Taxing Timeshare Occupancy

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Abstract

In this paper, we evaluate the manner in which timeshare occupancy is taxed in the State of Hawaii. Our objective is to ascertain how best to design a timeshare occupancy tax that treats all types of visitor accommodations equitably and enhances tourism's net economic benefit to Hawaii's residents. In particular, we address two concerns. First, what is the incidence of the timeshare occupancy tax? Second, what is its appropriate tax base? Answers to these two questions inform optimal timeshare taxation policy in Hawaii and elsewhere in the U.S.

JEL:
Keywords: Timeshares, Occupancy tax, Transient accommodation tax, Hotel room tax, Tourist taxes.

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I. Introduction

State and local governments often levy special taxes on tourists in order to appropriate economic rents from tourism to benefit residents and to compensate for tourism-induced negative externalities and increased demand for public goods. The hotel room occupancy tax is the most widely imposed such tax around the world (Mak, 2005; Mak, 2006). Where it is levied, the hotel room tax is most often an ad valorem tax levied on the rental price of an occupied hotel room. However, the tax is often not automatically applied to timeshare occupancy.

Legislating timeshare occupancy tax in any jurisdiction is complicated by the fact that there may be several types of occupants of timeshare units—the owner occupants, guests who occupy units by exchanging timeshare intervals they own for other timeshare intervals, guests who "pay" with vacation points obtained from timeshare companies, or renters who rent units like hotel or vacation condominium guests.[1] In the U.S. there remains strong political opposition to taxing timeshare units occupied by their owners and exchange guests.[2] The American Resort Development Association (ARDA), which represents the interests of timeshare owners, has lobbied vigorously across the nation against the extension of transient (i.e. hotel) occupancy taxes to timeshares (ARDA, 2005; ARDA, 2006 Update; ARDA, 2007). In 2005, rental of U.S. timeshare units generated a modest $80 million in state and local occupancy taxes.[3] As the timeshare industry gains

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[1] Rezer (2002, p. 252) found that nationally nearly two-thirds of all occupancy in the typical timeshare unit is not the timeshare owner. Also Miner (2000), p. 4.

[2] For example, California's Revenue and Taxation Code Section 7280 specifically forbids local governments from imposing a transient accommodation tax on timeshare owners and exchange guests. In 2007, the Washoe County Commission (Nevada) passed an ordinance containing similar provisions (ARDA, 2007). A 2007 bill introduced in the South Carolina legislature to impose a $5 per night tax on all non-owner occupied timeshare units did not get a committee hearing but the bill may resurface (ARDA, 2007). ARDA claims that it had successfully stalled efforts to impose a $5 *per diem* tax on timeshare exchangers at the state and county levels in South Carolina since 2005; earlier in 1998, ARDA helped to prevent the imposition of a 7 percent sales tax on the fair market rental value of timeshare exchanges (ARDA, 2005).

[3] ARDA, "Economic Impact of the Timeshare Industry on the U.S. Economy" http://www.arda.org/AM/Template.cfm?Section=Economic_Impact. There were 176,232 timeshare units at 1,615 resorts in the U.S. in 2007; Florida (30.4%), California (6.7%) and South Carolina (6.5%) led the states in the

importance in the hospitality sector (Upchurch and Gruber, 2002), its potential to generate tax revenues has attracted increased attention from state and local lawmakers across the country.[4]

In this paper, we examine and evaluate the manner in which timeshare occupancy is taxed in the State of Hawaii. Unlike in other states, Hawaii levies an occupancy tax on all occupied timeshare units whether they are occupied by renters, their owners, or exchange (and other non-paying) guests. Our objective is to ascertain how best to design a timeshare occupancy tax that treats all types of visitor accommodations equitably and enhances tourism's net economic benefit to Hawaii's residents. We address two main points. First, we ask who bears the burden of timeshare occupancy taxation. Second, because Hawaii's timeshare occupancy tax is levied on the "fair market rental value", we ask how best to determine this "fair market rental value" in the absence of an observed market price.

On the first point, we find that the burden of the tax falls primarily on visitors rather than on the providers of the accommodations as alleged by the timeshare industry except where owners occupy their own units. On the second point, we find that Hawaii's current use of maintenance costs as its timeshare occupancy tax base falls far short of ideal. This analysis of Hawaii's experience in taxing timeshare occupancy should be of interest to other states with a significant number of (and market for) timeshare units. As far as we are aware, this paper represents the first scholarly research on this topic.

Sections II and III of the paper describe evolution of the timeshare industry and provide basics of timeshare taxation in Hawaii, respectively. Section IV analyzes the incidence of the timeshare occupancy tax; Section V analyzes the timeshare occupancy tax base; Section VI

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number of timeshare units.

[4] In addition to the growing interest in the taxation of timeshare occupancy, some jurisdictions are examining the manner property taxes are levied on timeshare units as well. For example, in Taney County, Missouri a dispute recently surfaced on whether timeshares should be assessed as commercial or residential property. (See ARDA, 2007.)

concludes.

II. Evolution of the Timeshare Industry

Timeshare ownership—also commonly referred to as "vacation ownership" in North America—is one of the fastest growing sectors in travel and tourism around the world (Pryce and Bruère, 1999). The first timeshare program in the world began in France in 1967 when one of the largest construction companies in Europe sold specific hotel units in a ski resort to individuals guaranteeing the buyers occupancy of the purchased unit for a specified time interval (e.g., one week) each year. The company's sales pitch touted the benefits of owning rather than renting a hotel room (Pryce and Bruère, 1999, p. 16).

A major disadvantage of timeshare ownership in the early years was its inflexibility: the buyer was restricted to vacationing in the same place, in the same unit, and at the same time each year. A new institutional arrangement had to be created to enable owners of timeshare units to exchange use of their units for other units either at other times of the year, and/or for units in other locations. The founding of the timeshare exchange company, RCI—formerly known as the Resort Condominiums International—in 1974 was a major institutional innovation that substantially mitigated the inflexibility of early timeshare ownership. Research has shown that flexibility and the availability of exchange opportunities are the most important motivations for timeshare purchase (Pryce and Bruère, 1999, p. 28; Rezer, 2002, p. 251; Crotts and Ragatz, 2002, pp. 232 and 234; ARDA 2006). RCI, currently the world's largest timeshare exchange company, boasts that it has arranged exchange vacations for more than 54 million people worldwide since its founding.[5]

[5] There are currently two major timeshare exchange companies in the world, RCI (1974) and Interval International (1976), both headquartered in the U.S. So dominant are these two exchange companies that Pryce and Bruère (1999, p. 28) describe them as "an effective duopoly for worldwide timeshare exchange services. " RCI is currently affiliated with more than 4,000 resorts worldwide and a membership of 3 million (http://www.rci.com/RCIW/)

The establishment of the exchange company did not entirely overcome the inflexibility of traditional timeshare ownership. That is not surprising given the inherent inflexibility of a barter system. A points-based system provides more flexibility.[6] Timeshare resorts developed on the points-based system—often sold as "vacation club memberships"--operate much like hotels. Rather than purchasing deeded shares for a week in specific units, buyers buy points from a timeshare company. These points are used as "currency" to "purchase" accommodation at any of the timeshare company's resorts, or they can also be used to purchase airline tickets, car rentals, restaurant meals and other vacation goods. The points are renewed each year, and if a member desires more points this year, he/she can purchase more points from the timeshare company or borrow points from future allocations.

Pryce and Bruère (1999, p. 91) opine that "the metamorphism of timeshare is almost complete with the introduction of the points-based system. The original real estate concept has been transformed into a flexible, pre-paid vacation membership concept."[7] Since 1999, points-based timeshares represent 10 to 15 percent of annual timeshare sales (Pryce and Bruère, 1999, p. 87; Rezer, 2002, p. 251). By 2004, almost half of the timeshares sold in the U.S. were based on the points system rather than based on fixed blocks of time in specific units (Stock, 2004).

History of Timeshares in Hawaii

Hawaii became the first vacation destination in the U.S. to develop timeshares in 1968 by converting a hotel to timeshare ownership. There was little follow-up activity until the collapse of the whole-ownership condominium market in 1974 right after the first oil crisis of 1973 and

compared to around 2,200 affiliated resorts and 2 million members for Interval International (http://www.intervalworld.com/web/cs?a=5). Information accessed from their respective websites.

[6] It also has some negatives. See Pryce and Bruère (1999), p. 79.

[7] The evolution of the points-based system obviously poses a threat to the exchange companies (Pryce and Bruère, 1999, p. 83).

timeshare developers found it profitable to convert excess condominium units into timeshare intervals (Pryce and Bruère, 1999, p. 16). The State began to regulate the industry in 1980 primarily to protect consumers from the aggressive selling practices of timeshare sales agents and developers (State of Hawaii, Office of the Auditor, 1992).

Timeshare development accelerated in the 1980's (Hobson Ferrarini Associates, 2002; PKF Hawaii, 2002). Hobson Ferrarini Associates (2002, p. 40) attribute the acceleration to several factors, among them: (1) Maturation of the industry and wider consumer awareness; (2) Quality improvement and better marketing; (3) The entry of bigger and more reputable timeshare companies; and (4) Increased opportunities for developers to convert existing condominiums to timeshares, especially after the massive damage inflicted on the condominium inventory by Hurricane Iniki (1992) on the island of Kauai (Hobson Ferrarini Associates, 2002, p. 40).

By 2000, the 4,603 timeshare units in Hawaii represented an increase of 40 percent from 3,261 units in 1995/96 and comprised 6 percent of all timeshare units in the U.S. In 2000, about 66 percent of the timeshare intervals in Hawaii were ownership units with the purchasers receiving deeded interest. The remaining 34 percent entitled the purchasers to the right to use a facility/accommodation but did not involve deeded interest (Hobson Ferrarini Associates, 2002, p. 40). While the first timeshare units in Hawaii were converted from former hotel and condominium units, more recently properties are being built by global hotel brands (e.g. Marriott, Hilton, etc.) specifically as timeshares, frequently in mixed-use resorts that also contain traditional hotel and condominium units. At the end of 2007, the State of Hawaii Department of Business, Economic Development and Tourism (DBEDT, 2008b) reported 7,997 timeshare units statewide or about 11 percent of the total visitor lodging inventory. Hawaii's timeshare inventory continues to rise even as its hotel inventory has declined in recent years.

III. Genesis of the Timeshare Occupancy Tax in Hawaii

Taxation of timeshare occupancy in Hawaii did not immediately follow the onset of regulation in 1980. In fact, the State did not initially levy a specific excise tax on the occupancy of any of the nearly 55,000 transient accommodation units in Hawaii, including hotels (DBEDT, 2008). The Hawaii State Legislature finally enacted a statewide hotel room tax in 1986 (also known as the transient accommodation tax, or TAT). In addition to the 4 percent general excise tax levied on the gross receipts (inclusive of the tax) on all final sales in Hawaii, the state began to levy 5 percent on the gross receipts from the rental of an occupied transient accommodation.[8] However, the TAT did not apply to timeshare occupancy.

With the anticipated completion of the Hawaii Convention Center in 1997 and the need to finance the project, the Legislature raised the TAT from 5 to 6 percent in 1994. It was not until 1998 that the state began to apply the TAT to timeshares by enacting Act 156. Act 156 raised the TAT to the current level of 7.25 percent and imposed the same rate on the "fair market rental value" (FMRV) of occupied timeshare units, regardless of whether the units are occupied by their owners, exchange guests, or renters.

Although the language of the 1998 statute (HRS 237D) extending the TAT to timeshares is relatively simple, the administration of the tax is actually quite complex (see Table 1). Hawaii Revised Statutes HRS 237D requires the owner of a timeshare who rents his unit to pay the TAT equal to 7.25 percent of the gross rental proceeds; he must also obtain a general excise tax license and pay the general excise tax (4 percent in 1999) on the gross rental proceeds. HRS 237D also requires the timeshare plan manager of a unit to file and pay the "timeshare occupancy tax" (or, TOT) of 7.25 percent of the estimated "fair market rental value" if the unit is occupied by its owner

[8] Fujii, Khaled, and Mak (1985) and Bonham, Fujii, Im and Mak (1992) found that the hotel room tax was largely forward shifted to tourists. In their study Miklius, Moncur, and Leung (1989, Table 4, p. 10) found that over 90 percent of the hotel room tax was exported to nonresidents.

or an exchange guest. Hence, two separate taxpayers are responsible for paying occupancy taxes to the tax department on a timeshare unit if it is partly rented (TAT) and partly occupied either by the owner or an exchange (or any nonpaying) guest (TOT). In effect, Act 156 extended the TAT to rented timeshare units and established a TOT to units occupied by owner occupants and nonpaying guests. Curiously, before the passage of Act 156 in 1998, the State did not impose the TAT on timeshare units that were rented out in the open market. In 2006, an attempt to extend the TAT to timeshare exchange guests (HB1026) failed when the industry mounted a coordinated campaign at the Legislature opposing the measure (Zimmerman, 2006).[9]

While Act 156 was vigorously opposed by the timeshare industry, it was strongly supported by the Hawaii Hotel Association. The President of the Hawaii Hotel Association argued that the timeshare industry in Hawaii was not paying its fair share of state taxes. He noted that in 1996 the state's hotels and condominiums paid $124 million in transient accommodation taxes in addition to local property taxes (Yuen, 1997).

Fairness in the treatment of timeshare versus hotel/vacation condominium occupancy was the ostensible reason for taxing timeshare occupancy. However, the primary motivation—though not explicitly mentioned in Act 156-- was the state's pressing need for tax revenues. The 1990s were challenging years for Hawaii's tourist industry and the economy in general. Visitor arrivals grew at an anemic rate of .4 percent per year; and in four of those ten years, visitor arrivals recorded negative growth. By contrast, there was only one year of negative tourism growth in the preceding 30 years (Mak, 2008, Chapters 2 and 3). The overall state's economy stagnated for 7 straight years beginning in 1991 following the first Gulf War (Grandy, 2002). Toward the end of the decade, the State Government's accumulated fiscal surplus from past years had nearly vanished. Lawmakers sought to replenish the treasury with new sources of revenue but as one lawmaker observed "there

[9] ARDA claims that it saved timeshare owners from paying a 4-fold increase in timeshare accommodation taxes. Accessed at http://www.arda.org/AM/Template.cfm?Section=Done_lately_2006_PDF

are not a lot of revenue generators out there" (Yuen, 2007). Moreover, the conversion of existing visitor accommodation units to timeshares was eroding the transient accommodation tax base. A tax on timeshare occupancy paralleling that on other forms of transient accommodations was expected to generate between $20 and $30 million each year (Yuen, 1997).

Though it is not unusual to enact new taxes in tight fiscal times, the question of whether these taxes are well-enacted (i.e. the question of "how" the taxes are levied) remains independent of motives (the question of "why" the taxes are levied). There are no studies that evaluate the efficacy of the timeshare tax policy as it exists in Hawaii (or anywhere else) today. In the next two sections, we attempt to answer two important questions addressing the efficacy of this tax policy. Where does the tax incidence fall? And is the tax levied on the correct base?

IV. Analysis of the Incidence of the Timeshare Occupancy Tax

In this section we analyze the consequences of extending Hawaii's hotel occupancy tax to timeshares. Absent suitable micro-data and the opportunity for direct empirical estimation of these effects, we conduct a theoretical examination of incidence and provide predictions of the direction of change following increased timeshare taxation. Instead of treating the vacation lodging sector as a single market, we envision two vacation accommodation markets in Hawaii: hotels and timeshares. All occupants are treated as renters[10], and vacationers search for the highest utility available to them across potential accommodations. In equilibrium, the price of timeshares and hotels should be such that $U_T = U_H = \overline{U}$, where U_T is the utility to the vacationer of renting a timeshare, U_H is the utility of renting a hotel room. We also assume that vacationers care only about the relative price of the rentals, p_T and p_H when choosing between timeshares and hotel accommodations. The timeshare

[10] Thus timeshare owners who occupy their units rent from themselves.

industry produces timeshare units according to some production function, $f(\bullet)$. Furthermore $f'(\bullet) > 0$ and $f''(\bullet) < 0$.

Though we do not have specific empirical evidence on supply and demand elasticities in the timeshare and hotel markets, we have empirical evidence that demand for vacation rentals overall is highly price inelastic (Mak, 2005; Mak, 2006). Indeed, Bonham et. al. (1992) found *ex post* that a 5 percent hotel room tax enacted by Hawaii in 1986 had no negative impact on Hawaii's lodging industry. So we assume there are N total vacationers in Hawaii and hold this number fixed throughout. This assumption may not appear to be entirely realistic, but we claim it closely approximates empirical reality Initially, we consider an equilibrium where hotels garner $(1-m)*N$ of the market and timeshares garner the remaining $m*N$ visitors, where m is the share of total visitors who choose to stay in timeshares. Now suppose we increase the tax on timeshare occupancy, t. If rental prices do not adjust, U_T falls so that $U_T < \overline{U}$ and no one will want to rent timeshares. Thus, it must be the case that prices adjust to allow $U_T = \overline{U}$ and demand for timeshares is in the interval $[0,\infty]$. Suppose m(t) is the share of visitors who choose timeshare accommodations at timeshare tax, t. We saw from the previous analysis that $m'(t) < 0$. In other words, the number of vacationers who choose timeshare accommodations falls when the timeshare occupancy tax increases, assuming all else is constant.

To fully understand where the burden of the tax falls, examine what happens to the relative profits of the timeshare and hotel owners. First, we see that in initial equilibrium, $f'(m(t)) = f'(1-m(t)) = \overline{p}$. When a new timeshare occupancy tax is levied, it must be true that for timeshares $f'(m(t)) = p(t) + t$ and for hotels $f'(1-m(t)) = p(t)$, where p(t) is the price of vacation accommodations at tax, t. If we differentiate these with respect to the tax rate t, we find that $-f''(1-m(t))m'(t) = p'(t)$ and $f''(m(t))m'(t) = p'(t) + 1$. Adding the two together, we arrive at the following:

$$p'(t) = \frac{m'(t)\{f''(m(t)) - f''(1-m(t))\} - 1}{2} \qquad (1)$$

We know that $m'(t) < 0$ and $m(t) < 1 - m(t)$. Since $f''(\bullet) < 0$ is must then be the case that $f''(m(t)) > f''(1-m(t))$. As a result, $p'(t) < 0$.

We now examine what happens to aggregate profits in the timeshare and hotel industries. The change in aggregate profits due to a change in the tax rate t is given by:

$$\pi'(p)p'(t) + \pi'(p)p'(t+1)$$

$$= \pi'(p)\left(\frac{m'(t)\{f''(m(t)) - f''(1-m(t))\} - 1}{2} + \frac{m'(t)\{f''(m(t)) - f''(1-m(t))\} - 1}{2} + 1\right)$$

$$= \pi'(p)\left(m'(t)\left(\frac{p'(t)+1}{m'(t)} - \frac{p'(t)}{m'(t)}\right) - 1\right)$$

$$= 0.$$

In other words, a general equilibrium analysis predicts that the full incidence of the tax is shifted away from the hotel and timeshare providers and falls on the visitors. Thus, the timeshare occupancy tax increases the net gain from tourism to Hawaii's residents.

V. Analysis of Hawaii's Timeshare Occupancy Tax Base

While the "fair market rental value" (FMRV) of a rented unit is in general unambiguous (i.e. it is the market rental price), this terminology becomes ambiguous when a unit is occupied by its owner or an exchange (or other nonpaying) guest. HRS 237D defines the "fair market rental value" as:

> An amount equal to one-half the gross daily maintenance fees that are paid by the owner, are attributable to the time share unit, and include maintenance costs, operational costs, insurance, repair costs, administrative costs, taxes, other than

> transient accommodation taxes, and other costs including payments required for reserves or sinking funds.

The current definition greatly understates the fair market rental value.

To understand this better, suppose the interval owner of a timeshare unit purchases it as an investment to be rented for profit. The prevailing rental price would be its fair market rental value. Over the entire period of ownership, at minimum, that daily rental price (P) must recover the average daily operating and capital cost of the investment, including a reasonable return on the capital invested (AC). In markets that are highly competitive, the long run average daily rental price (P) must be equal to the average daily (operating and capital) cost (AC); i.e. P=AC. P is observable. The problem in establishing the fair market rental value when a timeshare unit is not rented for profit is that P is not observed. Thus, we require a more creative method of estimating the approximate value of P. A good approximation of P is an estimate of AC. AC is the sum of operating cost (OC) and capital cost (CC).[11] More precisely the capital cost is the user cost of capital, defined as:

$$CC = r(B + E) + D$$

where r is the real interest rate, B is debt, E is equity, and D is economic depreciation (Bruce, 1998, pp. 570-571). Thus the user cost of capital is the sum of interest on the value of the timeshare unit plus economic depreciation. For the timeshare interval owner, an approximation of a timeshare unit's fair market rental value (FMRV) is therefore:

$$FMRV \approx OC + r(B + E) + D$$

which is very different from the definition of FMRV in HRS 237D. The current statute defines FMRV as one-half the "gross daily maintenance costs"—which roughly equals 1/2 x OC. Moreover, the user cost of capital is not included in the definition. Thus, HRS 237D is flawed by design and understates the fair market rental value of occupied timeshare units that are not rented in

[11] Another option is to find actual rental prices of comparable units. More on this below.

the open market. Using information from a sample of timeshare units in Hilton Head Island, South Carolina, Ziobrowski and Ziobrowski (1997, Table 2, p. 376) show that there is a positive correlation between the rental price and the purchase price of a timeshare unit but not a strong correlation between the rental price and annual operating costs.[12] Hence, operating costs are a poor proxy for a timeshare unit's fair market rental value.

We can also calculate a rough estimate of the extent of the understatement in Hawaii's statutory timeshare occupancy tax base relative to its fair market rental value. ARDA Hawaii Chapter's 2008 study of the state's timeshare industry estimates that in 2007 the average daily rate for a rented timeshare unit was $218 (Hospitality Advisors LLC, 2008). The average daily maintenance fee was $143.71 (=$1,006 per week divided by 7 days); one-half of that amount is $71.85. Thus, in 2007, the statutory average daily timeshare tax base amounted to a mere one-third of the unit's fair market rental value.

Table 2 shows Hawaii state tax revenues collected on transient accommodations between calendar years (CY) 1999 and 2007. Note that the TAT column aggregates all transient accommodation tax collections from rentals of all types of visitor units, including TAT revenues from rented timeshare units; the TOT column includes only tax revenues derived from units occupied either by their owners or exchange (and other non-paying) guests.

Table 2 shows that TOT tax collections increased at a faster pace than TAT revenues, but the dollar amounts were modest. It is also noteworthy that the TOT revenue series showed no decline following the September 11, 2001 terrorist attacks. By contrast, TAT revenues decreased for two straight years between 2000 and 2002. Timeshare owners continued to travel even when terrible

[12] They note (p. 377) that "…there was no significant correlation between the price of the timeshares and their respective annual maintenance fees." Both Ziobrowski and Ziobrowski and Rezak (2002) find very little variation in maintenance fees among timeshare units of different sizes.

events dissuaded others (e.g. occupants of hotels) from traveling.[13] Between 2000 and 2001, the number of visitors to Hawaii staying in timeshares increased by 20 percent while visitor arrivals staying in hotels decreased by 12.4 percent. Between 2001 and 2002, the number of visitors to Hawaii staying in timeshares increased by 11 percent while the number of visitors staying in hotels increased by only 2.8 percent (DBEDT, 2002, p. 6 and also 2003, p. 8). Pryce and Bruère (1999, p. 146) also point to the "recession-proof nature of timeshare." All else being equal, a tax revenue series that is tied to operating costs is almost certainly less likely to be adversely impacted following negative external shocks than one tied to hotel rental prices.

Table 3 displays data on the number of visitors to Hawaii who stayed in timeshare units, timeshare inventory, and TAT and TOT tax revenues for calendar years (CY) 2000, 2005, 2006, and 2007. Tax revenues collected under the TOT comprised only 2.5 percent (or less) of combined TAT and TOT revenues and are much lower than their respective visitor arrival and timeshare inventory shares of total visitor arrivals and total visitor accommodation units in Hawaii. Timeshare resorts typically enjoy higher occupancy than other types of tourist accommodations (ARDA and ARDA-Hawaii, 1997, p. 2-11; ARDA International Foundation, 2001, p. 2-13; PKF Hawaii, 2002; Hospitality Advisors LLC, 2008.) and rented at higher average prices.[14] TOT collections per available timeshare unit in 2007 was $726 compared to $3,476 in TAT collections per unit for all other types of transient accommodations. This works out to about $1.99 (=$726/365 days) per available unit per day for timeshares and $9.52 (=$3,476/365 days) per available unit per day for all other transient accommodations.

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[13] In the month of September, 2001 average occupancy rate at timeshares in Hawaii declined from 86.5 percent to 79.9 percent while the average occupancy rate at other resorts and hotels declined from 77.9 percent to 58.6 percent (Cruz, 2002). Occupancy of timeshares also held up better than hotels in Phoenix, Arizona after 9/11 (Luzadder, 2005).

[14] The average daily rental price of timeshare units in 2007 (among ARDÅ Hawaii members) was $218; the average daily rental price of all transient accommodation units in Hawaii in 2007 was $200 (State of Hawaii, 2008a, Table 7.35).

Note that the TOT revenues displayed in Table 3 do not include all transient accommodation tax revenues collected from timeshare units, as undetermined amounts of tax revenues collected from units rented in the open market are reported in the TAT totals rather than under the TOT column. However, the missing amounts are not likely to be very large. Only two percent of the Hawaii timeshare owners responding to a survey in the mid-1990s rented out their units (ARDA and ARDA-Hawaii, 1997, p. 3-4). In 2000, 40.2 percent of Hawaii's timeshare intervals were occupied by their owners, 43.3 percent were exchanged, 5.2 percent were given away at no charge, and only 3.5 percent of the intervals were rented (ARDA International Foundation, 2001, Exhibit 3-E).[15] ARDA Hawaii (Hospitality Advisors LLC, 2008) estimated that in 2007, timeshare units that were rented out collected less than $3 million in transient accommodation tax (TAT) revenues compared to nearly $227 million in TAT revenues collected from all transient accommodation rentals.

Why did the 1998 Hawaii Legislature define the "fair market rental value" of occupied timeshare units as 50 percent of "gross daily maintenance fees"? It was certainly not because the lawmakers wanted to give timeshare visitors preferential tax treatment vis-à-vis visitors who elect to stay in hotels and condominiums; in fact, lawmakers sought equity between timeshare and hotel rentals (See State of Hawaii Department of Taxation, 1998, p. 1.) Rather, PMCI Hawaii—the local lobby retained by the Hawaii chapter of the American Resort Development Association (ARDA)—explains the outcome as follows:[16]

> Beginning in 1992, measures began being introduced to impose the State hotel room tax on timeshare properties. Working with the industry, PMCI was able to defer enactment of the tax for six years. Because of the leadership change in 1998, there

[15] By comparison, among RCI members who reside and own a timeshare interval in the U.S. in 2000, Miner (2000, p. 4) found that 33.6 percent of the time intervals was personal use or use by other household members; 28 percent of the time was exchanged; 25.2 percent of the time was banked for future use; 3.7 percent of the time was given away to friends, relatives and co-workers; 2.8 percent of the time was rented; and 6.5 percent of the time was left unused.

[16] Accessed at http://www.pmcihawaii.com/pages/cs_ARDA.html

> was a virtual certainty that a bill imposing a hotel room tax on timeshare properties would finally pass. The focus of PMCI's engagement was then shifted to minimize the impact of the tax on timeshare owners. A nationwide e-mail campaign of timeshare owners and industry leaders was designed and implemented and local timeshare owners were organized to testify in person. As a result of this campaign, PMCI was able to negotiate an acceptable protocol for application of the tax based on a percentage of maintenance fees.

In sum, politics is the cause behind the economically faulty definition of "fair market rental value" in HRS 237D. Although Act 156 professed to extend the state's hotel room tax to timeshare occupancy to achieve equity across types of accommodations, it ultimately failed to do so. ARDA (2005) claims that this political victory "limited the amount when finally enacted from about $24 per day to about $6 per day." This amounts to taxing timeshare occupancy at 25 percent of fair market rental value. HRS 237D provides for adjustment in the calculation of the "fair market rental value" if "the taxpayer proves or the director determines that the gross daily maintenance fees do not fairly represent fair market rental value taking into account comparable transient accommodation rentals or by other appraisal methods." However, due to the political strength of the timeshare industry, it is conceivable that those involved in the negotiation expected occupancy of timeshares to be taxed at below fair market rental value. The lack of *any* timeshare occupancy tax in many other states perhaps attests to the political strength of the timeshare industry.

VI. Conclusion and Lessons

Timeshare occupants in Hawaii and across the country enjoy preferential treatment in the form of low tax rates under existing transient occupancy tax laws. If preferential treatment induces consumers to substitute timeshares for hotel rentals, the current laws result in the unintended consequence of eroding the hotel occupancy tax base. The preferential tax treatment of timeshares also creates economic inefficiency by inducing more resources than are optimal to be directed to timeshare development.[17]

Tourist destinations impose transient occupancy taxes for a variety of reasons, among them to appropriate economic benefits for the residents of the host communities. Entry and departure taxes and hotel occupancy taxes are the most frequently imposed taxes to appropriate gains from tourism (Bird, 1992). One Hawaii lawmaker who opposed the enactment of Act 156 argued that the State's hotel occupancy tax should not be applied to timeshares because timeshares involve ownership, whereas hotel occupancy is transient (Yuen, 1997). However, today's timeshares do not necessarily involve ownership as the original real estate concept of timeshares has increasingly evolved into a flexible prepaid membership vacation club concept.

Owners of timeshares also argue that they should not have to pay timeshare occupancy taxes because they already pay property taxes and maintenance fees (Zimmerman, 2006). Similarly, the President and CEO of ARDA has argued that timeshare exchange guests should not have to pay occupancy taxes in places they visit because "exchangers own timeshares and already pay real estate taxes in the communities in which they own their intervals." (Lodging Hospitali*ty,* 2005). Hawaii's TAT and TOT are levied on personal consumption. Mak (2008, Chapter 4) argues that the enactment of the TAT in 1986 was a sound policy decision. By contrast, property taxes levied on hotels and timeshare units represent taxation of capital (Fisher, 2007, Chapter 14). An owner of a timeshare unit who occupies his own unit is both an investor and consumer; he can be a pure investor by buying the timeshare interval and renting his unit out for profit.[18] On both horizontal

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[17] The growing timeshare inventory (relative to hotel properties) in Hawaii has also decreased the demand for the services of travel wholesalers. Seiden (2008).

[18] Crotts and Ragatz (2002, p. 234) found in their nation-wide survey that more than 10 percent of the timeshare owners purchased them for "investment or resale potential." However, Ziobrowski and Ziobrowski (1997) argue that timeshares are unprofitable investments.

and vertical equity grounds[19], the consumption tax on timeshare occupancy, arguably, should be levied on all units whether occupied by owners, exchange guests, or renters. Pryce and Bruère (1999, p. 57) note that from the standpoint of the major hotel companies that have entered the industry, "timeshare is really just another way of packaging and pricing a hospitality product." However, in the real world, whether to tax or not to tax owner- and guest occupied timeshare units is ultimately decided in the political arena and the outcome must achieve political equilibrium. There remains strong political opposition in the U.S. to taxing owner- and exchange occupancy of timeshare units.

Hawaii's experience demonstrates that under the right circumstances it is politically possible to tax all timeshare occupants. However, in several respects, Hawaii's approach to taxing timeshare occupancy is seriously flawed. Most importantly, Act 156 fails to bring parity to the taxation of timeshares versus other transient accommodations. Instead, it produced a system that generates very modest amounts of tax revenues at high compliance and administrative costs. If horizontal equity cannot be achieved for political reasons, the State should consider redesigning the tax system to reduce its high cost of compliance and collection. Currently, a unit that is partly rented and partly occupied by the owner or exchange guest requires two separate individuals to file two separate excise tax returns plus the end of the year annual reconciliation. Moreover, the data required to estimate "average daily maintenance fees" are costly to compile; clearly more so than "gross rental proceeds." For the Tax Department, the current TOT is virtually impossible to enforce as the timeshare plan manager is only required to report an aggregate estimate for maintenance fees without having to provide specifics on what is included. Auditing out-of-state timeshare owners for

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[19] Hawaii's timeshare owners on average are generally more affluent than the general tourist population; they also stay longer and travel with a larger party. ARDA and ARDA-Hawaii, 1997, p. 3-1; Hobson Ferrarini Associates, 1999, p. 43; and PKF Hawaii, 2002.

compliance is also impractical.[20] In sum, Hawaii's current system of taxing timeshare occupancy is too complicated.

Ideally, the fair market rental values of timeshare units that are not rented are estimated from actual rental prices of comparable units. That may not be so easy where the rental market for timeshares is thin.[21] Actual rental prices must be gathered on comparable timeshare units of different sizes (hotel room, studio, one bedroom, two bedrooms, etc.), different qualities (standard vs. deluxe; ocean vs. garden view, etc.), different times of the year (high season vs. prime season), and so on. Data must be collected on too many comparable rentals. Rentals of hotel and vacation condominium units might serve as the closest proxies.

One solution, albeit less equitable, might be a per diem tax as proposed in the South Carolina General Assembly, but with a two-tier price—for example, $10 per day for one bedroom (and smaller) units and $15 per day for two bedroom (and larger) units—on all occupied units. The initial per diem values, if desired, can be calibrated to collect roughly the same (average) amount of tax revenues per day as would be collected on hotel or vacation condominium rental units. The per diem charges are periodically adjusted to account for price changes.

Ultimately, the decision on whom to tax and how heavily depends on the policymakers' objectives (Mathematica, 1970, pp. 54-59). Consider the following three tourism sector objectives: (1) maximize returns to timeshare owners; (2) maximize net government revenues (i.e. revenues minus expenditures); and (3) maximize total social benefits minus social costs. These three objectives may entail different tax policies. The first objective implies a light tax burden; the second objective implies a heavier tax burden; and the third objective may imply either a light burden if residents want to encourage the development of timeshares in their community or a heavier tax

[20] In 2000, ninety-nine percent of Hawaii's timeshare owners were not residents of Hawaii.
[21] See, for example, http://www.redweek.com As well, a check of one national website offering timeshare rentals finds that rental prices are typically not posted in advance; instead interested renters are asked to make an offer. http://www.sellmytimesharenow.com/searchrent.php?crt=on&state=18&unitType=&bath

burden if they want to (and are able to) export taxes to nonresidents.[22] It is generally agreed (see for example World Tourism Organization, 1994) that in designing tourism policies, the overall wellbeing of destination residents is the most important.

[22] Gade and Adkins (1990) note that it is not uncommon for states and local governments to design their tax systems to export taxes to non-residents.

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Table 1. Summary of HRS 237D on Taxation of Timeshare Occupancy in Hawaii

	TAT on Rented Units	TOT on Owner-Occupied and Non-Paying Guest Occupied Units
Tax Rate and Base	7.25% on Gross Proceeds	7.25% on "Fair Market Rental Value"
Additional Taxes	4% General Excise Tax + Cost of General Excise Tax License	None
Who Files?	Timeshare Owner	Timeshare Plan Manager

Source: State of Hawaii Department of Taxation (1998).

Table 2. TAT and TOT Collections: CY 1999- CY 2007

Year	TAT Revenues	% Change	TOT Revenues	% Change	Total	% Change
1999	$151,935,527	--	$1,431,417	--	$153,366,944	--
2000	173,440,002	14.2	1,920,499	34.2	175,360,501	14.3
2001	172,581,948	-0.5	2,019,812	5.2	174,601,760	-0.4
2002	159,178,975	-7.8	2,453,711	21.5	161,632,686	-7.4
2003	167,870,116	5.5	2,810,809	14.6	170,680,925	5.6
2004	186,341,527	11.1	3,566,737	26.9	189,908,264	11.3
2005	203,515,764	9.2	3,865,643	8.4	207,381,407	9.2
2006	216,023,150	6.1	4,526,434	17.1	220,549,584	6.3
2007	226,735,412	5.0	5,806,789	13.0	232,542,201	5.4

Source: Unpublished data from the records of the State of Hawaii, Department of Taxation (DoTax) kindly supplied by Titin Sakata of DoTax.

Table 3. Timeshare Visitors, Plant Inventory and Tax Revenues: CY 2000 and 2005-2007.

Year	# of Timeshare Visitors	# of Timeshare Units	TAT Revenues	TOT Revenues
2007				
Number	656,504	7,997	$226,735,412	$5,806,789
% of state total	8.9%	10.9%*	97.5%**	2.5%**
2006				
Number	630,726	6,592	$216,023,150	$4,526,434
% of state total	8.5%	9.1%*	97.9%**	2.1%**
2005				
Number	539,706	6,429	$203,515,764	$3,865,643
% of state total	7.3%	8.9%*	98.1%**	1.9%**
2000				
Number	293,316	4,603	$173,440,002	$1,920,499
% of state total	4.2%	6.4%*	98.9%**	1.1%**

Note: * These represent percentages of all visitor lodging (including hotel room and condo) units
** These represent percentages of total TAT + TOT revenues.

Sources: Timeshare visitors from the State of Hawaii, Department of Business, Economic Development and Tourism, *2006 Annual Visitor Research Report* (2007), p.11; *2001 Annual Visitor Research Report*, p. 6; and Monthly Visitor Statistics at http://hawaii.gov/dbedt/info/visitor-stats/tourism/2007/dec07.swf. Timeshare inventory for 2005-2007 from the State of Hawaii, Department of Business, Economics Development and Tourism (DBEDT) (2008b) and from Minh-Chau Chun, Tourism Specialist at DBEDT, dated June 18, 2008. For 2000, from American Resort Development Association International Foundation (2001), p. 4-8. TAT and TOT revenues are unpublished data from the records of the State of Hawaii, Department of Taxation (DoTax) kindly supplied by Titin Sakata of DoTax.