

# Taxation of Online Travel Companies (The Hawaii Experience)



# Overview

- ◆ Who's involved
- ◆ Types of Taxes
- ◆ Background on assessments and appeals
- ◆ Explanation of Business Model Used
- ◆ Discussion of applicable Hawaii law
- ◆ Summary of court proceedings and current status

# Background—The Players

## – The Expedia Group

- ◆ Expedia.com
- ◆ Hotwire.com
- ◆ Hotels.com

## – The Orbitz Group

- ◆ Orbitz.com
- ◆ Cheaptickets.com
- ◆ Lodging.com

## – The Travelocity Group

- ◆ Travelocity.com
- ◆ Site59.com

## – The Priceline Group

- ◆ Priceline.com
- ◆ Travelweb.com
- ◆ Lowestfare.com

# Background

- ◆ The case started in 2007 when the AG and Department of Taxation engaged a special deputy attorney general
- ◆ Document requests went out in 2008 but the case was “mothballed” at the direction of Hawaii’s former Governor
- ◆ Case regained its “legs” in 2010 with new Governor

# Background

- ◆ Two Tax Types Involved
  - General Excise (“GET”)(a business & occupations tax in some states)
  - Hotel room tax (Transient Accommodations Tax or “TAT”)
  - Unlike elsewhere TAT is collected by the State and Hawaii’s counties share in the revenue stream

# The Hawaii Assessments

- ◆ On or about January 31, 2011, the Director assessed the OTCs for TAT and GET for the period from January 1, 2000 through December 31, 2010 (the “2011 Assessments”).
- ◆ The OTC’s booked \$2.7 billion from the sale of Hawaii hotel rooms
- ◆ The 10 year “look back” period resulted from the OTC’s failure to file tax returns in Hawaii

# The Hawaii Assessments

After obtaining actual data from the OTC's the Department issued superseding assessments in 2012 that were appealed and consolidated with the pending appeals.

# The Hawaii Assessments

- ◆ After discovery the amount of TAT and GET owed was calculated to be:
  - TAT: \$429.8 Million (with penalties and interest)
  - GET: \$246.9 Million (with penalties and interest)
  - The TAT and GET tax rates are 9.25% and 4% respectively

# The OTC's Appeals

- ◆ The OTCs appealed to Hawaii's Tax Appeal Court
- ◆ The cases were consolidated for discovery and trial.
- ◆ The parties entered into a discovery sharing agreement—meaning discovery taken in mainland cases could be used in Hawaii

# OTC's Business Models

- ◆ The OTCs have two models:
  - The Merchant Model
  - The Agency Model
- ◆ The bulk of OTCs' income comes from the Merchant Model
- ◆ The Hawaii Assessments involve ONLY the OTCs' Merchant Model

# Merchant Model

Merchant transactions can best be described as OTC controlled sales. The way these work is the OTCs enter into contracts with Hawaii hotels. These contracts grant the OTC the right to offer rooms to the public out of the hotel's inventory

# Merchant Model

In these sales, the OTC – and not the hotel – controls virtually every aspect of the commercial relationship with the hotel guest. These transactions are called “merchant model” in the industry because the OTC (not the hotel) is the “merchant of record” on the credit card transaction.

# Merchant Model

- Once an OTC has a contract with a hotel, the OTC uses its website, call centers and other means to market the hotel rooms to the public.
- The consumer books a room with the OTC, the OTC provides the consumer with the room confirmation, the consumer pays the OTC (and not the hotel), the OTC provides the consumer with a receipt for the consumer's payment, and the OTC – again, not the hotel – provides “24-7” customer support.

# Merchant Model

- ◆ Aside from handing over the room key and making the bed, the OTC – not the hotel – controls the relationship with the guest when the OTCs do business using the Merchant Model. The OTC sets the retail price for the room. The hotel is removed from the reservation process.
- ◆ The hotel receives its room revenue from the OTC per its contract with the OTC.  
**There is no contract between the hotel and the guest.**

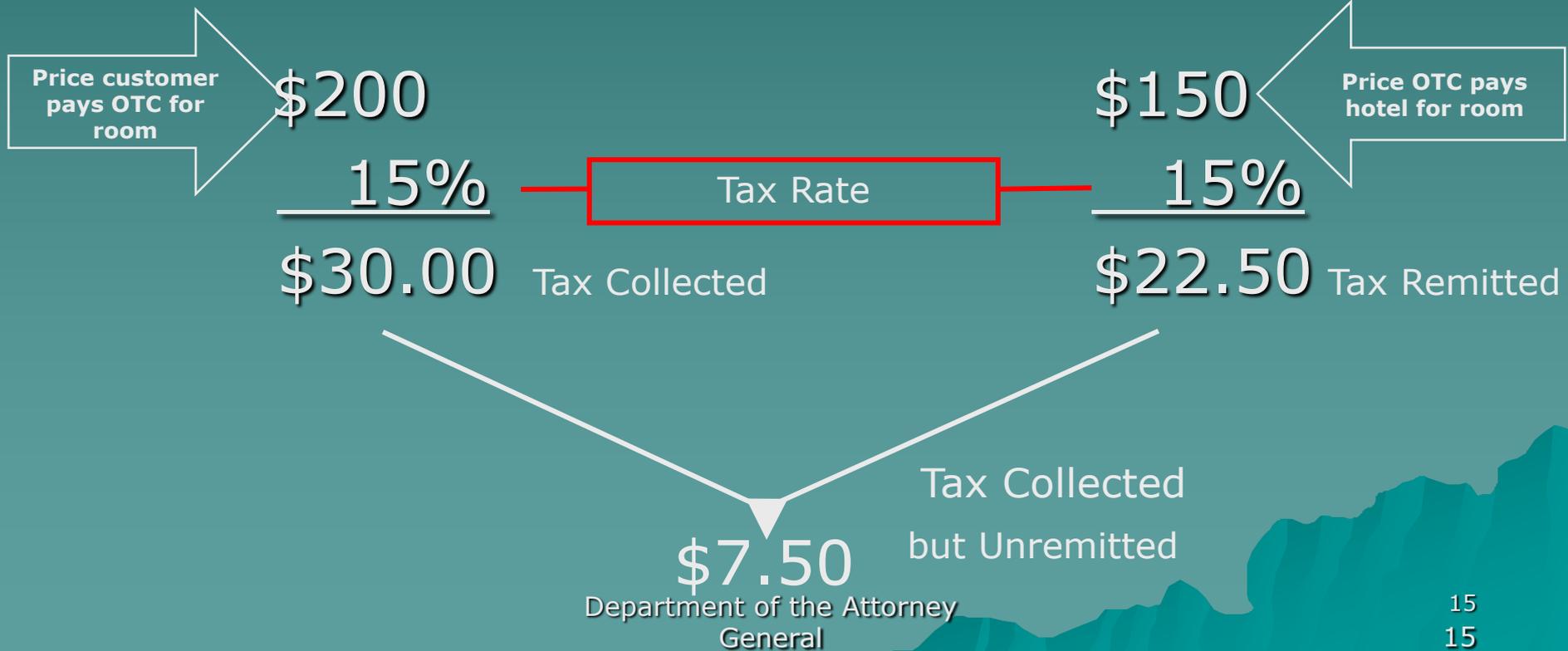
# Online Transaction

## Retail

Customer Pays OTC

## Wholesale

OTC Pays Hotel





Halekulani Hotel

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*Member of  
The Leading Hotels  
of the World*

### HALEKULANI

2199 Kalia Road  
Honolulu, Hawaii 96815

**Arrival Date:** Wednesday, September 09, 2009  
**Departure Date:** Thursday, September 10, 2009  
**Room Type:** [Diamond Head Ocean Front](#)  
**Rate Type:** [Sunrise Package](#)

City: \*  
State: Select  
or  
Country: Select  
Postal Code: \*  
Daytime Phone: \*  
E-mail Address: \*

Retype Your E-mail Address: \*  
To create an account with us, please enter a password this when logging on to our web site in the future, so remember. Starting an account will speed up your future. We will prefill the data in this page next visit with your visit.

Create a New Profile

Yes, please send me special offers over email.



Halekulani

<b>Room Charges:</b>	USD 670.00
<b>Package Total:</b>	USD 0.00
<b>Fees:</b>	USD 0.00
<b>Tax:</b>	USD 86.85
<b>Total Rate:</b>	USD 756.85
<a href="#">View Price Breakdown</a>	



(Tax Rate)

$$\$670.00 \times 12.962\% = \$86.85$$

HALEKULANI  
2199 Kalia Road  
Honolulu, Hawaii 96815  
**Arrival Date:** Wednesday, September 09, 2009  
**Departure Date:** Thursday, September 10, 2009  
**Room Type:** [Diamond Head Ocean Front](#)  
**Rate Type:** [Sunrise Package](#)

<b>Room Charges:</b>	USD 670.00
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<b>Fees:</b>	USD 0.00
<b>Tax:</b>	USD 86.85
<b>Total Rate:</b>	USD 756.85
<a href="#">View Price Breakdown</a>	



Hotel: 1 Room, 1 Night

**Halekulani**

South Shore: Waikiki  
2199 KALIA ROAD  
Honolulu, HI 96815

Room 1: Diamond Head Ocean Front with  
Daily Full Breakfast (1 Adult)

**Halekulani**

South Shore: Waikiki  
2199 KALIA ROAD  
Honolulu, HI 96815

Check in: **Wed, Sep 9, 2009**  
Check out: **Thu, Sep 10, 2009**

Any incidental charges will be assessed directly to you by the hotel upon check-out. Examples:  
Parking, Phone Calls, Room Service.

Room: Diamond Head Ocean Front with Daily Full Breakfast (1 Adult)  
1 Night:

Wed, Sep 9 \$670.00

Sum of Nightly Rates: \$670.00

Taxes & Fees:  \$103.72

**Total for 1 Room: \$773.72**

<https://travel.travelocity.com/checkout/CheckoutReview.do?sessionId=0AC23D8A6F37F4435C4...> 8/11/2009



**Halekulani**  
 South Shore: Waikiki  
 2199 KALIA ROAD  
 Honolulu, HI 96815

Check in: **Wed, Sep 9, 2009**  
 Check out: **Thu, Sep 10, 2009**

Room: Diamond Head Ocean Front with Daily Full Breakfast (1 Adult)	
1 Night:	
Wed, Sep 9	\$670.00
<hr/>	
Sum of Nightly Rates:	\$670.00
Taxes & Fees:	\$103.72
<hr/>	
<b>Total for 1 Room:</b>	<b>\$773.72</b>

$$\begin{array}{r}
 \$670.00 \times 12.962\% = \$86.85 \quad \text{Tax Collected} \\
 \\
 \$515.00 \times 12.962\% = \$66.75 \quad \text{Tax Remitted} \\
 \text{(Assume 30\% Markup)} \\
 \hline
 \$20.10 \quad \text{Tax Collected/Unremitted} \\
 \\
 \text{Loss to Government}
 \end{array}$$

$$\begin{array}{r}
 \$103.72 \quad \text{Taxes \& Fee} \\
 -\$86.85 \quad \text{Tax Collected} \\
 \hline
 \$16.87 \quad \text{Fee (2.5\% of \$670)}
 \end{array}$$

# Hawaii TAT/GET

- A. Who Must Collect The Tax?
- B. What Is Tax Applied To?
- C. Duty to Register, Report, and Remit
- D. Penalty for Nonpayment
- E. Statute of Limitations

# Who must collect the TAT?

“Every **operator** shall pay to the state the tax imposed by Subsection (a) as provided in this chapter.” HRS § 237D-2(b).

“**Operator**” means any **person** operating a **transient accommodation**, 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**.” HRS § 237D-1.

“**Person**” includes every individual, **partnership . . . unincorporated association, joint adventure, group . . . or other entity, whether such persons are doing business for themselves or in a fiduciary capacity, and whether the individuals are residents or nonresidents of the State**, and whether the corporation or other association is created or organized under the laws of the State or of another jurisdiction.” HRS § 237-1(2).

“**Transient accommodations**” means the **furnishing of a room . . . which is customarily occupied by a transient for less than one hundred eighty consecutive days . . .**” HRS § 237D-1.

# Who must collect the TAT?

“Every **operator** shall pay to the state the tax imposed by Subsection (a) as provided in this chapter.” HRS § 237D-2(b).

“**Operator**’ means any person operating a transient accommodation, 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.” HRS § 237D-1.

“**Person**’ includes every individual, partnership, unincorporated association, joint

**“. . . any service business which involves the actual furnishing of transient accommodation.”**

occupied by a transient for less than one hundred eighty consecutive days . . . HRS § 237D-1.

# What is Tax Applied To?

The tax is levied “on the **gross rental** or **gross rental proceeds** derived from **furnishing transient accommodations.**” HRS § 237D-2(a)(3).

“**Gross rental**” or “gross rental proceeds” means the gross receipts . . . of the taxpayer received as compensation for furnishing of transient accommodations . . . without any deductions on account of the cost of property or services sold . . . .” HRS § 237D-1.

# Gross Rental Proceeds

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Hotel: 1 Room, 1 Night

**Halekulani**  
 South Shore: Waikiki  
 2199 KALIA ROAD  
 Honolulu, HI 96815

Room 1: Diamond Head Ocean Front with Daily Full Breakfast (1 Adult)

Check in: **Wed, Sep 9, 2009**  
 Check out: **Thu, Sep 10, 2009**

When you complete your reservation, any incidental charges will be assessed directly to you by the hotel upon check-out. Examples: Parking, Phone Calls, Room Service.

Room: Diamond Head Ocean Front with Daily Full Breakfast (1 Adult) 1 Night:	
Wed, Sep 9	\$670.00
Sum of Nightly Rates:	\$670.00
Taxes & Fees: 	\$103.72
<b>Total for 1 Room:</b>	<b>\$773.72</b>

<https://travel.travelocity.com/checkout/CheckoutReview.do?sessionId=0AC23D8A6F37F4435C4...> 8/11/2009

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Marriott Waikiki Beach Resort and Spa

Room 1: Deluxe Ocean View (1 Adult)

South Shore: Waikiki  
 2552 KALAKAUA AVE  
 Honolulu, HI 96815

Check in: **Wed, Sep 9, 2009**  
 Check out: **Thu, Sep 10, 2009**

Hotel Policies

- All GoodBuy hotel reservations are prepaid. Your credit card will be charged when you complete your reservation. View further details.

Room: Deluxe Ocean View (1 Adult) 1 Night:	
Wed, Sep 9	\$299.00
Sum of Nightly Rates:	\$299.00
Taxes & Fees: 	\$49.39
<b>Total for 1 Room:</b>	<b>\$348.39</b>

# OTCs Collect But Don't Remit TAT

## Interactive [Expedia] 2003 10-K

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0-K 1 a2131189z10-k.htm EXHIBIT 10-K

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As filed with the Securities and Exchange Commission on March 15, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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"Summary of Significant Accounting Policies," Revenue Recognition, in the Notes to Consolidated Financial Statements for discussion of the factors considered by Hotels.com and Expedia in arriving at their conclusions.

For comparison purposes, in order to provide the reader with a more complete discussion on this topic, we present IACT pro forma information under the assumption of both companies presenting revenue on a net basis and both companies presenting revenue on a gross basis.

Assuming that both companies presented merchant revenue on a net basis, IACT's pro forma net revenues for the years ended December 31, 2003 and 2002 would have been \$1.67 billion and \$907.0 million, respectively.

Effective for the first quarter 2004, IACT will begin reporting revenue for Hotels.com business on a net basis rather than on a gross basis due to changes in business practices at Hotels.com that were implemented around the beginning of 2004. The change in business practices conforms Hotels.com with other IACT businesses in regards to its merchant hotel business and thus requires a change in its revenue presentation on a prospective basis.

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hotel charges taxes based on the room rate paid to the hotel and IACT recovers an equivalent amount from the customer. IACT does not collect or remit taxes on the portion of the customer payment it retains, and some jurisdictions have questioned IACT's practice in this regard. While the applicable tax provisions vary among the jurisdictions, IACT believes it generally has sound arguments that it is not required to collect and remit such taxes.

INTERACTIVECORP

IACT has established a reserve with respect to potential occupancy tax liability for prior periods, consistent with applicable accounting principles and in light of all current facts and circumstances. IACT's reserves represent its best

152 West 57th Street, New York, New York  
(Address of Registrant's principal executive offices)

10019  
(Zip Code)

(212) 314-7300  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:  
None  
Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, \$0.01 par value  
Warrants to Acquire One Share of Common Stock  
Warrants to Acquire 1,93875 Shares of Common Stock



Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be obtained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a shell company.  Yes  No  
The amount of liability of IACT on account of this issue, if any, will have a material adverse effect on its past or future financial results.

reimbursements with one or more jurisdictions, with business who may attempt to ultimately assert a claim and prevail in assessing such additional tax or negotiate a settlement, changes in statutes and the timing of all of the foregoing. IAC notes that there are more than 7,000 taxing jurisdictions, and it is not feasible to analyze the statutes, regulations and judicial and administrative rulings in every jurisdiction. Rather, IACT has obtained the advice of state and local tax experts with respect to tax laws of certain states and local jurisdictions that represent a large portion of IACT's hotel revenue. In addition, IACT continues to engage in a dialog with and receive feedback from certain state and local tax authorities. IAC will continue to monitor the issue closely and provide additional disclosure, as well as adjust the level of reserves, as developments warrant. The reserve balance at December 31, 2003 is \$13.2 million as compared to \$10.4 million at December 31, 2002.

It is possible that some jurisdictions may introduce new legislation regarding the imposition of occupancy taxes on businesses that arrange booking of hotel accommodations, but to date the Company is aware of only one jurisdiction that has introduced such legislation, and its passage faces opposition and uncertainty.

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### Seasonality

IACT's businesses are subject to the effects of seasonality with revenues typically lowest in the first quarter of the year and highest in the fourth quarter, primarily as a result of seasonality at our travel business as well as Entertainment Publications and, to a lesser extent, HSN.

<http://www.sec.gov/Archives/edgar/data/891103/000104746904008077/a2131189z10-k.htm>

2/18/2009

# General Excise Tax (GET)

## 1. Who must collect the GET?

Those engaging in any service business

- ◆ Service businesses: “Upon every person engaging or continuing within the State in any service business or calling including professional services not otherwise specifically taxed under this chapter, there is likewise **hereby levied and shall be assessed and collected a tax equal to four per cent of the gross income of the business. . .**” Section 237-13(6)(A).
- ◆ All other businesses: “Upon every person engaging or continuing within the State in any business, trade, activity, occupation, or calling not included in the preceding paragraphs or any other provisions of this chapter, there is likewise **hereby levied and shall be assessed and collected, a tax equal to four per cent of the gross income thereof.**” Section 237-13(9).

# General Excise Tax (GET)

2. What is the GET collected on?
  - “‘Gross income’ means the gross receipts, cash or accrued, of the taxpayer received as compensation for personal services and the gross receipts of the taxpayer derived from trade, business, commerce, or sales and the value proceeding or accruing from the sale of tangible personal property, or service, or both, and all receipts, actual or accrued as hereinafter provided...‘Gross proceeds of sale’ means the value actually proceeding from the sale of tangible personal property **without any deduction on account of the cost of property sold or expenses of any kind.**”  
Section 237-3(a).

# Duty to Register, Report, and Remit

“Each operator . . . as a condition precedent to engaging . . . in the business of furnishing transient accommodations . . . **shall register** with the director . . .” HRS § 237D-4(a).

“. . . every operator taxable . . . shall file **a sworn return with the director . . . with a remittance for the amount of the tax in the form . . .**” HRS § 237D-6(a).

# Penalty for Nonpayment/Non-Filing and Interest

**Failure to file tax return.** In case of failure to file any tax return required to be filed on the date prescribed therefor . . . there shall be added . . . **five per cent** of the amount of the tax if the failure is for not more than one month, with an **additional five per cent** for each additional month or fraction thereof during which the failure continues, **not exceeding twenty-five per cent** in the aggregate. HRS § 231-39(b)(1).

**Failure to pay tax.** If any part of any underpayment is due to negligence or intentional disregard of rules (but without intent to defraud), there shall be added . . . **up to twenty-five per cent of the underpayment** as determined by the director. If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount up to fifty per cent of the underpayment as determined by the director. HRS § 231-39(b)(2)(A)-(B).

**Interest** on underpayment or nonpayment of tax. If any amount of tax is not paid on or before the last date prescribed for payment, interest on such amount at the rate of **two-thirds of one per cent a month** or fraction of a month shall be paid . . . HRS § 231-39(b)(4)(A).

# Statute of Limitations

TAT: “Except as otherwise provided by this section, the amount of taxes imposed by this chapter shall be assessed or levied within three years after the annual return was filed . . . .” HRS § 237D-9(c).

“In the case of a false or fraudulent return with intent to evade tax, or of a **failure to file the annual return, the tax may be assessed or levied at any time** . . . .” HRS § 237D-9(d).

GET: General rule. The amount of excise taxes imposed by this chapter shall be assessed or levied within three years after the annual return was filed, or within three years of the due date prescribed for the filing of said return, whichever is later . . . .” HRS § 237-40(a).

“In the case of a false or fraudulent return with intent to evade tax, or of a **failure to file the annual return, the tax may be assessed or levied at any time** . . . .” HRS § 237-40(b).

# Top 40 Reasons Why OTCs Control the Rooms

1. Each OTC **negotiates contracts with hotels** for the purchase of hotel rooms at discounted wholesale prices.
2. Each OTC determines a **mark-up** to be applied to the wholesale room price.
3. Each OTC determines the **retail room price** at which the room will be offered to its customers.
4. Each OTC determines whether to add a **service fee** to the price of the hotel room and, if so, the amount of the service fee.
5. Each OTC determines whether to impose a **penalty for cancelling or changing a hotel reservation**, as well as determining the **amount of the cancellation penalty**.
6. Each OTC establishes additional **terms and conditions of its cancellation policy**.
7. In the event of a cancellation or change to a reservation, the **cancellation or change is handled by the OTC** and not the hotel.
8. Each OTC provides a **toll-free number** that its customers can use **to book hotel** reservations over the phone.
9. Each OTC operates or controls **call centers** that its customers can use to **book hotel reservations**.
10. Each OTC operates or controls customer service centers, which allow customers to contact the OTC regarding **questions** they may have or problems they may be experiencing.

# Top 40 Reasons Why the OTCs Control the Rooms

11. Each OTC **owns and operates a website** that its customers use to book hotel reservations through the internet.
12. Each OTC determines **which hotels or hotel chains** will have the right to list rooms **on the OTC's website**.
13. Each OTC determines the "**affiliates**" with whom it will have a contractual relationship allowing those affiliates to offer OTC's hotel bookings on the affiliates' websites.
14. Each OTC determines the **contractual and financial** terms of its affiliate program.
15. Each OTC determines whether to offer merchant hotel bookings and/or agency hotel bookings.
16. Each OTC establishes the "look and feel" of its website that it uses to offer rooms for sale to the public.
17. Each OTC determines the manner in which it will market the hotel rooms on its website, such as determining the star ratings it will assign to each hotel and the manner and order in which the hotel content will be displayed on the website.
18. Each OTC gives priority to listing rooms that it offers pursuant to the merchant model compared to the agency model.
19. Each OTC provides its customers an ability to input a search request for a hotel booking through its website.
20. Each OTC processes the customer's search request using certain search criteria and algorithms relating to that OTC's business.

# Top 40 Reasons Why the OTCs Control the Rooms

21. Each OTC **calculates** the mark-up, **the taxes, and any service fees** that will be **charged to its customers**.
22. Each OTC **determines the amount of the tax** that it collects that it will, in turn, **remit to the hotel**.
23. Each OTC presents the cost of a merchant model transaction to the consumer using three line items: (i) the retail room price, (ii) a combined "taxes and fees" line, and (iii) the total cost, which is the sum of the first two line items.
24. Each OTC determines whether to calculate the mark-up on the wholesale room price or the retail room price.
25. Each OTC **collects the tax from its customers**.
26. **No OTC ever informs the hotel of the retail** rate for which it has sold the hotel room to its customers.
27. No OTC ever informs its customers **of the wholesale** rate for which the OTC has purchased the room from the hotel.
28. No OTC ever informs its customers **of the amount of tax** that it has **collected from them**.
29. Each OTC prohibits the hotel from disclosing the wholesale rate to the OTC's customers.
30. As between the OTC, the hotel, and the customer, only the OTC knows all the financial aspects of any given transaction, including the wholesale room price, the mark-up, the retail room price, the taxes, and the service fees.

# States with Furnishing Statutes

- ◆ Court decisions in Alabama, South Carolina, District of Columbia and have found that the OTCs liable for lodging tax because they are a person “engaging . . . in the business of renting or **furnishing** any room . . . in any hotel”
  - City of Charleston v. Hotels.com, 520 F. Supp.2d 757, 767-78 (D.S.C. 2007)(denial of OTCs’ motion to dismiss) and 586 F.Supp.2d 538, 543-45 (denial of motion for reconsideration).
  - Travelscape v. Dep’t of Revenue, 705 S.E.2d 28, 33-35 (S.C. 2011)(affirming judgment in favor of state against OTCs).
  - District of Columbia v. Expedia, 2011 CA 002117 B at 11-17 (D.C. Super., Oct. 11, 2011) (D.C. Super., Sept. 24, 2012) (granting District’s summary judgment)
  - 20090128 Ind. Reg. 045090026NRA at 2-3.
  - City of Birmingham v. Orbitz, 93 So. 3d 932, 936-37(Ala. 2012).

# OTCs Have Lost 4 of 5 “Furnishing Cases”

- ◆ With the single exception of City of Birmingham, the OTCs have lost each “furnishing” case.
- ◆ The Alabama court was constrained by an existing Alabama Department of Revenue ruling that the OTCs were not engaged in the business of renting or furnishing accommodations, upon which ruling the court placed significant reliance.

# Hawaii Admin Rules Support State's Position

- ◆ HAR § 18-237D-1-03(b) states that “[c]ommissions paid to travel agents” are included in “gross rental proceeds.”
- ◆ The TAT Rules then list a number of items for which deductions are “**disallowed**” including labor cost; commissions; taxes; royalties; interest; and “[a]ny other expenses whatsoever, such as costs of furnishing the service or overhead.” HAR § 18-237D-1-03(e)(2).

# State's General Excise Tax Case

- ◆ Hawaii's Tax Appeal Court granted the State's motion for summary judgment upholding tax assessments, interest and penalties totaling almost \$249 Million
- ◆ The GET is a "business privilege" tax on the privilege of doing business
- ◆ Generally 4 percent (.5 percent surcharge on Oahu)

# Hawaii's GET is Broad Based

- “In enacting Chapter 237, the legislature cast a wide and tight net.” In re Island Holidays, Ltd., 59 Haw. 307, 316, 582 P.2d 703, 708 (1978) .
- Read as a whole, HRS 237-13 subjects to the general excise tax virtually every economic activity imaginable.” Pratt v. Kondo, 53 Haw. 435, 436, 496 P.2d 1, 2 (1972).
- The plain and unmistakable language in section 237-13, HRS, “evidences the intention of the legislature to tax every form of business, subject to the taxing jurisdiction, not specifically exempted from its provisions” (emphasis added.) In re Grayco Land Escrow, Ltd., 57 Haw. 436, 443, 559 P.2d 264, 270 (1977).

# OTCs are not Travel Agents

- ◆ The OTCs denied in admissions that they were acting as agents in “merchant model” transactions
- ◆ The OTCs’ expert witness testified in deposition not acting as travel agents in merchant model transactions
- ◆ In their SEC filings, the OTCs distinguish their role in agency transactions where the OTC “acts an agent” as compared to their role in merchant transactions where the OTC is “[a]cting as a merchant.”

# OTC's SEC Filings

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## Travel Services

### Expedia

USA acquired a controlling interest in Expedia in February 2002. Expedia sells a variety of travel services to leisure and corporate customers around the world. This encompasses providing real-time access to schedule, pricing and availability information for booking reservations for airlines, hotels, rental cars and cruises and for other travel products such as sightseeing tours, show and event tickets and theme park passes. Expedia sells these travel services both individually and as components of dynamically assembled custom travel vacations and trips. In addition, Expedia provides content that presents travelers with information about travel destinations, maps and other relevant travel details.

Expedia is a leading world-wide online travel service and was ranked by Travel Weekly in 2002 as the eighth largest travel agency overall based on 2001 gross bookings. Expedia operates websites offering travel planning services located at Expedia.com.

Expedia utilizes two different business models in selling travel: the agency model and the merchant model. Under the agency model, Expedia acts as an agent in the transaction, passing a customer's reservation to the airline, hotel, car rental company or destination service provider. Expedia receives a commission from the travel supplier for its services as an agent. In an agency transaction, the supplier determines the retail price paid by the customer, and the supplier is the merchant. Under the merchant model, an Expedia subsidiary contracts for inventory from suppliers at negotiated rates, determines the retail price that the customer pays and processes the transactions as the merchant in the transaction. Acting as a merchant enables Expedia to bypass intermediaries and achieve a significantly higher level of gross profit per transaction than acting as an agent. Integrating the merchant inventory with the ESP technology platform has allowed Expedia to create product offerings that benefit both customers and suppliers.

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Expedia's business relies heavily upon its intellectual property rights. The software code, informational databases, and other components that make up Expedia's travel planning service are protected by copyright registrations and patent applications. Trademarks, service marks and logos associated with the names "Expedia," "Expedia.com," the "Airplane Design," "Don't Just Travel. Travel Right," "Travelscape," "Metropolitan Travel," "Newtrade," "Newtrade.ca," "Newtrade.com," "Rent-a-Holiday" and "WWTE" provide and promote brand recognition for Expedia's travel planning services. Consumers have come to recognize and associate the "Expedia" brand with Expedia's service. Expedia also relies on trademark and trade secret protection law, copyright law, patent law and confidentiality and/or license agreements with its employees, customers, associates and others to protect its proprietary rights. Expedia vigorously pursues the defense and regulation of its copyrights, patents, trade secrets, trademarks and service marks in the United States and internationally.

Expedia has several arrangements relating to intellectual property with Microsoft Corporation, its former parent company and a current USA shareholder. Expedia licenses certain retail products and other technology from Microsoft. All of the licenses relating to Expedia-specific software content and data are royalty-free, irrevocable and perpetual. Pursuant to a hosting services agreement, Microsoft provides Expedia with internet service provider services for its Expedia websites. Pursuant to a map server agreement, Microsoft licenses to Expedia certain server technology related to the Expedia Maps service whereby Microsoft will develop, maintain, host and serve maps to the Expedia websites. Pursuant to a patent assignment agreement, Microsoft assigned to Expedia all of Microsoft's patents relating to the operation of Expedia's websites with a limited license of such patents from Expedia to Microsoft.

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Department of the Attorney  
General

# Penalty for Nonpayment/Non Filing

**Failure to file tax return.** In case of failure to file any tax return required to be filed on the date prescribed therefor . . . there shall be added . . . **five per cent** of the amount of the tax if the failure is for not more than one month, with an **additional five per cent** for each additional month or fraction thereof during which the failure continues, **not exceeding twenty-five per cent** in the aggregate. HRS § 231-39(b)(1).

**Failure to pay tax.** If any part of any underpayment is due to negligence or intentional disregard of rules (but without intent to defraud), there shall be added . . . **up to twenty-five per cent of the underpayment** as determined by the director. If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount up to fifty per cent of the underpayment as determined by the director. HRS § 231-39(b)(2)(A)-(B).

**Interest** on underpayment or nonpayment of tax. If any amount of tax is not paid on or before the last date prescribed for payment, interest on such amount at the rate of **two-thirds of one per cent a month** or fraction of a month shall be paid . . . HRS § 231-39(b)(4)(A).

# Penalties and Interest

The OTCs were actively considering their potential TAT exposure to Hawai'i as far back as September 2001; yet, they submitted no contemporaneous evidence to support their "good faith" defense.

# Hawaii Prevails on GET Assessments

- ◆ On January 11, 2013, the Tax Appeal Court orally ruled, upholding the GET Assessments
- ◆ Further hearings were conducted on penalties and interest that the Court also upheld the interest and penalties (and interest on penalties)
- ◆ The OTC's have had to pay \$246.9 Million to file further appeals.

# Court's Oral Ruling

5                   The singular basis for the OTCs' business  
6 activity in question is the existence of transient  
7 accommodation in Hawaii. Therefore, for the privilege of  
8 engaging in a very lucrative business activity that exists  
9 and thrives upon Hawaiian transient accommodations, Hawaii  
0 is authorized by law to levy a general excise tax upon  
1 that privilege. Therefore, the court concludes that the  
2 business activities of the taxpayer-appellant OTCs are  
3 subject to general excise tax in Hawaii.

# Court's Oral Ruling

7                   The internet and the dynamics of global  
8 economics mandate the general excise tax statutes be read  
9 expansively rather than restrictively or archaically. So  
10 broad is the phrase "in the state" that business activity  
11 that physically occurs outside the state but which  
12 involves or continues in such a way as to culminate or be  
13 consumed in the state is considered by Hawaii law to  
14 constitute business activity in the state.

# Status of the Tax Appeals

- ◆ The State has appealed from the adverse ruling on TAT and the OTCs have cross appealed on the general excise tax ruling
- ◆ The record on appeal is almost docketed

# Status of the Tax Appeals

- ◆ The appeals could be fully briefed by the end of the year if the appeal is expedited
- ◆ Supreme Court's decision will affect the OTCs' subsequent tax years and other business activities in Hawaii.

# Thank You!

The screenshot shows a Mozilla Firefox browser window displaying the website for the State of Hawaii Department of the Attorney General. The browser's address bar shows the URL `ag.hawaii.gov`. The website header includes the `hawaii.gov` logo, text size controls, and a "Stay Connected" link. The main content area features the state seal and the text "State of Hawaii Department of the Attorney General". A search bar is present with the text "search this site" and a "Search.USA.gov" link. A navigation menu includes "Home", "About Us", "News Releases", "Employment", "Publications", and "Quick Links". A large banner for the "Hawaii Partnership SEX OFFENDER REGISTRY" is displayed, with the URL `sexoffenders.hawaii.gov` and a "Read More" link. To the right, a sidebar contains links for "Frequently Asked Questions", "Mortgage Settlement", "Employment Opportunities", and "Contact Us". The footer includes the text "ALOHA FROM THE DEPARTMENT OF THE ATTORNEY GENERAL" and "DIVISIONS". The Windows taskbar at the bottom shows the system clock as 11:30 AM on 9/30/2013.

# Questions?

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