



STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Wednesday, March 28, 2018
Time: 3:00 P.M.
Place: Conference Room 308, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2868, S.D. 3, H.D. 1, Relating to Taxation

The Department of Taxation (Department) supports S.B. 2868, S.D. 3, H.D. 1, and offers the following comments for the Committee's consideration.

Summary of S.B. 2868, S.D. 3, H.D. 1

The following is a summary of key points of the bill, which is effective on July 1, 2018 and applies to taxable years beginning after December 31, 2018.

Imposition of TAT

- The TAT will be imposed on transient accommodations brokers, travel agencies, and tour packagers who arrange transient accommodations at noncommissioned negotiated contract rates.
- When transient accommodations are furnished through transient accommodations brokers, travel agencies, or tour packagers at noncommissioned negotiated contract rates, the TAT will apply to each person with respect to that person's portion of the proceeds.

Registration

- Transient accommodations brokers, travel agencies, and tour packagers who enter into arrangements to furnish transient accommodations at noncommissioned negotiated contract rates will be required to register with the Department.

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 notes that to clarify that the \$15 registration fee in Section 1 of the bill is a one-time fee that applies to each transient accommodations broker, travel agency, or tour packager, and is not a fee that is assessed per transient accommodation, the Committee may consider the following amendments:

§237D- Certificate of registration for transient accommodations broker, travel agency, and tour packager. Each transient accommodations broker, travel agency, or tour packager, as a condition precedent to entering into an arrangement to furnish transient accommodations at noncommissioned negotiated contract rates, shall register with the director. The transient accommodations broker, travel agency, or tour packager shall make a one-time payment of \$15 [~~for each registration, upon~~] to register with the director. Upon receipt of [which] the registration payment, the director shall issue a certificate of registration to the transient accommodations broker, travel agency, or tour packager in a form as the director determines, attesting that the registration has been made. The registration shall not be transferable and shall be valid only for the travel agency or tour packager in whose name it is issued.

The registration shall be effective until canceled in writing. Any application for the reissuance of a previously canceled registration identification number shall be regarded as a new application for registration and shall be subject to the payment of the one-time registration fee. The director may revoke or cancel any registration issued under this section for cause as provided by rule under chapter 91.

The Department further notes that it will be able to administer this measure with its current effective date.

Thank you for the opportunity to provide testimony in support of this measure.

TAX FOUNDATION OF HAWAII

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SUBJECT: TRANSIENT ACCOMMODATIONS, Require Brokers, Travel Agencies, and Tour Operators to Register

BILL NUMBER: SB 2868, SD-3, HD-1

INTRODUCED BY: House Committee on Tourism

EXECUTIVE SUMMARY: Attempts to require those transient accommodations brokers, travel agencies, and tour packagers to register with the Department of Taxation before they may enter into an arrangement to furnish transient accommodations at noncommissioned negotiated contract rates. Those who are required to register also will need to pay tax on their share of receipts for those accommodations. The biggest problem, however, is acquiring jurisdiction over those brokers who might not have a physical presence in Hawaii. The Committee may consider adding “economic nexus” provisions to address this problem.

SYNOPSIS: Adds a new section to chapter 237D, HRS, requiring registration of each transient accommodations broker, travel agency, or tour packager as a condition precedent to entering into an arrangement to furnish transient accommodations at noncommissioned negotiated contract rates.

Amends the definition of “gross rental” in section 237D-1, HRS, to remove the current provision allowing income splitting between an operator of transient accommodations and a transient accommodations broker. The provision as amended reads: “Where transient accommodations are furnished through arrangements made by a transient accommodations broker, travel agency, or tour packager at noncommissionable negotiated contract rates and the gross income is divided between the operator of transient accommodations on the one hand and the transient accommodations broker, travel agency, or tour packager on the other hand, the tax imposed by this chapter shall apply to the transient accommodations broker, travel agency, or tour packager with respect to that person's respective portion of the proceeds and no more. “

Amends section 237D-2, HRS, to provide that the registered transient accommodations broker, travel agency, or tour packager is responsible to pay transient accommodations tax on the amount that it keeps.

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.*, 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. The bill would charge the hotelier with tax on the \$120 even though the hotelier is getting only \$100.

The income splitting language dates back to Act 241, SLH 1988, a bill that reflected extensive discussions between government and industry. At the time, the Tax Foundation of Hawaii testified about the need for the language:

The measure also addresses those situations where the accommodations may be sold through a third party such as a travel agency or tour packager at noncommissionable negotiated contract rates and recognizes that it would be impossible for an operator to know what the customer is ultimately charged for a room which may be included in a tour package. This provision would make the hotel operator responsible for the tax only on that portion of gross rental proceeds actually received.

Tax Foundation of Hawaii, Legislative Tax Bill Service 136(c), 138(c) (Mar. 31, 1987) (SB 1712).

That problem still has not gone away even with the technological advancements we now have. Many of the transient accommodations brokers are not even in Hawaii, and may not be subject to the State's regulatory or taxing jurisdiction under federal constitutional principles. (This issue was not litigated in the *Travelocity* case.) If this legislation is made to apply to transient accommodations brokers who have presence in Hawaii and can't apply to those that do not have such presence, an imbalance or unfairness or will be created. To address this issue, the Committee may wish to consider adopting economic nexus standards such as those being considered in SB 2514, SD-1, that is also being heard by this Committee.

Digested 3/27/2018

March 28, 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: SB2868, SD3, 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.

This bill would expand the application of the TAT to the fee collected by a transient accommodations broker for arranging the reservations. Currently, the TAT is only collected for the portion of the fee that is attributable to the furnishing of the accommodations and not the fee that is attributable to the travel company arranging non-commissioned reservations. This proposed expansion would apply the TAT to fees collected by transient accommodations brokers that are not associated with the direct furnishing of accommodations. Those fees do not pay for the accommodations rather, they are ONLY compensation for online services provided by transient accommodations brokers, including the ability to comparison shop and 24/7 customer support. This expansion would result in a higher total cost to visitors to Hawaii.

Online travel companies 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 Hawaii's small businesses 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.

This proposed expansion of the TAT will make visiting Hawai'i even more expensive than it is today. Last year, the TAT was increased from 9.25% to 10.25%, this bill will increase the costs to visitors further. We have worked hard to market Hawai'i as a desirable destination for potential visitors, but this expansion of the TAT would make Hawai'i less competitive as a travel destination.

It will also make it far, far less attractive to online businesses which market travel destinations around the world by cutting deeply into the compensation they receive for booking services. Through the GET burden on booking income, Hawai`i already imposes more tax on online agents than most other destinations. If TAT were added, transactions involving travel to Hawai`i would become far less profitable than transactions involving similar destinations. 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.