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To: The Honorable Richard H.K. Onishi, Chair
and Members of the House Committee on Tourism

Date: Tuesday, February 13, 2018
Time: 9:00 A.M.
Place: Conference Room 429, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 2008, Relating to Taxation

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

H.B. 2008 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.

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

First, the Department notes that although this bill attempts to create parity between commissioned and noncommissioned transactions by imposing the TAT on each person's share of income when transient accommodations are booked through an intermediary at noncommissioned negotiated contract rates, the bill will also increase the base for TAT on certain commissioned transactions. The bill, by imposing the TAT on all travel agencies and tour packagers, will result in situations in which the TAT is imposed on the commission income

twice—once on the operator and a second time on the travel agency or tour packager.

For example, if a room is sold for \$100 to the guest, \$20 of which is paid to the travel agency as a commission, the operator will be subject to TAT on \$100 and the travel agency, if it has nexus, will be subject to TAT on \$20. The base of the TAT will therefore exceed 100 percent of the total charged to the customer (*i.e.*, although the customer is charged \$100, the base of the TAT will be \$120). In comparison, the base of the TAT for noncommissioned transactions will only be 100 percent of the total charged to the customer because of the provision in the bill that each person in a noncommissioned transaction is only liable for TAT on that person's share. The Department notes that a similar provision that each person is only liable for TAT on that person's share in a commissioned transaction is not advisable, as it will result in a decrease in TAT, as commissions would not be subject to TAT if the travel agency does not have nexus.

The Department therefore suggests amending HRS section 237D-2(b) so that the TAT is only imposed on travel agencies and tour packagers who arrange or book transient accommodations at noncommissioned negotiated contract rates. The Department suggests the following language:

Every operator, and every travel agency or tour packager [~~licensed pursuant to section 237D—~~], who arranges transient accommodations at noncommissioned negotiated contract rates, shall pay to the State the tax imposed by subsection (a) as provided in this chapter.

Second, the Department respectfully requests that the bill is amended to apply to tax years beginning after December 31, 2018 to allow sufficient time to make the necessary form and computer system changes.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

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SUBJECT: TRANSIENT ACCOMMODATIONS; Attach Liability to Intermediary

BILL NUMBER: HB 2008; SB 2697

INTRODUCED BY: HB by ONISHI, CACHOLA, FUKUMOTO, ITO, MORIKAWA, SAIKI;
SB by WAKAI

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. 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.

STAFF COMMENTS: This bill appears to be a reaction to the Hawai'i Supreme Court's decision *In re Travelocity.com, L.P.*, 346 P.3d 157 (Haw. 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. 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 2/9/2018



February 13, 2018



TO: House Committee on Tourism
The Honorable Richard H. K. Onishi, Chair
The Honorable Beth Fukumoto, Vice Chair

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

RE: HB2008 RELATING TO TAXATION -- OPPOSE

Dear Chair Onishi, Vice Chair Fukumoto, and distinguished members of the House Committee on Tourism,

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.

**Testimony of Stephen Shur, President of the Travel Technology Association,
in Opposition to H.B. 2008:
Applying the Transient Accommodations Tax to Travel Agent Service Fees**

My name is Stephen Shur, and I am the President of the Travel Technology Association. My organization represents companies like Expedia, Priceline, Orbitz, Booking.com, TripAdvisor, and many others.

Our industry is responsible for booking hundreds of thousands of room nights in Hawaii annually. We are in strong opposition to any proposal that would impose new and burdensome taxes on the fees charged by travel agents, both online and in Hawaii.

One of the biggest myths in our industry is that online travel agents buy rooms in bulk at wholesale rates and resell them at retail rates. This is simply not true.

When a traveler books a room via a travel agent, either online or in Hawaii, the total amount the traveler pays for the room includes:

1. the room rate set by the hotel,
2. all applicable taxes based on that room rate, and
3. a service fee charged by the travel agent (online or in the community)

Further, Hawaii hotels willingly and enthusiastically partner with my members to help market unsold rooms. And they benefit tremendously from their participation with online travel sites. Online travel agents market Hawaii hotels to the world.

- OTAs market Hawaii hotels to the world but are never responsible for unsold rooms.
- The hotel controls the inventory and sets the price.
- The terms wholesale and retail have no meaning in the travel agency arena.
- There is only one room rate and that is what the hotel requires to allow a guest in the room on a given night.
- Taxes on hotel rooms in Hawaii are based on the amount the hotel requires to allow someone to occupy a room on a given night. That is the basis for the calculation of the tax.

- Hotels have many rates on any given night. If a traveler has a AAA or AARP discount, for example, the tax is based on that discounted rate.
- OTAs do not operate hotels. Online travel agents are just that, travel agents. They connect travelers with hotels and charge the traveler a service fee for the service they provide (the ability to search for, compare and book a hotel room).
- The playing field between hotels and OTAs is not “uneven”. OTAs are a valued marketing channel for large hotel chains and independent hotels.
- Hilton CEO said this in an article April 7, 2016: “The OTAs are a good partner for us to be able to access customers that we might not otherwise be able to access.”
 - <https://skift.com/2016/04/07/hilton-ceo-heaps-praise-on-his-good-partners-the-online-travel-agencies/>
- For independent hotels, the value of OTAs is even greater.
 - By partnering with OTAs, independent hotels get to compete for travelers with the major hotel chains when their property shows up on a comparison screen next to Marriott and Hilton.

Applying new taxes to the fees charged by travel agents will have the opposite of the intended effect of raising revenue. Travel agents are the engine that help steer travelers to Hawaii. 30% of all hotel bookings in the US are via online travel agents and the number is even higher for international travelers. Taxing online and community travel agents will serve as a disincentive for them to steer travelers to the state.

Leisure travelers are hyper sensitive to price. These taxes will ultimately be passed on to the consumer in the form of higher room rates. Priceline.com found that when the room rate is increased by 1%, there is a 2% reduction in bookings. Raising room rates in Hawaii through higher taxes will have a ripple effect through the state’s economy as leisure travelers choose to visit other states to save money, or not travel at all.

On average, 25% of rooms booked on OTAs are in-state bookings, which means Hawaii residents will be paying more for hotels. Small businesses who benefit from travel and tourism will be negatively impacted by these taxes as well as fewer travelers stay in Hawaii.

What is being considered here with this legislation is the imposition of a new tax on service fees in Hawaii.

This is bad for Hawaii tourism. If even just a small percentage of travelers choose to stay in California, for example, for a lower cost room or not travel at all, any revenue gained

by a tax on travel agent fees will be small compared to the tax revenue lost when a traveler doesn't visit Hawaii and spend their money on goods and services.

The proposal is particularly bad for Hawaii travel agents, tour operators, wedding and event planners who charge their clients fees for booking hotel rooms and already pay tax on the service fees (income) they charge their clients. Recently, Marriott announced that they are cutting commissions to travel agents. This means that travel agents will now be charging their clients a service fee. These fees would be subject to the tax imposed by H.B. 2008. Hawaii travel agents, wedding planners, tour operators and event planners already pay tax on their income. This would amount to a double tax on these Hawaii small businesses.

It has been said that when you tax something, you get less of it. In this case, we are talking about hotel bookings in Hawaii.

The opportunity cost of this tax is high. It's not about raising revenue. It's not about closing a loophole that doesn't exist. It's not about leveling any playing field. It's simply a new tax on services and a disincentive for travel agents, both online and in Hawaii to steer people to Hawaii hotels.

This new tax on services is a job killer, a small business killer and a burden on Hawaii businesses and citizens. I urge you to reject this proposal.

Thank you.

Stephen Shur
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