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December 11, 2017

Ted Shiraishi, Rules Officer, Department of Taxation
Room 219, Princess Ruth Keelikolani Building
830 Punchbowl Street
Honolulu, Hawaii 96813

Re: Proposed Rules Relating to Exported Services
Public Hearing Monday, December 11, 2017, 9:00 a.m.
Room 310, 830 Punchbowl Street

Dear Mr. Shiraishi:

I represent various online travel companies (OTCs) including Priceline and Expedia. We believe that the Proposed Rules would treat companies providing **online** travel reservation services using an agency model differently from other companies providing similar services, in violation of the Internet Tax Freedom Act ("ITFA")[1] and the U.S. Constitution.

On October 21, 1998, the United States Congress enacted the ITFA to "foster the growth of electronic commerce and the Internet by facilitating the development of a fair and consistent Internet tax policy." S. Report No. 105-184, at 1 (1998). One of the ITFA's primary purposes is to prevent state and local taxing authorities from imposing discriminatory taxes on electronic commerce, to "establish a level playing field between electronic commerce using the new media of the Internet and traditional means of commerce." S. Rep. No. 105-184, at 2, 11 (1998); *see*

[1] Originally enacted as P.L. 105-277, extended multiple times and eventually made permanent by P.L. 114-125.

also H.R. Rep. No. 105-570, pt. 1, at 7–8, 10–11 (1998); H.R. Rep. No. 105-808, pt. 1, at 8–9 (1998).

The ITFA thus prohibits "discriminatory taxes on electronic commerce." Pub. L. 105-277, as amended, §1101(a)(2) (codified at 47 U.S.C. §151 note). The ITFA's ban on discriminatory taxes ensures that companies engaged in electronic commerce are not required to pay taxes that their brick-and-mortar competitors do not pay. 105 Cong. Rec. S4625 (daily ed. May 11, 1998) (statement of Sen. Wyden) (emphasizing that state and local taxation of electronic commerce must be technology-neutral); 105 Cong. Rec. S11660 (daily ed. Oct. 7, 1998) (statement of Sen. Hutchinson) (declaring that the focus of the ITFA is technological neutrality).

"Electronic commerce" is defined as "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access." ITFA §1105(3). Thus, travel facilitation services provided over the Internet constitutes electronic commerce.

A tax on electronic commerce is deemed to be a "discriminatory tax" if it:

> (i) is not generally imposed and legally collectible by such State or political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;
>
> (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services or information accomplished through other means . . . ; [or]
>
> (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means . . . .

Thus, a tax is discriminatory under the ITFA if it applies to transactions performed online, but does not apply to similar transactions that occur offline. ITFA §1105(2)(A)(i) and (iii). Applying this definition, the Proposed Rule would clearly create a discriminatory tax. As proposed, the rule would impose GE Tax on commissions earned through online transactions but would not impose GE Tax on similar commissions earned through substantively identical transactions accomplished through non-internet means.

With respect to travel agents paid on a commission basis, the Proposed Rules create a general rule that the GE Tax applies, or does not apply, depending upon whether the travel agent is located within the State of Hawaii or outside the State. Proposed Rule §18-237-29.53-10 provides:

> (a) Except as provided in section 18-237-29.53-04, services performed by a commissioned agent are used or consumed **where the agent is located** at the time the agent's services are performed. [emphasis added]

Thus, if a travel agent in, say, Kansas City, helps a customer to make a reservation for a stay at a Hawaii hotel, the agent's services would be considered to be used or consumed in Kansas City, where the agent is located at the time the service is performed.[2] That would result in no Hawaii GE Tax on the commission.[3]

There is an express exception, however, where the transaction is conducted online. In that situation, the Proposed Rule would treat it differently. Sub-part (3) of §18-237-29.53-10(a) provides:

> (3) when transient accommodations or travel-related bookings are sold, purchased, or arranged online through a commissioned agent, the agent's

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[2] In this letter, we are discussing travel agents operating on an agency model and receiving compensation in the form of commissions.

[3] Proposed Rule §18-237-29.53-02 establishes a general rule that the gross income from services is exempt if the services are used or consumed outside the State.

> service is used or consumed **where the transient accommodation or travel-related booking is located.** [emphasis added]

Thus, in the example where a travel agent in Kansas City helps a customer to make a reservation for a stay at a Hawaii hotel, if the transaction is conducted online, the travel agent's services would be considered to be used or consumed in Hawaii, where the hotel is located. That would result in Hawaii GE Tax being payable on the commission.

In short, two economically identical transactions would be taxed differently, with the travel agent's commission being subject to GE Tax if, and only if, the reservation was facilitated online. This is a clear example of discriminatory taxation of online transactions.

The ITFA defines a "discriminatory" tax in §1105(2)(A):

> For the purposes of this title:
> ...
> (2) Discriminatory tax.—The term 'discriminatory tax' means—
> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that—
> "(i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means; [or]
> ...
> "(iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.

The example above falls squarely within this definition. If a customer walks into a travel agent's office in Kansas City and the travel agent helps that customer to reserve a hotel room in Honolulu, there is no Hawaii GE Tax due on the travel agent's commission. However, if the same customer contacts the same travel agency and reserves the same hotel room through an online transaction, then Hawaii GE Tax would apply to the travel agent's commission. That is

discriminatory taxation based on using the internet as a means of transacting business. Because the Proposed Rule calls for that result, the Proposed Rule is inconsistent with the ITFA.

The Illinois Supreme Court reviewed a similar situation in *Performance Mktg. Ass'n v. Hamer*, 375 Ill. Dec. 762, 767-68, 998 N.E.2d 54, 59-60 (2013). In that case, Illinois law imposed a use tax collect-and-pay-over obligation on certain out-of-state retailers entering into marketing agreements with Illinois companies. The tax applied to internet marketing (*i.e.*, advertising on websites) but not to other forms of marketing (*e.g.*, newspapers and radio). The court found that the law discriminated on the basis of whether the relevant activity took place online or not:

> In short, under the Act, performance marketing over the Internet provides the basis for imposing a use tax collection obligation on an out-of-state retailer when a threshold of $10,000 in sales through the clickable link is reached. However, national, or international, performance marketing by an out-of-state retailer which appears in print or on over-the-air broadcasting in Illinois, and which reaches the same dollar threshold, will not trigger an Illinois use tax collection obligation. The relevant provisions of the Act therefore impose a discriminatory tax on electronic commerce within the meaning of the ITFA. ... Because we hold that the provisions of the Act are void based on preemption, we do not reach plaintiff's alternative argument that the new definitions provisions of the Act violate the commerce clause of the United States Constitution.

The ITFA prohibits states from imposing discriminatory taxes against electronic commerce. ITFA §1101(a)(2). Here, even if the Proposed Rule were consistent with Hawaii statutory law – which it is not[4] – the Proposed Rule violates the ITFA and is therefore preempted by federal law.

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[4] There is absolutely no statutory basis for treating a transaction done through the internet differently from an economically identical transaction conducted by other means. The difference in treatment also raises Equal Protection issues under the U.S. Constitution, and Commerce Clause issues relating to discrimination against interstate business.

Simply put, the ITFA prohibits the Department from taxing receipts from travel reservation services differently based on whether such receipts are earned through electronic commerce or via other means. That is exactly what the Proposed Rule purports to do, and therefore the Proposed Rule is prohibited by federal law.

Very truly yours,

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