

TIME TO END THE PREFERENTIAL TAXATION OF TIMESHARE OCCUPANCY?

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Timeshares comprise a significant percentage of visitor accommodations in Hawaii. There are currently over 11,000 timeshare units in the state, and unlike traditional hotel accommodations, their number keeps growing. Timeshare visitors represented almost 10% of all visitor arrivals in Hawaii during the third quarter of 2017. In Hawaii timeshare owners are required to pay an occupancy tax to the State. State lawmakers want to increase the amount timeshare owners pay.

It took many years of political wrangling before Hawaii lawmakers enacted a transient accommodation tax (TAT)—also commonly known as a hotel room tax—in 1986. The initial rate of 5% was levied on the gross rental receipts of hotel room (and short-term condo) rentals. Although the tax was levied on hoteliers, it was passed on to occupants (consumers) as lawmakers had intended. The law did not apply to timeshares.

To eliminate the preferential tax treatment of timeshare ownership, in 1998 state lawmakers enacted legislation (HRS 237D) to tax occupancy of timeshares. Under the new law timeshare owners who rent out their units, like hoteliers, are required to pay the TAT.

However, most timeshare units are not rented out in the open market. For example, in the third quarter of 2017, 15.5% of timeshare occupied room nights in Hawaii were transient rentals, owners using their timeshare intervals accounted for 56.9%, 19.9% were “exchanges” (units occupied by timeshare owners who participate in an exchange program), and 7.7% were used for sales/marketing purposes (e.g. free rooms to attend a timeshare sales pitch).¹

Under HRS 237D, owners of occupied units not rented out must pay the timeshare occupancy tax (TOT); that includes owners who occupy their own units.² The amount is calculated by applying “the appropriate tax rate multiplied by the fair market rental value of the time share unit and multiplied by the number of days the time share unit is occupied.”³

How does a timeshare owner determine the fair market rental value of a unit that is not rented out? Ideally, it should be estimated from actual rental prices of comparable units that are rented out. That may not be possible where the rental market for timeshares is thin. Lawmakers came up with their own definition.

HRS 237D defines the “fair market rental value” of timeshares 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.”

A UHERO 2008 working paper noted that the definition in HRS 237D greatly understates a timeshare’s fair market rental value. An approximation of a timeshare unit’s fair market rental value is equal to

¹ Hawaii Tourism Authority (HTA), Hawaii Timeshare Quarterly July–September 2017 at <http://www.hawaiitourismauthority.org/default/assets/File/research/Timeshare/Hawaii%20Timeshare%20Quarterly%20Survey%20Q3%202017%201-3.pdf>

² A UHERO 2008 working paper provides an economic rationale for taxing owner occupants and exchangers. Briefly, the timeshare occupancy tax is a tax on consumption, and the purchase of a timeshare interval is prepayment for future vacations (consumption) rather than a real estate investment. At http://uhero.hawaii.edu/assets/UHERO_WP2008-02.pdf A shorter version of the working paper is published in State Tax Notes, February 2009.

³ State of Hawaii, Department of Taxation, Tax Facts 98-4 at <http://files.hawaii.gov/tax/legal/taxfacts/tf98-4.pdf>

the sum of upfront capital cost and operating cost. HRS 237D only captures roughly one-half of the operating cost. Thus, HRS 238D “fails to bring parity to the taxation of timeshares versus other transient accommodations.” The law gives timeshare developers an unintended advantage. 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.” The tax department has not used this option to change the timeshare occupancy tax base.

By comparison, the timeshare occupancy tax base in Palm Springs, California comes closer to meeting the economic definition of fair market rental value. Chapter 3.24.030 of the Palm Springs Municipal Code specifies the fair market rental value of timeshare occupancy “shall be computed by determining the pro rata share of the total purchase price of the time-share right or entitlement.., which share is allocable to the period transient occupancy currently involved, and adding thereto the total applicable operating costs including, but not limited to the applicable real and personal property taxes, plus the total amount of any and all fees, assessments, charges and expenses (not including the previously referred to taxes) charged by the operator as attributable to the time-share occupancy of the transient...”⁴ Palm Spring’s timeshare occupancy tax base takes into consideration both capital and operating costs of timeshare ownership.

Senate Bill 2489 SD2 currently under consideration by the 2018 Hawaii State Legislature proposes to level the playing field by increasing the amount of occupancy taxes paid by most timeshare occupants.⁵ It increases the TOT tax base from one-half of the gross daily maintenance fees to an unspecified per cent of the gross maintenance fees. Presumably the final percentage will be greater than 50 per cent. The problem is determining what the appropriate percentage should be. That will not be easy. UHERO’s 2008 working paper also concluded that HRS 237D is too complicated for owners to comply and for the tax department to administer.

An alternative to tying the timeshare occupancy tax base to maintenance fees is a per diem tax—a fixed dollar amount per day per unit determined by legislation. The tax is severed from “fair market rental value.” For example, in 2017 the U.S. Virgin Islands (USVI) enacted legislation to levy a \$25 per day occupancy fee (tax) on timeshare units in the territory regardless of the size or value of the units.⁶ A per diem tax is relatively easy to administer; a fixed sum per day is collected from occupants at the time of check-out. Owners who rent their units out are exempt from paying the TAT; all occupants now pay the per diem tax. But per diem taxes are widely viewed as unfair; in the case of timeshares, it is obviously unfair if everyone is required to pay the same amount regardless of the size or the value of the units. Tax rates could be varied to make the occupancy tax more equitable.

Lawmakers are right to reassess the way the State currently taxes timeshare occupancy to achieve greater equity and economic efficiency. Ultimately, whether or not to raise taxes on timeshare occupancy depends on the legislators’ objective. If lawmakers seek to raise short-term tax revenue, raising the occupancy tax on timeshares is the right strategy. Whether that can be best achieved by tying the tax base to timeshare maintenance fees as in SB2489 SD2 is questionable. Raising taxes on timeshares is not the right strategy if lawmakers want to encourage the development of timeshares in the state.

⁴ <http://www.palmspringsca.gov/home/showdocument?id=6021> The chapter further states, “In making the computation referred to above of the pro rata share of the total purchase price, in any case wherein the time-share right or entitlement is in perpetuity or for life or otherwise not for a definite or ascertainable term, such pro ration shall be made upon an assumed term of forty years.”

⁵ <https://legiscan.com/HI/bill/SB2489/2018> It would apply to taxable years after 12/31/2018.

⁶ <https://stjohnsource.com/2017/05/02/timeshare-group-suing-over-timeshare-fee-2/> The initial proposed fee/tax was \$30 per day.

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