

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

**HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS & MILITARY
AFFAIRS
TESTIMONY REGARDING HB 1585 HD 1
RELATING TO THE TAXATION OF ONLINE TRAVEL COMPANIES**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 17, 2009
TIME: 8:30AM
ROOM: 312

This measure assesses the transient accommodations tax (TAT) and the general excise tax (GET) on online travel companies that facilitate hotel stays in Hawaii over the internet, to the extent of the online travel company's "markup" or portion of proceeds received.

The House Committee on Tourism, Culture & International affairs passed this measure unamended.

The Department of Taxation (Department) takes **no position** on this measure.

I. ACTIVE LITIGATION THROUGHOUT THE COUNTRY ON ONLINE TRAVEL COMPANY MARKUPS.

Throughout the country, there is active litigation being pursued by local governments seeking to collect unassessed and unpaid hotel or "bed" taxes by companies that facilitate hotel or other transient accommodations online. Online travel companies dispute being liable for hotel or bed taxes based upon the theory that the online travel company does not provide the actual hotel room, but rather the hotel itself provides the room and is therefore liable for any commensurate taxes.

Based upon a review of current cases and literature in the area, the arguments from online travel companies stem mainly from plain readings of various hotel or bed tax statutes, which were written before the advent of online travel facilitation. Hence, many of the local statutes being litigated appear unclear whether they rightfully apply in certain online travel company cases. The dispute about taxes stems from the taxation of the "markup," or the difference between what a hotel charges the online travel company for the resale of a room and what the online travel company charges a customer at retail. The difference or "markup," apparently goes untaxed in many states

because the laws were not equipped to handle third-party reselling, such as through online travel companies.

II. HAWAII'S TAXATION OF HOTELS.

The purpose of Hawaii's taxation of the hotel industry was to levy a tax on the amount of money for which a room is rented. Where third parties become involved in facilitating the rental of the room, depending upon the means by which the room is rented through the third party, the state may be losing out on taxing the retail rate of the hotel room rented in the State. Hawaii law assesses the TAT on the person "actually furnishing" transient accommodations. Whether an online travel company is actually furnishing a hotel room is disputable.

This measure would clarify the definition of "furnish" to include the online facilitating through whatever means. This expanded definition would reach online travel companies.

III. CAUTION MUST BE CONSIDERED WITH CURRENT STATE OF TOURISM INDUSTRY.

As a state whose economy is greatly dependent upon the tourism industry and the taxes on that industry to sustain tourism-related and state funded advertising, entertainment, and other tourism programs, Hawaii should be cautious when considering policies to extend its taxes to the online travel industry. The concern relates to possibly making Hawaii a more expensive destination during a time when tourism has slowed. However, simultaneously, as defenders of the general fund, the Department should ensure that it is not being undercut on what it should rightfully collect due to outdated laws and other developments in the industry.

IV. IMPORTANT NEXUS STANDARD

Currently, the state of the law with regard to taxing out-of-state entities has expanded greatly to include the concept of economic nexus. In short, before a state can constitutionally tax an out-of-state entity, the entity must have certain minimum contacts (substantial nexus) with the taxing entity. Substantial nexus used to only include physical presence. However, two state tax law cases in recent years upheld the concept of "economic nexus," which allowed taxation based upon a certain number of customers or sales. One of the important features of economic nexus was that the administrative burden of paying the taxes had to be relatively low, such as annual filing versus monthly filing.

This legislation adopts a nexus standard proved constitutional in other states when applied to other taxes. Also, this measure allows online travel companies with economic nexus to Hawaii to petition the Director of Taxation to make a return and remit taxes on a basis that will meet constitutional thresholds for good cause. The Department supports these provisions.

V. REVENUE IMPACT

The bill results in the following revenue gains—

General Fund: \$6.4 million per year.

Tourism Special Fund: \$3.7 million per year

Convention Center Special Fund: \$1.9 million per year.

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, TRANSIENT ACCOMMODATIONS, Taxable transaction

BILL NUMBER: SB 1321; HB 1585, HD-1(Similar)

INTRODUCED BY: SB by Hanabusa by request; HB by House Committee on Tourism, Culture, & International Affairs;

BRIEF SUMMARY: Adds a new section to HRS chapter 231 to provide that an online transient accommodations facilitator that is located out-of-state shall be presumed to be systematically and regularly engaging in business in this state and taxable under HRS chapters 235, 237, and 237D, if, during any year, it receives income from engaging in online transient accommodations facilitation services or activities in this state, and the facilitator: (1) solicits business from 20 or more persons in the state; or (2) its income, gross proceeds of sale, gross rental, or gross rental proceeds taxable under chapter 235, 237, or 237D, attributable to sources in this state, equals to or exceeds \$100,000.

Amends HRS section 237D-2 to provide that the online transient accommodations facilitator shall be subject to the transient accommodations tax of 7.25 per cent of the gross rental or gross rental proceeds derived from furnishing transient accommodations; provided that where transient accommodations are furnished through arrangements made by an online transient accommodations facilitator and the gross rental or gross rental proceeds are divided between the operator of transient accommodations and the online transient accommodations facilitator, the tax imposed under this section shall only apply with respect to the online transient accommodations facilitator's respective portion of the proceeds, and no more.

Amends HRS section 237D-1 to add the definitions of "furnish" and "online transient accommodations facilitator" for purposes of the measure.

Makes conforming amendments to HRS section 237-18.

EFFECTIVE DATE: HB - July 1, 2112; applicable retroactively to tax years beginning after December 31, 2008; SB - retroactively to January 1, 2009

STAFF COMMENTS: This measure attempts to subject out-of-state online travel companies that book transient accommodations in Hawaii to general excise and transient accommodations tax (TAT). When an online travel service, i.e., Expedia, Orbitz, etc., is used to purchase a transient accommodation, the travel company searches for the transient accommodation based on the client's criteria - date, location, etc., and provides a selection of transient accommodations for the client to choose. Once the client chooses the transient accommodation, he has the option to book the transient accommodation and pay for the transient accommodation when he is here, then the TAT and general excise tax would be paid by the client at the time of checkout since he is here in the state. The other option offered by the online travel companies either requires or allows the client to prepay for the transient accommodation - the online travel company bills the client for the transient accommodation and any taxes and fees. Since the

taxes and fees charged by the online travel company include any taxes imposed on the transient accommodation, including any handling fee charged by the online travel company, the adoption of this measure does not appear to be necessary.

Given the fact that the online facilitator remits the compensation for the transient accommodations, one would assume that the hotel operator makes sure that the commensurate taxes are also collected from the facilitator's clients as the hotel operator is liable for the payment of the general excise tax and transient accommodations tax on that income.

Digested 2/13/09

GOODSILL ANDERSON QUINN & STIFEL

A LIMITED LIABILITY LAW PARTNERSHIP LLP

GOVERNMENT RELATIONS TEAM:
GARY M. SLOVIN
CHRISTOPHER G. PABLO
ANNE T. HORIUCHI
MIHOKO E. ITO

ALII PLACE, SUITE 1800 • 1099 ALAKEA STREET
HONOLULU, HAWAII 96813

MAIL ADDRESS: P.O. BOX 3196
HONOLULU, HAWAII 96801

TELEPHONE (808) 547-5600 • FAX (808) 547-5880
info@goodsill.com • www.goodsill.com

INTERNET:
gslovin@goodsill.com
cpablo@goodsill.com
ahoriuchi@goodsill.com
meito@goodsill.com

MEMORANDUM

TO: Representative Angus L.K. McKelvey
Chair, Committee on Economic Revitalization, Business, & Military Affairs

FROM: Gary M. Slovin

DATE: February 16, 2009

RE: **H.B. 1585, HD1 - Relating to the Taxation of Online Travel Companies Hearing on Tuesday, February 17, 2009 at 8:30 a.m., Room 312**

Dear Chair McKelvey and Members of the Committee on Economic Revitalization, Business, & Military Affairs:

I am Gary M. Slovin, testifying on behalf of Orbitz, Expedia and Travelocity, who provide online travel bookings services for consumers worldwide. Orbitz, Expedia and Travelocity strongly oppose H.B. 1585, which seeks to impose general excise tax and transient accommodations tax for services provided by online booking companies.

The online travel companies view themselves as partners with Hawai'i, sharing a common goal of bringing visitors from across the globe to the Hawaiian Islands. This longstanding partnership has prospered because Hawai'i has pursued a smart tourism policy that welcomes and encourages travel intermediaries. This legislation would reverse that policy by pulling in the welcome mat.

We believe that this measure will have a very negative impact on the tourism economy in Hawai'i, which is already ailing in the present economic downturn. The proposed tax in H.B. 1585, H.D. 1 would be the first of its kind in the country. The online travel industry is a critical part of the tourism marketplace in Hawai'i and around the world. Online travel companies can offer customized and affordable travel packages that help price-sensitive travelers.

The online travel industry has become a major force in promoting travel and tourism throughout the world. The major online travel companies booked over \$400 million in hotel gross bookings in 2008 resulting in nearly 2 million room nights. These companies have global reach with points of sale in 52 countries and 73 languages. And

February 16, 2009

Page 2

with over 120 million consumers visit their websites each month, there simply is no larger sales channel in the world.

Taxing the services provided by this industry may create a shift in tourism from Hawai'i to other, non-taxable destinations. We recognize the need for the state to generate funds given the present fiscal situation; however, keeping the tourism industry stable, is also critical to stimulating the economy. Attempting to add this tax will make Hawaii less competitive.

It is for these reasons that we request that the committee hold this bill. Thank you very much for the opportunity to submit testimony.



**HAWAII HOTEL & LODGING
ASSOCIATION**

2270 Kalakaua Ave., Suite 1506
Honolulu, HI 96815
Phone: (808) 923-0407
Fax: (808) 924-3843
E-Mail: hhla@hawaiihotels.org
Website: www.hawaiihotels.org



31st Anniversary
Are You Walking???
May 16, 2009
(Always the 3rd Saturday in May)
www.charitywalkhawaii.org

**TESTIMONY OF MURRAY TOWILL
PRESIDENT
HAWAII HOTEL & LODGING ASSOCIATION**

February 17, 2009

RE: HB 1585 Relating to the Taxation of Online Travel Companies

Good morning Chairman McKelvey and members of the House Committee on Economic Revitalization, Business & Military Affairs. I am Murray Towill, President of the Hawaii Hotel & Lodging Association.

The Hawaii Hotel & Lodging Association is a statewide association of hotels, condominiums, timeshare companies, management firms, suppliers, and other related firms and individuals. Our membership includes over 170 hotels representing over 47,300 rooms. Our hotel members range from the 2,523 rooms of the Hilton Hawaiian Village to the 4 rooms of the Bougainvillea Bed & Breakfast on the Big Island.

The Hawaii Hotel & Lodging Association opposes HB 1585 Relating to the Taxation of Online Travel Companies. We are concerned that HB 1585 would impose an additional cost on the online companies participating in the Hawaii visitor industry. As you know, we are facing a global economic crisis that has dramatically impacted Hawaii and our visitor industry.

Since last Spring, the Hawaii Tourism Authority ("HTA"), its marketing contractors and numerous companies in Hawaii's visitor industry have been partnering in multi million dollar campaigns to attract visitors to Hawaii. The major theme of these initiatives has been the value of a Hawaii vacation and how affordable these vacations have become.

Travel wholesalers and these online entities have been major partners in the campaigns. Their assistance and support have been significant factors in helping to get Hawaii's message out and attract visitors. We urge you not to take action that will diminish their support or discourage their participation in our future efforts.

We urge you to hold this bill. Mahalo again for this opportunity to testify.



Representative Angus L.K. McKelvey
Chair, Committee on Economic Revitalization,
Business, & Military Affairs
Hawaii State Capitol, Room 427
Honolulu, Hawaii 96813

**Re: H.B. 1585, HD1 - Relating to the Taxation of Online
Travel Companies
Hearing: Tuesday, February 17, 2009 at 8:30 a.m**

Dear Chair McKelvey and Members of the Committee on Economic Revitalization,
Business, & Military Affairs:

I am Dave Evans of Group RCI which is a leading provider of vacation exchange and rental in the United States. We ask that you oppose HB 1585, relating to the taxation of online travel companies.

Our concern is simple – additional Hawaii taxes on tourism will likely result in consumers choosing to travel to other destinations. As you are no doubt aware, hotels and timeshares in Hawaii are fighting to attract every last customer in these tough economic times.

Online travel is an important component of the tourism industry and significantly helps drive local tax revenues. Over 100 million people each month shop for travel at an online travel company such as Expedia, Orbitz, Priceline or Travelocity. The online travel companies estimate that they have generated more than \$39 billion in travel related gross bookings in 2008. Those bookings from online travel sites resulted in the collection of approximately \$4.7 billion in Federal, state and local taxes (based on a blended average tax rate of 12%) in 2008.

Hawaii can drive more tourism-related revenues for local government by working in partnership with online travel companies to help fill accommodations...not by taxing their services and seeing tourists travel instead to destinations like Mexico, Florida, or other parts of the South Pacific.

Please support the tourism industry and oppose this legislation.

Testimony Re: HB 1585
February 17th-8:30am

My name is Cheryl Williams. I have lived in Hawaii and worked in the hospitality industry in the area of sales & marketing for over 26 years. My primary responsibility is to generate room nights and revenue by selling and marketing the destination of Hawaii and our 14 hotels located on the islands of Kauai, Oahu, Maui and the Big Island. I work with Meeting Planners, Travel Agents, Tour Wholesalers, On Line Travel partners and directly with our most loyal guests.

During these past 26 years, Hawaii has weathered many storms in our business but never a storm as big as the one we are now experiencing. As you know, we have seen a decline in our visitor arrival count starting with the exit of two NCL cruise ships, followed by the demise of ATA and Aloha Airlines and now the recession. Many of our hotels have experienced occupancy declines as high as 30% resulting in several lay-offs these past few months.

Travel partnerships are critical to Hawaii's success. Combined, our travel partners spend millions of dollars marketing Hawaii and bring millions of visitors to our state. Without their support, we will see our business decline at a pace like we have never seen before.

Most, if not all of our travel partners do business with other destinations. Mexico, Caribbean, Europe, S. Pacific. That being said, these partners are committed to Hawaii and Hawaii receives the largest share of their business. Our destination must embrace this loyalty and commitment and make it easier and not more difficult to do business with us. We must wrap our arms around our partners and work together to get a bigger piece of the vacation pie. If you pass this bill, our travel partners will have no other choice than to steer their focus and efforts to other more profitable destinations. This will have devastating affects to our tourism industry.

I ask that you consider the consequences of passing this bill and vote NO.

Sincerely,

Cheryl Williams
Regional Vice President, Sales & Marketing
Starwood Hotels & Resorts Worldwide, Inc.