basis. In Travelocity.com, L.P. v. Director of Taxation, 135 Hawaii 88 (2015), the Hawaii Supreme Court explained that a "commission" is a "fee paid to an agent or employee for a particular transaction, usually as a percentage of the money received by the transaction." Travelocity, 135 Hawaii at 111 (quoting Black's Law Dictionary 327 (10th ed. 2014) (internal quotations omitted)). The court further explained that a "noncommissioned rate" is "an amount of money paid to an entity or person other than an agent or an employee." Travelocity, 135 Hawaii at 111. The court clarified that unlike a commissioned transaction, in which a fee is usually paid as a percentage of the income received, in a noncommissioned transaction, a hotel has no means of knowing what the travel agent's mark-up will be. Id. In

sum, when a hotel pays a travel agent for a room on a commission basis, the room rate is readily definable, but in a noncommissioned transaction, the hotel has no means of knowing the travel agent’s markup and actual room rate. Id.

When transient accommodations are furnished through arrangements made by a travel agency or tour packager at noncommissioned negotiated contract rates, the TAT is imposed solely on the operator on its share of the proceeds. There is no tax imposed on the travel agency's or tour packager's share of proceeds. In comparison, when transient accommodations are furnished through a travel agency or tour packager on a commissioned basis, the TAT is imposed on the gross proceeds of the operator, including the commission paid to the travel agency or tour packager. Similarly, when transient accommodations are sold directly by the operator, the TAT is imposed on the gross proceeds of the operator. Accordingly, the TAT imposed on a unit will differ depending on whether the unit was sold directly by the operator, sold by a travel agent or tour packager on a commissioned basis, or sold by a travel agent or tour packager on a noncommissioned basis.

For example, if a room is sold for \$100 to a guest directly by a hotel, the hotel will owe \$10.25 in TAT (10.25 percent of \$100). Similarly, if a room is sold for \$100 by a travel agency who earns a \$20 commission on the transaction, the hotel will owe \$10.25 in TAT (10.25 percent of \$100). If, however, the same room is sold for \$100 by an online travel company (OTC) who has a noncommissioned agreement with the hotel and keeps \$20 from the transaction, the hotel will owe \$8.20 in TAT (10.25 percent of \$80); the \$20 kept by the OTC is not subject to TAT. These concepts are illustrated in the following table:

Type of Transaction	Amount Paid by Guest	Amount Kept by Travel Agency	Amount Kept by Operator	TAT Base	TAT Due
Direct sale by hotel	\$100	\$0	\$100	\$100	\$10.25
Sold by travel agent on commissioned basis	\$100	\$20	\$80	\$100	\$10.25
Sold by travel agent on noncommissioned basis	\$100	\$20	\$80	\$80	\$8.20

Comments

The Department appreciates that its proposed amendments were adopted by the House Committee on Tourism. The Department notes, however, that in Section 4 of the bill, a comma has been omitted after the word “operator,” which could be interpreted as only requiring operators who enter into arrangements to furnish transient accommodations at noncommissioned rates to be subject to the TAT. The imposition of TAT should apply to (1) all operators regardless of whether there is a direct sale, commissioned sale, or noncommissioned sale and (2) travel agents and tour packagers, but only when the sale is made at noncommissioned rates. In

lieu of adding a comma after the word “operator,” and to avoid any confusion, the Department suggests the following clarifying amendment:

Every [~~operator and every~~] travel agency or tour packager who arranges transient accommodations at noncommissioned negotiated contract rates[~~7~~] and every operator shall pay to the State the tax imposed by subsection (a), as provided in this chapter.

Finally, the Department notes that is able to administer this measure with its current effective date. Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: TRANSIENT ACCOMMODATIONS; Attach Liability to Intermediary

BILL NUMBER: HB 2008, HD-1

INTRODUCED BY: House Committee on Tourism

EXECUTIVE SUMMARY: Imposes registration requirements and transient accommodations tax on travel agencies and tour packagers that enter into arrangements to furnish transient accommodations at noncommissioned negotiated contract rates on their share of the proceeds. Such agencies and packagers would then be required to pay TAT on their share of the proceeds. It is questionable whether such a registration requirement is enforceable against an agency or packager with no presence in Hawaii. Also, as a practical matter, trying to expand the tax base in such a manner may have the unintended effect of discouraging those who would like to bring tourists to Hawaii and take care of them here.

SYNOPSIS: Adds a new section to chapter 237D, HRS, requiring any travel agency or tour packager entering into an arrangement to furnish transient accommodations at noncommissioned negotiated contract rates to register with the department of taxation.

Amends the definition of “gross rental” in section 237D-1, HRS, to clarify that compensation for entering into arrangements to furnish transient accommodations is also taxable.

Amends section 237D-2, HRS, to impose tax on travel agencies or tour packagers registered under the above provisions.

EFFECTIVE DATE: July 1, 2018, applies to taxable years beginning after December 31, 2018.

STAFF COMMENTS: This bill appears to be a reaction to the Hawai’i Supreme Court’s decision *In re Travelocity.com, L.P.*, 135 Haw. 88, 346 P.3d 157 (2015). The Travelocity case dealt with hotel rooms provided under a “merchant model.” To illustrate what this model is and what the case held, suppose a hotelier wants to rent out a short-term rental for \$110. An online travel company (OTC) contracts to rent the room for \$100, at which point it becomes the OTC’s obligation to pay the \$100 whether or not the OTC is able to find a tourist to put in the room. If the OTC is successful in finding a tourist, suppose the OTC charges the tourist \$120 (something the hotelier wouldn’t know and isn’t told).

In this situation, the Department of Taxation assessed the OTC for TAT and GET on the \$120, although the hotelier was paying TAT and GET on the \$100. Our supreme court held that the OTC was not a hotel operator and was not liable for the TAT. The court also held that the OTC was subject to the GET, but that the room was provided at noncommissioned negotiated contract rates, triggering an “income splitting” provision providing that each of the parties involved is to pay the GET on what they keep. Thus, the OTC would pay GET on \$20, which is the spread between the tourist’s price (\$120) and the room rent that was paid to the hotelier (\$100).

The concern that this bill seems to address is that TAT is now being paid on only \$100 when the tourist has parted with \$120 for a hotel room.

Stepping back for a second, consider Attorney General Opinion 65-6, from the days before the TAT even existed. There, the Attorney General considered the taxability of a local travel agent earning money in Hawaii for organizing a tour to the mainland including sending a local tour conductor with the group, and, conversely, a mainland travel agent organizing a tour to Hawaii. The Attorney General held that our GET applied to the local travel agent's commissions, even if they were earned partly because of the local tour conductor's services outside Hawaii; and, conversely, that it did not apply to the mainland travel agent's commissions, even if the mainland agent sent a tour conductor here.

The result appeared to be largely practical: if the state attempted to tax an out-of-state travel agent with no presence or only a fleeting presence within Hawaii, difficult federal constitutional questions would be presented.

That problem still has not gone away even with the technological advancements we now have. If the only connection an OTC has with Hawaii is a software platform used by Hawaii hotels and other customers, questions of practicality and constitutionality will be presented. These questions cannot be legislated away. That brings up two issues:

First, if there is a travel agent or packager with no physical presence in Hawaii and whose only connection with Hawaii is the properties that it advertises, the intermediary could take the position that it has not purposefully availed itself of the privilege of conducting activities within Hawaii because advertising doesn't occur in a particular place, and thus cannot be regulated by Hawaii because of the Due Process Clause of the U.S. Constitution. *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

Second, if we attempt to grab and wring dry the travel agents and tour companies that have set up a branch in Hawaii when we can't do the same to travel agents and tour companies that never set foot on our shores, we run the very practical risk of discouraging those who want to take care of their tourist customers in Hawaii while employing local people, and encouraging those who stay offshore, take our tourists' money, and contribute much less to our culture and economy.

Digested 2/21/2018

LATE



February 23, 2018

TO: House Committee on Finance
The Honorable Sylvia Luke, Chair
The Honorable Ty J.K. Cullen, Vice Chair

FROM: Amanda Pedigo, Vice President, Government and Corporate Affairs
Expedia, Inc.

RE: HB2008, HD1 RELATING TO TAXATION -- OPPOSE

Dear Chair Luke, Vice Chair Cullen, and distinguished members of the House Committee on Finance,

I represent the Expedia family of companies providing online travel booking to the world. We oppose this bill's effort to extend Transient Accommodations Tax (TAT) collection beyond the furnishing of the accommodations.

We oppose this bill's effort to extend Transient Accommodations Tax (TAT) collection beyond the furnishing of the accommodations. The bill does not create “parity;” rather, it greatly harms the interests of brokers—online and on ground—that facilitate non-commissioned transactions for lodging by imposing that large tax on the services we render, instead of the actual cost of the accommodations a traveler occupies. The fees collected by transient accommodations brokers are not compensation for accommodations; rather, they are for online services that hotel owners do not provide, including quality ratings, bundle package (air, hotel, car rental), the ability to comparison shop, and 24/7 customer support. This expansion of the TAT tax base would result in a higher total cost to visitors and undermine competition.

We also have concerns with the bill's introduction. It seems to imply that *Travelocity.com, L.P. v. Director of Taxation, 135 Hawaii 88, 346 P.3d 157 (2015)* changed the law. It did not. The Supreme Court simply confirmed the current law in the face of a baseless effort to expand it in ways the legislature never contemplated.

Online travel agencies provide a critical service to travelers, our hotel partners, and the destinations we market. Hotels voluntarily use our services because we market their property on a global platform helping them reach new travelers and fill rooms that would otherwise remain vacant. For example, an out-of-state visitor planning a trip to Maui might assume there is a Hyatt or Westin nearby, and there is. They could call the hotel chains' 24-hour reservation line and take care of their booking. But, there is a much smaller chance that they would have heard of the Haiku Plantation Inn without the help of an online travel agency that displays multiple properties in response to a geographic search, or without calling a brick-and-mortar travel agent to help make recommendations

on where to stay. In exchange for providing these search and facilitation services, we charge a fee to the traveler.

Expedia, Inc. platforms shine an international spotlight on Hawai`i's small businesses. We connect them to a world of potential travelers on 200 travel booking sites in more than 75 countries, allowing them to transact business in foreign languages and currencies, and to be displayed side-by-side with some of the biggest hotel chains in the world. This model helps travelers, helps hotels, and helps the many other tourism-related industries, which are vital to a state's economy, like restaurants, museums, arts venues, transportation companies, and others.

We have worked hard to market Hawai`i as a desirable destination for potential visitors, but this expansion of the TAT would make Hawaii less competitive as a travel destination. We have done this because of the GET burden on booking service fees-- Hawai`i already imposes more tax on online agents than most other destinations. If this bill passes, our tax burden would more than triple and transactions involving travel to Hawai`i would become **far** less profitable than transactions involving similar destinations.

If TAT is imposed on the services travel agents provide for Hawai`i-bound travelers, it becomes difficult for Hawai`i to remain a competitive destination. Hawai`i will become far, far less attractive to online businesses, which are agnostic about the travel destinations they market around the world. Traditional and online travel services that are economically rational will choose to promote other destinations and urge travelers to visit other, tax-friendly destinations. No business person would do otherwise.

Economics dictate that online companies promote profitable destinations. This bill is a big step toward undermining Hawai`i's market position.

Thank you for the opportunity to share this testimony.