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RECEIVED
Date & Time
Mar 19, 2018, 10:02 am

STATE OF HAWAII
DEPARTMENT OF TAXATION
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To: The Honorable Richard H.K. Onishi, Chair
and Members of the House Committee on Tourism

Date: Tuesday, March 20, 2018
Time: 9:15 A.M.
Place: Conference Room 429, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

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

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

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

The following is a summary of key points of the bill, which has a defective effective date of July 1, 2050 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 appreciates that its proposed amendments were adopted by the Senate Committee on Ways and Means. The Department notes that it will be able to administer the changes in this bill for taxable years beginning after December 31, 2018.

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



**Testimony of Stephen Shur, President of the Travel Technology Association,
in Strong Opposition to S.B. 2868:**

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 S.B. 2868 which would impose a registration tax of \$15 per hotel listed and marketed by online travel agents. This provision will have a devastating impact on Hawaii's independent hotels which benefit greatly from the exposure they get by being listed on online travel agent websites and apps. In the event that online travel agents choose to de-list properties, those properties will be the collateral damage of these discriminatory and unnecessary "registration taxes" on online travel agents.

These new registration taxes will be passed-on to the consumer in the form of higher room rates, thereby harming Hawaii's tourism economy. A recent study by TripAdvisor's TripIndex found that Hawaii was the 2nd most expensive destination in America. Leisure travelers are hyper sensitive to price and these increases will put Hawaii out of reach for many families.

No other state in America imposes such fees (registration taxes) and such a requirement is an unnecessary and harmful provision. If the state wants to ensure that the proper taxes are being collected and remitted by travel agents, the state already has the ability to do so through audits and administrative proceedings. Such discriminatory registration fees (taxes) will only serve as a disincentive for travel agents to partner with Hawaii hotels to help them market their rooms to the world.

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.”**
- 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.

Levying new fees (taxes) on online 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.

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

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 online travel agents and a disincentive for travel agents, 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 registration tax on online travel agents.

Thank you.

Stephen Shur
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Mar 19, 2018, 12:02 pm

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March 19, 2018

Rep. Richard H.K. Onishi, Chair
Committee on Tourism
Hawaii House of Representatives
Honolulu, HI

RE: **Opposition to SB 2868 – Creating a New Tax on Travel Agents and Websites**

Dear Chairs Onishi and members of the committee,

We encourage you to not advance SB 2868 as it imposes a new tax on services provided by travel agents and online travel companies. SB 2868 imposes a new tax on the fees these travel agents charge for researching, comparing, and booking rooms for travelers.

Cities and states favor hotel taxes since they fall mostly on visitors – not on resident voters. But under SB 2868, this approach would backfire since the new service tax would be paid *only* by Hawaiians– *not by travelers* from out-of-state.

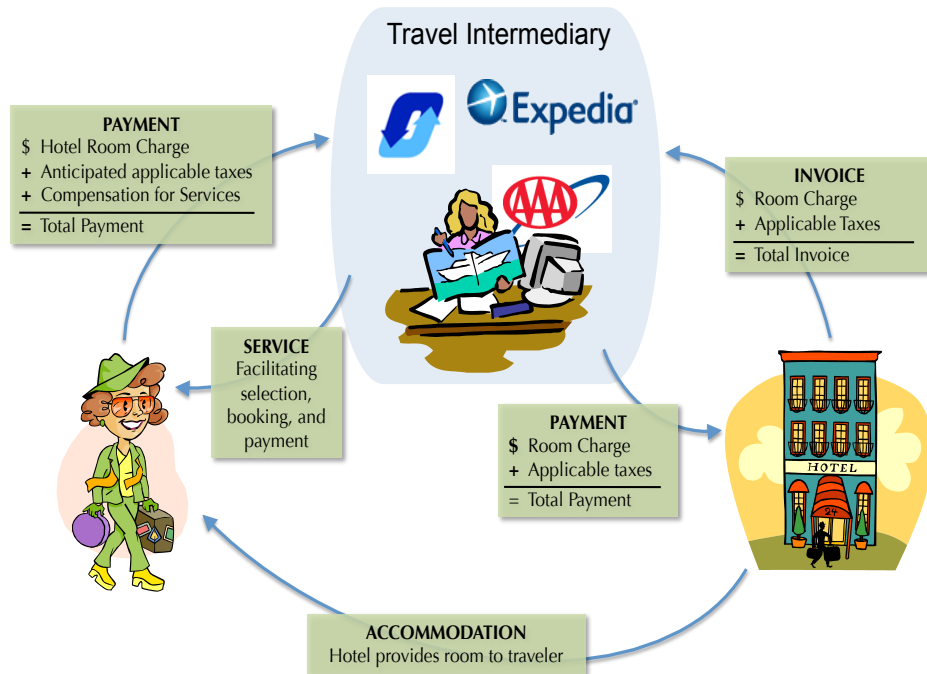
Imposes a new tax on Hawaiians

Today, Hawaii does not impose sales tax or lodging tax on service fees charged by travel agents. These service fees compensate travel agents for researching and comparing available hotel options, booking the room, and handling payment to the hotel. But SB 2868 would impose a new tax on these service fees provided by travel agents and online travel companies, a tax that is passed on to your constituents.

Nearly all travel agents and travelers rely upon online services to research, compare, and book reservations

From our work on this issue in states and at NCSL, it's clear there is some misunderstanding about travel reservation services and taxes. The chart below shows the flow of services, taxes, and payments in a typical transaction where a traveler uses a travel agent or online travel company to research and book a hotel reservation.

As shown in the chart, travel agents and online travel companies are providing a *service* to travelers. These services include comparisons of rates and amenities at multiple hotels, plus facilitation in making the reservation, processing the payment, and sending charges and applicable taxes to the hotel operator. Clearly, this facilitation service is distinct from the room provided by the hotel where the traveler eventually stays.



Creates a new tax on travel service fees that would only apply when *Hawaiians* book their travel

The new tax imposed on booking service fees by SB 2868 would impact only Hawaii’s citizens and businesses. That’s because of the rules for determining the source jurisdiction for taxable services – when a tourist uses a travel service, the reservation service fee is sourced to the traveler’s home location – not to the traveler’s destination.

For example, say two tourists are booking a hotel room in Hawaii. One lives in San Francisco, the other in Hilo. The California tourist would *not* pay the tax created by SB 2868 when they booked through a travel agent since they received their online booking services outside of Hawaii.¹ But, the tourist living in Hilo who books through a travel agent *would* pay the tax created by SB 2868.

This new tax would therefore only apply to services provided to Hawaii-based travelers. The tax would *not* apply to service fees paid by out-of-state travelers booking Hawaiian hotels.

Will cost Hawaii travel agents hundreds of dollars

SB 2868 would penalize Hawaii travel agents with a registration fee for every hotel with which they engage. Even a “small” tax of \$15 per hotel can add up quickly.

Take for example the Hawaiian travel agent working with 100 hotels. SB 2868 would impose a tax of \$1,500 on that Hawaiian travel agent. Now is not the time to impose these new taxes on your constituents.

¹ Note that the out-of-state tourist still pays the Hawaiian occupancy tax when they book the room.

Allows tax collectors to levy their occupancy tax on more than just hotel rooms

Hawaii travel agents routinely create packages that bundle hotel rooms, food, travel, and events into one price. But SB 2868 allows Honolulu tax collectors to impose their occupancy taxes on all kinds of goods and services when included in travel packages:

- taxi from the airport to the hotel
- food served at a hotel restaurant
- tours of Pauhai Crater

This new tax on service fees would only be collected by Hawaii-based travel websites

The requirement to collect this new tax on booking services could *only* be enforced against travel agents and websites that have a physical presence in Hawaii.

As noted above, out-of-state travel agents and websites already collect and remit lodging taxes when they make payment to the Hawaii hotel operator. But out-of-state travel agents would not be required to collect this new tax on service fees for providing reservation services at the time that travelers book their hotel.

Minimal revenue generated

For reasons explained above, every state, city, and county that has enacted a similar new tax has failed to gain the anticipated tax revenue.

First, as discussed above, the service taxes could not be imposed on any out-of-state traveler. Second, Hawaii tax collectors do not have authority to force out-of-state travel agents to collect these new service taxes since states can only impose collection obligations on businesses with a physical presence.

So, when you consider this tax, please consider whether the minimal tax revenue is worth the harm to Hawaii's travel agencies and travel websites.

Avoid the conflation of travel services and lodging providers

By maintaining the true distinction between travel service providers and hotel operators, you can help Hawaii's travel and tourism industry focus on serving travelers and creating jobs – not on collecting nominal new taxes from the state's own citizens.

Instead of passing SB 2868 we suggest amending it to clarify when an occupancy tax applies. We suggest substituting the existing bill text with this language from Missouri law:

“Any tax imposed or collected by any municipality, any county, or any local taxing entity on or related to any transient accommodations, whether imposed as a hotel tax, occupancy tax, or otherwise, shall apply solely to amounts actually received by the operator of a hotel, motel, tavern, inn, tourist cabin, tourist camp, or other place in which rooms are furnished to the public.

Under no circumstances shall a travel agent or intermediary be deemed an operator of a hotel, motel, tavern, inn, tourist cabin, tourist camp, or other place in which rooms are furnished to the public unless such travel agent or intermediary actually operates such a facility. ...

This section is intended to clarify that taxes imposed as a hotel tax, occupancy tax, or otherwise, shall apply solely to amounts received by operators, as enacted in the statutes authorizing such taxes.”²

We appreciate your consideration of our views, and please let us know if we can provide further information.

Sincerely,

Carl Szabo

Vice President and General Counsel, NetChoice

NetChoice is a trade association of e-Commerce and online businesses. www.netchoice.org

² Missouri HB 1442 (2010), signed into law July 2010 (emphasis added).

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Date & Time
Mar 20, 2018, 8:17 am



March 19, 2018

Committee on Tourism and Finance

On behalf of the Independent Lodging Industry Association and over 5,000 independent hotel members nationwide, including the beautiful state of Hawaii, respectfully urge you to **Oppose SB 2868. Do not place an occupancy tax on services that benefit local lodges, inns and service providers in Hawaii. HB 2008 would create a new tax in Hawaii.**

SB 2868 would create a new tax on the service customers use to book rooms in Hawaii, increasing the cost of tourism in the state.

Independent hotel owners rely on travel agents and online travel companies to help sell hotel rooms that would otherwise go unsold. Because they lack the marketing infrastructure of large hotel chains, independent hotel companies often find it helpful to partner with travel agents and online travel companies—particularly during slower travel seasons. In this way, owners of independent hotels can reach out-of-state visitors throughout the world who might never hear of these properties but for the marketing reach of their online partners.

The lodging industry has suffered in this weakened economy. Online Travel Companies (OTCs) such as Expedia, Booking.com, and others are playing a vital role in boosting room sales in these difficult times. The heads OTCs put in beds often is the difference between profitability or loss for many hotel operators

This, in turn, means that **proposals to raise taxes on travel agents and online travel companies threaten to cause disproportionate harm on the small business owners who operate independent hotels.**

Independents can't match large corporate hotel's marketing war chests, thus they rely heavily on OTCs to compete with branded hotels. Without a robust OTC channel, independent hoteliers will be put at a competitive disadvantage with chain hotels. It's critical that OTCs not be marginalized as it would diminish the ability of independent hotels to compete effectively.

Hotels, with the help of Online Travel Companies, boost the local economy by supporting jobs and increasing tourism. When people travel, many supporting businesses benefit. Every effort must be made to stimulate the economy and job growth.

For the sake of tourism and the small business owners who operate independent hotels in the state, I urge you to oppose any efforts to tax interactive travel services and SB 2868.

Thank you very much for your attention to this matter. If I can answer any questions about this bill or its impact on our membership, please do not hesitate to contact me.

Respectfully yours,

Bobbie Singh-Allen

Bobbie Singh-Allen, J.D.
Executive Director

About Us:

The Independent Lodging Industry Association (ILIA) is a national association with over 5,000 members nationwide. It was founded in 2010 by the California Lodging Industry Association (CLIA). CLIA was established over 70 years ago by a group of independent hotel owners and operators. Over the past several decades, independent hotels, independently owned franchised hotels, and owners have been impacted by decisions being made out of the halls of State Capitols to Washington, D.C. Chain hotels have dominated the policy making process. ILIA will level the playing field and allow independent hotels a seat at the table. For more information, please contact me at: bobbie@independentlodging.org or 916-826-2075.

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: TRANSIENT ACCOMMODATIONS, Remove Income Splitting

BILL NUMBER: SB 2868, SD-3

INTRODUCED BY: Senate Floor Amendment

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: 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, 2050; 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.

Digested 3/19/2018