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Is Hawaii's Hotel Room Tax Law Obsolete?

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With tax collections falling behind expectations, State lawmakers are pressuring the tax department to increase effort to collect uncollected taxes from internet sales. In 2015 the State Attorney General's Office scored a "major" victory when the Hawaii Supreme Court ruled that online travel companies (OTCs) are required to pay Hawaii's general excise tax (GET) on their hotel bookings. Subsequently, the Tax Appeal Court ordered OTCs to pay $53.1 million in back general excise taxes plus interest to the state.

The State had also sued the OTCs for underpaying Hawaii's transient accommodation tax (TAT), also known as the hotel room tax.[1] That was a major loss for the Attorney General's Office. At issue in that suit was whether the OTCs should have been remitting TAT on the full retail price of the rooms they charge their consumers, or only the tax on the wholesale room rates (called net rates) that they pay to hotels for the rooms they contract with the hotels and resell to consumers. The State argued that OTCs should have been paying TAT on the full retail room rates; OTCs disagreed. The Hawaii Supreme Court (March 17, 2015) sided with the OTCs.[2]

Hawaii enacted its TAT in 1986. Hawaii's TAT is levied on the operator of transient accommodations. Hawaii Revised Statutes Chapter 237D states: the TAT is "assessed and collected each month…on the gross rental or gross rental proceeds received from furnishing transient accommodations. Every operator shall pay to the State the tax imposed by this section as provided in this chapter. An "operator" is "any person operating a transient accommodations whether as owner or proprietor or as lessee, sublessee, mortgagee in possession, licensee, or otherwise, or engaging or continuing in any service business which involves the actual furnishing of transient accommodation."

The Hawaii Supreme Court, basing its decision on the legislative history of the TAT, determined that "…a single operator is associated with the furnishing of transient accommodations…Here the hotels in the Assessed Transactions are acknowledged by all parties to be an operator within the meaning of the use of that term as provided by HRS & 237D-1; thus, for purposes of the TAT Assessments, only the hotels are operators in the Assessed Transactions. Therefore, the OTCs are not operators and the TAT is not applicable to the OTCs in the Assessed Transactions." That Hawaii lost so handily shouldn't have been surprising from the very beginning given the way the TAT statute was written.

[1] *In the Matter of Travelocity v. Dir. of Taxation*, 346 P.3d 157 (Haw. 2015)

[2] *In the Matter of Travelocity v. Dir. of Taxation*, 346 P.3d 157 (Haw. 2015)

The dispute between states and local governments in the U.S. and OTCs over the appropriate tax base for online lodging sales has been going on since at least 2004. According to the Tax Foundation, which keeps tabs on the ongoing litigations, as of February 2016, tax jurisdictions in 34 states and the District of Columbia have filed similar lawsuits against the OTCs; OTCs have won in 23 states and lost in 6 states.[3]

That OTCs have won most of the litigations is not surprising because in most cities and states hotel occupancy tax statutes were written before the advent of OTCs, and were not worded in a way that would allow state and local governments to prevail. Travelocity and Expedia didn't even exist before 1996.

Traditionally, hotel guests booked directly with hotels or with the assistance of travel agencies. Travel agencies acted as brokers and received a commission from the hotels. Under this "agency model" the hotel is the merchant of record. (The agency model is still in use by brick-and-mortar travel agencies and online travel companies.) The hotel guest paid his/her room rent to the hotel and not to the travel agency. Either way, what the hotel received from the guest was the same whether the booking was made directly with the hotel or through a travel agency. Typically, hotel occupancy tax statutes—including Hawaii's TAT--specify that the hotel room tax is some percent of the room rental revenues/price hotels received.

In the digital era, the relationship between hotels, guests and travel intermediaries changed as the OTCs found a more profitable business model. Under the "merchant model" OTCs are the merchants of record. They contract for rooms with hotels at wholesale rates (net rates), add their mark-up and "service fee and taxes" (bundled together) and resell them to customers. Hoteliers contract with OTCs to collect all the money, including applicable taxes. Consumers pre-pay their stay to the OTCs and not to the hotels. After check out, hotels invoice the OTCs; OTCs then pay the hotels the negotiated net rates and the taxes collected from the guest based on the net rate.

Thus, under the merchant model of distribution what a hotel guest pays to the OTC for the right to occupy the room and what the hotel receives from the OTC are not the same. Obviously, under traditional hotel occupancy tax statutes, taxes calculated on the net rates are lower than if they were calculated on the full retail rates paid by consumers. The same room booked by a hotel guest directly with a hotel will have a higher tax bill than one purchased from a merchant model OTC, assuming the rooms are sold at about the same price.[4]

For the consumer, the only price that matters is the total price charged by the OTC, inclusive of the net rate, mark-up, fees and taxes. If he/she does not pay the total price, he/she cannot occupy the room. Indeed, in 2014, the Wyoming Supreme Court ruled that OTCs' mark-ups were "services necessary to complete the sale" and hence part of the sale price subject to Wyoming's sales tax.[5]

[3] Tax Foundation, *Litigation Ongoing against Online Travel Companies for Hotel Occupancy Taxes*, February 17, 2016. Most of the law suits have been filed by cities.

[4] They are. See Michael Mazerov, *State and Local Governments Should Close Online Hotel Tax Loophole and Collect Taxes Owed*, Center on Budget and Policy Priorities, April 12, 2011. Agreements between hotel chains and OTCs tend to maintain price parity between the two channels of distribution.

[5] *Travelocity.Com LP, et al. v. Wyoming Department of Revenue*, Wyoming Supreme Court, No. S-13-0078, April 3, 2014, reported in Sales Tax Institute, "Online Travel Companies Liable for Tax on Total Amount Paid by Customers in Wyoming," April 7, 2014.

If one agrees that the appropriate tax base should achieve tax neutrality—i.e. the correct tax base should be the rental price paid by the hotel guest (excluding taxes)[6] regardless of how the room was purchased--then many existing hotel occupancy tax statutes should be rewritten.[7]

New York State did just that. In 2010 New York State revised its state sales tax statute to ensure that OTC mark-up and fees are fully taxed. Chapter 57 of the Laws of 2010 effective September 1, 2010 was enacted "to ensure that state and local sales taxes (sales tax) are paid on the full amount charged to customers by businesses such as Web-based travel companies (hereinafter room remarketers) for hotel occupancy in New York State."[8] The new law defines "*room remarketer* as 'a person who reserves, arranges for, conveys, or furnishes occupancy, whether directly or indirectly, to an occupant for rent in an amount determined by the room remarketer, directly or indirectly, whether pursuant to a written or other agreement'…Businesses, such as travel agencies, that reserve rooms on behalf of their customers and do not have the right to determine the amount of rent their customer pays for the room…are not room remarketers for purposes of this new law." Under the new law, a room remarketer is considered a hotel operator.[9]

New York State's law also applies to the hotel room occupancy tax imposed and administered by New York City requiring the hotel room occupancy tax in the City to be paid on the entire amount paid by consumers for a hotel room. Expedia filed a law suit against New York City, but the City won.[10]

In 2010 the District of Columbia also amended its lodging tax statute (Title 47 of the District of Columbia Office Code.) requiring online travel companies to pay sales tax on the total amount paid by consumers to online travel companies, including the retail margins.[11] Section 47-2202 (2) was amended to read as follows: "If the occupancy of a room or rooms, lodging, or accommodations is reserved, booked, or otherwise arranged for by a room remarketer, the tax imposed by this paragraph shall be determined based on the net sale or net charges received from the transient by the room remarketer." Net sale or net charges is defined as "the gross receipts from the sale of or charges for any room or accommodations received by a retailer from a room remarketer." The law was upheld by the D.C. Superior Court in 2012 and again by the D. C. Court of Appeals in 2015.[12]

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[6] This would require the OTS to separate the "fees and taxes" on consumer bills.

[7] Mak, J. 2012. "What Should Be the Appropriate Tax Base for OTCs' Hotel Room Sales?" Pages 775-786 *Tax Analysts*. Tax Analysts, Falls Church, Virginia.; Mazerov, 2011; National Conference of State Legislatures, *NCSL Task Force on State and Local Taxation Principles for the Taxation of Online Travel Companies*, August 12, 2013.

[8] New York State Department of Taxation and Finance, Office of Tax Policy Analysis, Taxpayer Guidance Division, *Amendments Affecting the Application of Sales Tax to Rent Received for Hotel Occupancy by Room Remarketers*, TSB-M-10(10)S, Sales Tax, August 13, 2010; also Breen M. Schiller, "Mind the Gap: The Current Debate Between States & Municipalities and Online Travel Companies over the Taxability of the Remittance Gap," *Journal of State Taxation*, January-February 2011.

[9] New York State Department of Taxation and Finance, *A Guide to Sales Tax for Hotel and Motel Operators*, Publication 848 (2/15), p.9.

[10] Schiller, 2011; http://law.justia.com/cases/new-york/court-of-appeals/2013/180-1.html

[11] D.C. Law 18-364. Payment of Full Hotel Taxes by Online Vendors Clarification Act of 2010.

[12] www.taxrate.com, "Online Travel Companies Liable for D.C. Sales Tax, Again," July 24, 2015.

Likewise, in 2010 North Carolina amended its state sales tax statute—G.S. 105-164.4(a) (3)—effective January 1, 2011 to tax the gross receipts of "facilitators" (OTCs) at "applicable combined state and county sales tax rates."[13] The "sales price of the rental of an accommodation marketed by a facilitator includes charges designated as facilitation fees and any other charges necessary to complete the accommodation rental."

In 2003 the Oregon Legislature passed House Bill (HB) 2267 to establish a state lodging tax; then in 2013 the Legislature passed HB 2656 which "requires transient lodging providers and transient lodging intermediaries to collect and remit taxes computed on the total retail price paid for occupancy of transient lodging."[14]

According to the National Conference of State Legislatures, as of 2015, seven states—Georgia, South Carolina, North Carolina, New York, Minnesota, Wyoming and Oregon—and the District of Columbia require OTCs to pay taxes based on the full retail rates paid by consumers.[15] The amended statutes have generally survived legal challenges in their highest courts.[16] However, there are strong anti-tax sentiments in some parts of the U.S. Florida failed to pass similar legislation. Missouri passed legislation stating specifically that OTC mark-ups and fees are not taxable.[17] Indeed, the Tax Foundation advocates a federal law that would bar "discriminatory taxation of online travel company services."[18]

The National Conference of State Legislatures has developed a number of principles regarding the taxation of online travel companies, among them: "To ensure full collection of taxes that are due and to promote equity and fairness in tax code, states should consider requiring OTCs to remit taxes based on the rental price paid by the user."[19] Moreover, "To ensure that taxation is efficient, states should consider imposing any tax on online travel companies through statutory provisions and not through administrative regulation." Hawaii state lawmakers should re-examine the state's transient accommodation tax law and determine if it should be amended to take account of changes in the way visitor accommodations are distributed in the digital age.

[13] Sales and Use Tax Division, North Carolina Department of Revenue, *Important Notice: Tax on Accommodations* at http://www.dornc.com/taxes/sales/impnotice1210.pdf

[14] Oregon Department of Revenue, *State of Oregon Lodging Tax Program*, 150-604-401 (Rev.01-17). A lawsuit filed by OTCs against the Oregon Department of Revenue was voluntarily dismissed in 2015.

[15] *The Baltimore Sun*, "Lawmakers stir travel industry furor over taxing online hotel bookings," March 28, 2015.

[16] Laws in Georgia, South Carolina and Wyoming survived challenges by the OTCs in their respective Supreme Courts.

[17] *Travel Weekly Daily Bulletin,* "New Missouri Law Says OTA Hotel Markups are Tax Free," July 13, 2012
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[18] Tax Foundation, *Special Report 230*, February 2016; also, Tax Foundation, *Special Report No. 198*, Taxation of Online Travel Service, May, 2012.

[19] National Conference of State Legislatures, *NCSL Task Force on State and Local Taxation Principles for the Taxation of Online Travel Companies*, August 12, 2013.

JAMES MAK, PH.D.
UHERO FELLOW, PROFESSOR EMERITUS OF ECONOMICS