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Multistate Tax
EXTERNAL ALERT

Hawaii court holds online travel companies owe general excise tax

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Overview

The Hawaii Supreme Court recently held that several online travel companies (OTCs) were:

- Subject to Hawaii's general excise tax (GET) on the difference between their online selling price and the amount paid to hotels from sales of stays in Hawaii hotel rooms; and
- Subject to failure to file and late payment penalties with respect to the GET assessments.[1]

The court cited its earlier decisions and explained that there were sufficient business and other activities in Hawaii surrounding the transactions at issue to impose the GET.[2] More specifically, the court explained that the GET taxable event was the receipt of income by the OTCs under agreements with transients (*i.e.*, hotel room customers) to provide accommodations in Hawaii hotel rooms – and thus the OTCs here were selling "occupancy rights," which were "wholly consumable and only consumable in Hawaii."[3]

However, the court also held that the OTCs were *not* subject to Hawaii's transient accommodations tax (TAT) because, unlike the hotel owners and hotel management companies, the OTCs in these transactions were *not* "operators," and the TAT should not be imposed more than once on the same hotel room stay.[4] In this Tax Alert we summarize the court's decision.

General excise tax

The 4 percent GET is generally assessed on any person doing business in Hawaii and is based on the gross income, gross proceeds of sales, or values of products in the distribution chain – *i.e.*, as "privilege taxes against persons on account of their business and other activities in the State . . . ."[5] Regarding GET imposition, the court explained that there were sufficient business and other activities in Hawaii surrounding the OTCs' transactions at issue because there was a taxable event in the receipt of income by the OTCs under agreements with transients to provide accommodations in Hawaii hotel rooms.[6] In this respect, the court reasoned the OTCs were selling "occupancy rights" for the tax years at issue, which were "wholly consumable and only consumable in Hawaii," and their agreements with customers were "effected with the intent that performance would occur entirely in Hawaii."[7]

The OTCs had unsuccessfully argued that their revenue generating activities did not occur in Hawaii – that they were merely selling the service of booking hotel reservations and that under Hawaii's "place-of-use-or-consumption rule" for sourcing income under Hawaii's export exemption and for state use tax purposes, this service occurred outside Hawaii because the OTCs' online customers generally used the service of booking reservations while they were located outside Hawaii.[8] The court rejected the OTCs' argument, explaining that these transactions constituted "business transactions that continue in the state" as performance of the OTCs' activities ultimately occurred in Hawaii, and case law shows that the statutory phrase "in the state" does not necessarily require that the taxpayer have a physical presence in Hawaii.[9]

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[1] *Travelocity.com, L.P. v. Dir. of Taxation*, 346 P.3d 157 (Haw. Mar. 17, 2015), *motion for reconsideration denied,* 345 P.3d 204 (Haw. Apr. 2, 2015).
[2] *Travelocity.com, L.P.,* 346 P.3d at 172-74.
[3] *Id.* at 174.
[4] *Id.* at 195-96.
[5] Haw. Rev. Stat. § 237-13.
[6] *Travelocity.com, L.P.,* 346 P.3d at 172-74.
[7] *Id.* at 174.
[8] *Tax Information Release No. 2009-2*, Hawaii Dep't of Taxation (Jun. 15, 2009), which included Proposed Haw. Admin. Rules § 18-237-29.53.
[9] *Travelocity.com, L.P.,* 346 P.3d at 172, 174, n.20.

Regarding the tax base computation, the court reasoned that the OTCs in these transactions operate similarly to travel agents when their underlying accommodations are provided pursuant to noncommissioned negotiated contract rates, and thus the OTCs could divide these gross receipts amongst the actual providers of the hotel and transient accommodations pursuant to "revenue splitting provisions" for travel agency and tour packagers contained within GET statutes.[10] That is, the OTCs were in essence deemed eligible to claim deductions for payments made to the providers of transient accommodations and, consequently, their GET liabilities must be based on gross income from sales to customers less the amounts paid to the hotels.

Penalties

With respect to the GET liability due, the court upheld the Hawaii Department of Taxation's (Department) assessment of underlying penalties for failure to file returns and for failure to pay tax because the OTCs failed to show that penalty abatement was warranted.[11] Note that the failure to file penalty in Hawaii is generally 5 percent per month of the tax due up to a maximum of 25 percent, and that both penalties (*i.e.*, for failure to file returns and for failure to pay tax) can be assessed in the case of negligence or intentional disregard of rules.[12]

More specifically, the court affirmed that the OTCs did not meet their requisite burden of proof to show "reasonable cause" and thus upheld the assessed penalties for failure to file returns. The court explained that to show reasonable cause for penalty abatement there must be both "other supporting circumstances" *and* an "honest belief" (*e.g.*, the advice of a competent accountant or attorney, or reliance on the statements of an agent of the taxing authority) that a taxpayer is not responsible for filing GET returns.[13]

With respect to the penalties for failure to pay tax, the OTCs unsuccessfully argued that the Department had the burden of proving that there was taxpayer negligence or intentional disregard. The court held that the Department generally has the presumption of correctness when penalties are assessed, and thus the burden of proof to demonstrate the absence of negligence and intentional disregard rested upon the OTCs.[14]

Transient accommodations tax

The TAT is generally based on the gross rental income from the furnishing of transient accommodations where the tax liability is imposed on the owner or "operator."[15] The Department unsuccessfully argued that both the OTCs and the hotels in which customers were booked constituted "operators" and thus both were subject to the TAT. The court reviewed the TAT's legislative history and found that the underlying intent is not for it to constitute a tax on the hotels but, instead, the tax is "a mechanism to tax visitors by assessing the cost of their hotel room to correlate to costs associated with visitor use of infrastructure and county services."[16] In this respect, the TAT does not "pyramid in its collection" and should not be imposed more than once (*i.e.*, should not be imposed on multiple operators) for the same hotel room stay.[17] Therefore, unlike the hotel owners and hotel management companies in these transactions, the court held that the OTCs were *not* "operators" subject to the TAT.[18]

Considerations

While this case involves OTCs and thus may readily impact businesses within the travel, tourism, and hospitality industries, the imposition and sourcing rationale used by the court may impact other businesses that historically have maintained they are not subject to the GET on their transactions. For example, commission-based businesses may potentially be affected if a commission is for the sale of an intangible or service that is intended for ultimate use or consumption in Hawaii. Accordingly, all such businesses may wish to consider their potential GET audit and assessment exposure in light of this ruling, as well as explore options for voluntary disclosure with the Department in exchange for a limited "look-back" period – especially given that assessments for discovered non-filers may potentially go back to the date that GET nexus was initially established. Also, regarding penalties, such businesses may wish to consider documenting the non-privileged advice of a competent tax consultant indicating

[10] *Travelocity.com, L.P.,* 346 P.3d at 175-77, *citing* Haw. Rev. Stat. § 237-18(g).
[11] *Travelocity.com, L.P.,* 346 P.3d at 182-84.
[12] Haw. Rev. Stat. § 231-39(b).
[13] *Travelocity.com, L.P.,* 346 P.3d at 182-83.
[14] *Id.* at 184.
[15] Haw. Rev. Stat. § 237D-2-01.1; Haw. Rev. Stat. § 237D-1-05(a).
[16] *Travelocity.com, L.P.,* 346 P.3d at 191.
[17] *Id.* at 195-96.
[18] *Id.* at 196.

that they are not responsible for filing GET returns to help show “reasonable cause” for their failure to file GET returns.

Contacts

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