

TRAVEL LAW: TAXES AND ONLINE TRAVEL COMPANIES IN HAWAII

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Municipalities and States have vigorously sought to tax online travel sellers [Travel Law 5.05[1]]. In Dickerson & Hinds-Radix, *Taxing Internet Transactions: Airbnb and the Sharing Economy* (2014),

www.nycourts.gov/courts/9jd/TacCert_pdfs/Dickerson_Docs/1.pdf

it was noted that "The issue of taxing Internet transactions is, primarily, about how to fairly tax new and unfamiliar business models. But it is also about trying to accommodate traditional and vested business interests threatened by the Internet...

Certainly, Internet businesses should pay their fair share of taxes in those environments in which they sell their goods and services...Developing fair and reasonable taxing methodologies for Internet businesses is a work in progress, which started sometime ago with the taxing of Internet retailers or

'resellers'" [see *Overstock.com v. N.Y. State Dep't of Taxation & Finance*, 20 N.Y. 3d 586 (2013) (Internet tax)] and has expanded to

taxing the sharing economy [see Kaplan & Nadler, *Airbnb: A Case Study in Occupancy Regulation and Taxation*, 82 U Chi L Rev Dialogue 103 (2015)]. In this article we examine a decision by the Supreme Court of Hawaii, *Matter of the Tax Appeal of Travelocity.Com, L.P. v. Director of Taxation*, 2015 WL 1207380 (Hawaii Sup. 2015) involving the assessment of Hawaii's General Excise Tax (GET) and Transient Accommodations Tax (TAT) upon of online travel companies (OTCs).

Introduction

"This case considers whether the (GET) and the (TAT) are assessable on the relevant income of commercial entities operating under business models that were not expressly considered by the legislature when the applicable GET and TAT statutes were originally enacted. The Director of Taxation, State of Hawaii (Director) retroactively assessed online travel companies (OTCs) for unpaid GET and TAT for periods beginning between 1999 and 2011 and continuing until 2011, plus applicable penalties. The OTCs appealed the assessments to the Tax Appeal Court (tax court) which ruled in favor of the Director with regard to the assessment of the GET...with penalties and interest, ruled in favor of the (OTCs) with regard to the assessment of the TAT...We affirm...in part and vacate in

part...the GET Assessments, affirm in regard to the TAT assessments and remand...for further proceedings". We only review herein the assessment of the GET and related penalties imposed since the Court held that "The TAT is not applicable to the OTCs in the Assessed Transactions".

The Assessed Transactions

"The OTCs are organizations doing business with Hawai'i hotel guests (transients) and Hawai'i hotels. They operate websites where transients can research their destinations, compare travel options and make reservations with third-party suppliers such as airlines, car rental companies and hotels. The OTCs do not own any hotels. The OTCs sell room accommodations using a business model that involves two different types of contracts: the first, the hotel grants the OTC the right to sell occupancy of a hotel room to a transient, and in the second, the right to occupy the hotel room is sold to the transient by the OTC. The Director's GET and TAT Assessments are on transactions made under this business model".

The OTC-Hotel Contracts

"...the hotel grants (by contract) the OTC the right to

offer room occupancy to the public out of the hotel's inventory (and) delegates to the OTC numerous 'day-to-day' responsibilities the hotel would otherwise perform itself, including the marketing, pricing, tax collecting, payment processing, legal contracting, tax collecting, payment processing, legal contracting, accounting and customer service functions (and) establishes the rate the hotel will charge the OTC for a room (net rate)...An OTC independently sets the price the transient is charged for the room based (on) the net rate, plus...a 'mark up' and a 'service fee' (all of which) equals the 'retail rate' the OTCs charge the transient for the room".

The OTC-Transient Contract

"...a contract with a transient...reserves the...right to occupy a hotel room for a certain period of time...Prior to check-in the transient is considered to be solely the OTC's customer (and) pre-pays the OTC in full (and) owes nothing to the hotel at check-in...the OTCs collect the room charge and taxes from the transients and control the monies paid by the transients...The hotel invoices the OTC for the hotel stay, typically after the transient has checked out".

Purpose Of GET Assessments

"The GET is imposed on the gross income derived from the sale of services or rental income resulting from all services or rental income resulting from all services activities that occur within the state...This court has previously stated that the GET statute 'evidences the intention of the legislature to tax every form of business...not specifically exempted from its provisions' ...'Read as a whole, the GET taxes 'virtually every economic activity imaginable'...The GET is a privilege tax assessed 'based on the privilege or activity of doing business within the state and not on the fact of domicile'".

GET Assessments Limited

"The GET would be assessed on the gross income received by the OTCs from the transient for the provision of Hawai'i hotel rooms. However, the 'inherent pervasiveness' of the GET, with its expansive definition of income, is mitigated by limited categories of income-reducing provisions...the GET Apportioning Provision divides income between hotel operators and a 'travel agency and tour packager'...Accordingly, if the income...may be divided between the hotel as 'the operator of the transient accommodation on the one hand' and the OTCs as the 'travel agent or tour packager on the other hand', the GET may only be imposed on the OTCs' 'respective portion' of the gross income-that is,

the gross income less the 'net rate'".

GET Assessments Apply To OTCs

After finding that "the OTCs operate as travel agencies in the Assessed Transactions" the Court held that "the GET is assessable on the gross income of each person providing transient accommodations in accordance with the respective portion of the proceeds of each. Accordingly, when travel agencies and hotel operators contract to provide transient accommodations to a transient, the GET Apportioning Provision provides that the GET is imposed on the travel agency and hotel operator on the respective portion of the gross income allocated or distributed to each, and no more".

Failure To File Penalty

A penalty "not exceeding twenty-five per cent in the aggregate" shall be imposed unless the taxpayer can demonstrate "that the failure (to file) is due to reasonable cause and not due to neglect". "Here, the tax court determined that OTCs failed to demonstrate a fact that indicated a dispute as to whether they were required to file GET returns and the OTCs failed to demonstrate that they were aware of any Department or AG letter,

opinion or communication to the contrary. The determination of the tax court that the OTCs failed to meet their burden to demonstrate their honest belief that they were not reasonable for filing GET returns was not clearly erroneous and is therefore affirmed".

Failure To Pay Penalty

"In light of the statutory mandate that the Department's assessments are prima facie correct, it is clear that the legislature intended an evidentiary presumption that the failure to pay was due to negligence or intentional disregard of the rules by the taxpayer, and it is the taxpayer's burden to prove otherwise. As such, the assessments of the Department, including penalties for failure to pay due to negligence or intentional disregard of the rules, are prima facie correct and the burden is on the taxpayer to prove otherwise...Thus, the determination of the tax court that 'there are no genuine issues of material fact on the question of penalties for failure to pay general excise taxes' was not clearly erroneous and is therefore affirmed".

Conclusion

For other cases involving the taxation of OTCs see Travel

Law at 5.05[1].

Justice Dickerson has been writing about *Travel Law* for 39 years including his annually updated law books, *Travel Law*, Law Journal Press (2015) and *Litigating International Torts in U.S. Courts*, Thomson Reuters WestLaw (2015), and over 350 legal articles many of which are available at www.nycourts.gov/courts/9jd/taxcertatd.shtml.

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