



**STATE OF HAWAII**  
**DEPARTMENT OF TAXATION**  
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To: The Honorable Donovan M. Dela Cruz, Chair  
and Members of the Senate Committee on Ways and Means

Date: Wednesday, February 28, 2018  
Time: 11:00 A.M.  
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director  
Department of Taxation

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

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

S.B. 2868, S.D. 1 amends the definition of "gross rental proceeds" in Hawaii Revised Statutes (HRS) section 237D-1 by providing that 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 and the broker, travel agency, or tour packager, the TAT applies to the transient accommodations broker, travel agency, or tour packager with respect to that person's respective portion of the proceeds and no more. The bill is effective upon approval 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:

<b>Type of Transaction</b>	<b>Amount Paid by Guest</b>	<b>Amount Kept by Travel Agency</b>	<b>Amount Kept by Operator</b>	<b>TAT Base</b>	<b>TAT Due</b>
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 the intent of this bill, as expressed by the Committee on Economic Development, Tourism, and Technology, is to impose the TAT on the share of proceeds received by a transient accommodations broker, travel agency, or tour packager in noncommissioned transactions. The current language in the bill, however, provides that in noncommissioned transactions, the TAT applies to the portion of proceeds kept by the transient accommodations broker, travel agency, or tour packager and no more. This provision would make the TAT inapplicable to the portion of proceeds kept by the operator in noncommissioned transactions, thereby reducing the tax base.

In order to impose the TAT on the portion of proceeds kept by the transient accommodations broker, travel agency, or tour packager in noncommissioned transactions, while maintaining the imposition of TAT on operators, the Department suggests the following amendments:

First, the definition of "gross rental" in HRS section 237D-1 should be amended to (1) specify that in noncommissioned transactions, the TAT applies to both the operator's and the transient accommodations broker, travel agency, or tour packager's portion of the proceeds; (2) clarify that gross receipts from entering into arrangements to furnish transient accommodations (as opposed to only gross receipts from furnishing transient accommodations) are part of the gross rental that is subject to TAT; and (3) exempting GET and TAT visibly passed on to the customer by a transient accommodation broker, travel agency, or tour packager, similar to the exemption for operators. The Department suggests the following language:

"Gross rental" or "gross rental proceeds" means the gross receipts, cash or accrued, of the taxpayer received as compensation for the furnishing of transient accommodations or entering into arrangements to furnish transient accommodations and the value proceeding or accruing from the furnishing of [~~such~~] transient accommodations or entering into arrangements to furnish transient accommodations without any deductions on account of the cost of property or services sold, the cost of materials used, labor cost, taxes, royalties, interest, discounts, or any other expenses whatsoever. Every taxpayer shall be presumed to be dealing on a cash basis unless the taxpayer proves to the satisfaction of the department of taxation that the taxpayer is dealing on an accrual basis and the taxpayer's books are so kept, or unless the taxpayer employs or is required to employ the accrual basis for the purposes of the tax imposed by chapter 237 for any taxable year in which event the taxpayer shall report the taxpayer's gross income for the purposes of this chapter on the accrual basis for the same period.

The words "gross rental" or "gross rental proceeds" shall not be construed to include the amounts of taxes imposed by chapter 237 or this chapter on operators of transient accommodations, transient accommodations brokers, travel agencies, and tour packagers and passed on, collected, and received from the consumer as part of the receipts received as compensation for the furnishing of transient accommodations[~~-~~] or entering into arrangements to furnish transient accommodations.

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]~~ each operator and transient accommodations broker, travel agency, or tour packager with respect to that person's respective portion of the proceeds and no more.

For purposes of this definition, where the operator maintains a schedule of rates for identifiable groups of individuals, such as kamaainas, upon which the accommodations are leased, let, or rented, gross rental or gross rental proceeds means the receipts collected and received based upon the scheduled rates and recorded as receipts in its books and records.

Second, HRS section 237D-2(b) should be amended to impose the TAT on transient accommodations brokers, travel agencies, and tour packagers. If this section is not changed, only operators will be required to remit TAT. The Department suggests the following language:

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

Third, because the TAT will be imposed on transient accommodations brokers, travel agencies, and tour packagers, said persons will need to obtain a certificate of registration from the Department. The Department suggests creating a new section in HRS chapter 237D with the following language:

**§237D-\_\_\_\_\_ Certificate of registration for 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 receipt of which the director shall issue a certificate of registration 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 transient accommodations broker, 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 registration application 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.

Fourth, the Department suggests adding a provision in HRS section 237D-15, providing that chapter 237D shall apply to transient accommodations brokers, travel agencies, and tour packagers who enter into agreements to furnish transient accommodations at noncommissioned negotiated contract rates in the same manner that it applies to operators. There are many provisions in HRS chapter 237D that impose various obligations on operators and plan managers, but not transient accommodations brokers, travel agencies, or tour packagers. For example, HRS section 237D-6 requires operators to file periodic tax returns, HRS section 237D-6.5 requires operators to file annual tax returns, and HRS section 237D-9 authorizes the Department to assess operators. All of these sections should also apply to transient accommodations brokers, travel agencies, and tour packagers. Accordingly, the Department suggests adding a subsection (c) to HRS section 237D-15 with the following language:

(c) Except as otherwise provided, this chapter shall apply to a transient accommodations broker, travel agency, or tour packager who enters into an agreement to furnish transient accommodations at noncommissioned negotiated contract rates in the same manner as it applies to an operator.

Thank you for the opportunity to provide comments.

# TAX FOUNDATION OF HAWAII

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SUBJECT: TRANSIENT ACCOMMODATIONS, Remove Income Splitting

BILL NUMBER: SB 2868, SD-1

INTRODUCED BY: Senate Committee on Economic Development, Tourism, & Technology

EXECUTIVE SUMMARY: Clarifies that the transient accommodations tax shall be calculated based on the gross rental price paid by a visitor. Specifies that the transient accommodations tax is to be collected from operators or transient accommodations intermediaries that collect whole or partial payment for transient accommodations. This bill would tax hoteliers on gross receipts that they now don't know about and have no reason to know about, and may be unfair for that reason.

SYNOPSIS: 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. "

EFFECTIVE DATE: Upon approval. 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. The transient accommodations brokers, many of which are not even in Hawaii, can't be expected to change their business model on account of this legislation, which means that local hoteliers will be in a pinch. Compliance and enforcement would be much more difficult as a result.

Digested 2/22/2018