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To: The Honorable Donovan M. Dela Cruz, Chair
and Members of the Senate Committee on Ways and Means

Date: Thursday, March 28, 2019
Time: 10:00 A.M.
Place: Conference Room 211, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: H.B. 1042, Relating to Tax Reporting

The Department of Taxation (Department) strongly supports H.B. 1042, an Administration measure, and offers the following comments for the Committee's consideration.

H.B. 1042 amends Hawaii Revised Statutes (HRS) sections 237-30.5 and 237D-8.5 to revise the way persons who collect rents or gross rental proceeds on behalf of owners of real property or operators of transient accommodations report such collection to the Department.

Under current law, persons collecting rent or gross rental proceeds on behalf of others must report information identifying each owner or operator on whose behalf they collect. However, they are not required to report the total amount of money collected on behalf of each owner or operator. Current law also requires the person to provide the owner or operator a copy of a tax liability notice. Under current law, there is no penalty for noncompliance with the reporting requirements.

H.B. 1042 would require persons who collect rents or gross rental proceeds on behalf of others to report to the Department the total amount of rent or gross rental proceeds collected on behalf of the owner or operator during the previous calendar year. The bill would maintain reporting of the identifying information required under current law as well as the requirement to provide a tax liability notice to the owner or operator. Finally, H.B. 1042 imposes a penalty for noncompliance with the reporting requirements. The penalty is $500 per violation per month.

The Department believes this bill will improve compliance in two ways. First, the increased reporting requirements will lead to increased voluntary compliance. If taxpayers know that the Department has information detailing how much rent they received, they will be more likely to complete returns and pay their taxes voluntarily. This will lead to both better collections and a reduced administrative burden.

Second, reporting of the total amount of rent and gross rental proceeds collected will provide an independent measure of a taxpayers' receipts. This will simplify and improve the accuracy of any eventual audit of the taxpayer.

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

LEGISLATIVE TAX BILL SERVICE

TAX FOUNDATION OF HAWAII

126 Queen Street, Suite 304 Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, TRANSIENT ACCOMMODATIONS, Reporting Rental Activity

BILL NUMBER: HB 1042; SB 1268 (Identical)

INTRODUCED BY: HB by SAIKI by request; SB by KOUCHI by request

EXECUTIVE SUMMARY: Updates the manner in which persons authorized to collect rent for others provide information to the Department of Taxation and establishes penalties for noncompliance.

SYNOPSIS: Rewrites section 237-30.5 and 237D-8.5, HRS, that now provides for notice to the property managers' clients. Imposes penalties of $500 a month for noncompliance unless it is shown that the failure was due to reasonable cause and not to neglect.

EFFECTIVE DATE: Upon approval.

STAFF COMMENTS: This is an Administration bill sponsored by the Department of Taxation and designated TAX-02 (19).

Under current law, property managers and similar businesses who collect rent for another are supposed to provide their clients with specific notices and are supposed to provide the Department specific information. However, since current law does not provide penalties for failure to do so, compliance with this provision appears to be spotty at best.

This bill attempts to address this problem.

Digested 2/4/2019

March 28, 2019

LATE

TO: Senate Committee on Ways and Means
The Honorable Donovan M. Dela Cruz, Chair
The Honorable Gilbert S.C. Keith-Agaran, Vice Chair

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

RE: HB1042 Relating to Tax Reporting - OPPOSE

Dear Chairman Dela Cruz, Vice Chairman Keith-Agaran and distinguished members of the Senate Committee on Ways and Means,

I represent the Expedia family of companies providing online travel booking to the world. While Expedia recognizes the Legislature's desire to find a reasonable way to collect taxes that are due to the State in this bill, we, unfortunately, cannot support HB1042.

HB1042 includes provisions that violate state and federal law and would not withstand judicial scrutiny. It also includes provisions that are simply bad policy that will both impact the financial benefits that the state enjoys from having a robust vacation rental market and lead to some portion of vacation rentals going "underground" to avoid onerous regulation.

Passing HB1042 would invite a legal challenge because the proposed amendments of law violate state and federal laws. HomeAway and other hosting platforms have filed lawsuits in other jurisdictions based on these legal grounds. By summarizing the requirements of the Stored Communications Act and U.S. and Hawai`i Constitutions, HomeAway hopes to persuade Hawaii to pass a workable state law that does not violate state and federal law.

Stored Communications Act – Privacy of Personal Information

HomeAway must protect the personal information of the homeowners and travelers who use its websites. A federal law, the Stored Communications Act (SCA), sets forth the legal process required before HomeAway may respond to a request for owner or traveler information from a governmental entity. Notably, the SCA provides a private cause of action to individuals whose information is provided to a governmental entity in violation of the statute's requirements. 18 U.S.C. § 2707. Should HomeAway fail to abide by the SCA's legal requirements for disclosing information, as HB1042 requires it to do, it risks incurring civil liability to the individuals whose information is disclosed.

Provisions of HB1042 violate the SCA. To protect the privacy of online communications, Congress passed the SCA, which "creates a set of Fourth Amendment-like privacy protections by statute, regulating the relationship between government investigators and service providers in possession of users' private information." Orin S. Kerr, *A User's Guide to the Stored Communications Act, and a Legislator's Guide to Amending It*, 72 Geo. Wash. L. Rev. 1208, 1212 (2004). "The Act reflects Congress's judgment that users have a legitimate interest in the

confidentiality of communications in electronic storage at a communications facility." *Theofel v. Farey-Jones*, 359 F.3d 1066, 1072–73 (9th Cir. 2004).

The SCA restricts government entities' ability to compel disclosure of the contents of users' communications and information from an electronic communications service (ECS) or a remote computing service (RCS). *See, e.g.*, 18 U.S.C. § 2703(a)-(c); *see also id.* § 2702(a). In simple terms, an ECS is any service that allows users to communicate electronically with one another, while a RCS is any service that stores or processes information submitted by users. *See* 18 U.S.C. §§ 2510(15), 2711(2). A single service may satisfy both definitions.

HomeAway is both an ECS and a RCS. HomeAway is fundamentally a communications platform and thus qualifies as an ECS because it enables communications between listing owners and travelers through the secured communication feature it provides on its websites. Indeed, most reservations are made through direct online communications between an owner and traveler. HomeAway is also a RCS because it stores and processes information provided by users, including communications, pictures of properties, and listing information provided by owners.

A federal court in Portland held that HomeAway was an ECS and RCS. *HomeAway.com, Inc. v. City of Portland* (D. Or. Mar. 20, 2017), No. 3:17-CV-91. And a federal court in Washington, D.C., recently held that Airbnb, which provides a similar secured communications service, is an ECS. *In re United States for an Order Pursuant to 18 U.S.C. § 2705(b)* (D.D.C. Jan. 30, 2018, No. MC-17-2490-BAH), 2018 WL 692923. An entity that is either an ECS or RCS is obligated to follow the SCA's requirements.

The SCA limits the forms of process a government entity may use to obtain information from HomeAway, as an ECS and RCS, depending on the type of information sought. It divides electronic information into two distinct categories: first, the *contents* of users' communications, 18 U.S.C. § 2703(a)–(b), and second, non-content customer *records*, *id.* § 2703(c). Within the second category, the SCA recognizes a "subset of noncontent records (sometimes known as 'basic subscriber information')" consisting *solely* of the customer's name, address, phone number, and other basic information. 18 U.S.C. § 2703(c)(2). A federal appellate court has stated that it is "abundantly clear" that the SCA applies to "even a list of customers." *Telecomms. Regulatory Bd. Of P.R. v. VTIA-The Wireless Ass'n*, 752 F.3d 60, 67 (1st Cir. 2014).

When a government entity seeks the *contents* of communications, the protections of the SCA are at their highest. *See* 18 U.S.C. § 2703(a)–(b). A warrant based upon probable cause is sufficient to obtain the contents of communications, and is required for communications that have been in the electronic storage of an ECS for 180 days or less. *Id.* § 2703(a), (b)(1)(A), (c)(1)(A). If the government seeks non-content customer "records," the SCA provides somewhat more limited protections. *See* 18 U.S.C. § 2703(c). But a subpoena is still insufficient to obtain most non-content records. For such records, the government generally must either obtain a court order authorizing disclosure, or demonstrate that the customer consented to disclosure. *Id.* § 2703(c)(1)(B)–(C). Section 2703 permits the disclosure of basic information—which, as explained above, is limited to a customer's name and address, and other discrete categories—*only* if the government employs an administrative, grand jury, or trial subpoena. *Id.* § 2703(c)(2). Thus, in Portland, the court held that the SCA barred the City's attempt to obtain user information from HomeAway without obtaining an appropriate subpoena or court order.

What this all means is that HB1042 would require HomeAway to hand over private homeowner information and transactional data particular to each owner *without any kind of legal process at all*, and therefore violates the process established by the SCA to protect individuals' privacy.

U.S. and Hawai`i Constitutions - Protected Privacy Interests

HB1042 also violates the provisions of the U.S. and Hawai`i Constitutions prohibiting unreasonable searches and seizures. Amendment IV to the U.S. Constitution[1] provides:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Article 1, § 7 of the Hawai`i Constitution provides:

> The right of the people to be secure in their persons, houses, papers and effects against unreasonable searches, seizures and invasions of privacy shall not be violated; and no warrants shall issue but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized or the communications sought to be intercepted.

Although the Congress that enacted the SCA in 1986 believed that it was supplementing constitutional protections, it now is well-established that the Fourth Amendment extends to electronic communications and protects against government searches. The U.S. Supreme Court has warned against allowing technological advances to "erode the privacy guaranteed by the Fourth Amendment." *Kyllo v. United States*, 533 U.S. 27, 34 (2001). It is long-established that the Fourth Amendment's protection of "papers" covers business records. *Hale v. Henkel*, 201 U.S. 43, 76-77 (1906); *see also Marshall v. Barlow's Inc.*, 436 U.S. 307, 311 (1978) (Fourth Amendment protects business property no less than residential property).

As such, hosting platforms like HomeAway have a protected privacy interest in the information sought under SB1268. This is true even though that information pertains to the owners and operators. *City of Los Angeles v. Patel*, 135 S.Ct. 2443 (2015) (hotel owners had reasonable expectation of privacy as to information on guests' names and addresses, and details about guests' vehicles).

This theory was recently accepted in a consolidated federal case in New York, in which HomeAway and Airbnb successfully enjoined a New York City ordinance similar to HB1042 that would require them on a monthly basis to turn over voluminous data regarding customers who use their websites to advertise vacation rentals. *Airbnb, Inc. v. City of New York*, (S.D. N.Y. Jan. 3, 2019), 18 Civ. 7712 (PAE) and 18 Civ. 7742 (PAE). The court had "little difficulty"

[1] By virtue of its incorporation through the Due Process Clause, the amendment is binding on states. *City of Ontario v. Quon*, 560 U.S. 746, 750 (2010).

holding that the ordinance "is a search or seizure within the Fourth Amendment." In so holding, the court discussed an expansive line of authority that "ma[de] clear that the compelled production from home-sharing platforms of user records is an event that implicates the Fourth Amendment." *See Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186 (1946) (holding that the Fourth Amendment applied to administrative subpoenas *duces tecum* issued in an investigation into violations of the Fair Labor Standards Act); *United States v. Morton Salt Co.*, 338 U.S. 632 (1950) (recognizing that the protection of the Fourth Amendment "is not confined literally to searches and seizures as such, but extends as well to the orderly taking under compulsion of process"); *See v. City of Seattle*, 387 U.S. 541 (1967) (compulsion of corporate books and records are subject to the Fourth Amendment); *McLane Co., Inc. v. E.E.O.C.*, 137 S.Ct. 1159 (2017) (compulsion of records implicates "the privacy interests protected by the Fourth Amendment").

The requirements sought to be imposed under SB1268 violate HomeAway's constitutionally-protected privacy interests. The protection's central command is that official searches and seizures be reasonable. *Riley v. California*, 134 S.Ct. 2473, 2482 (2014). In the context of civil cases, as opposed to criminal cases, federal courts require "special needs" to validate suspicion-less searches. *New Jersey v. T.L.O.*, 469 U.S. 325 (1985). The information-seeking party must show that it is impracticable or unreasonable to require the government to demonstrate individualized suspicion to a neutral decision-maker before conducting the search. *Id*.

The effect of HB1042 is to allow suspicion-less searches without *any* showing that it is impracticable or unreasonable to demonstrate individualized suspicion to a neutral decision-maker. Such an invasion violates both the U.S. and Hawai`i Constitutions.

* * * * *

The vacation rental industry plays a vital role in Hawaii's economy. We would like to work with the state and local governments to modernize the regulations of this important economic sector. We note that the City and County of Honolulu considered several measures last year on transient vacation rentals that are being prepared for consideration by the Planning Commission. We want to work to protect communities while also protecting the State's economy. This legislation does not meet those goals.

Thank you for the opportunity to share this testimony.