

LINDA LINGLE
GOVERNOR

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STATE OF HAWAII
DEPARTMENT OF TAXATION
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KURT KAWAFUCHI
DIRECTOR OF TAXATION

STANLEY SHIRAKI
DEPUTY DIRECTOR

March 23, 2010

LETTER RULING NO. 2010-06

[redacted text]

Re: [redacted text]

Dear [redacted text]:

[redacted text] ("Taxpayer") requests a ruling on the proper treatment under the general excise tax law of its withholdings from rental proceeds of monies used to pay expenses incurred in its rental program.

FACTS

You represent the following:

Taxpayer is a limited liability company, organized [redacted text], by certain owners of apartments in the [redacted text] property in [redacted text], to act as the Condominium Hotel Operator (CHO) for a rental program that markets and rents apartments in the [redacted text]. Taxpayer has operated this rental program on behalf of such owners since [redacted text]. [redacted text].

Taxpayer enters into a Rental Program Agreement ("RPA") with each individual apartment owner who participates in the rental program, whereby the owner appoints Taxpayer as the owner's agent. Each participating apartment owner is a member of Taxpayer. Acting as agent for all its owner-members, Taxpayer engages a rental manager, who markets the apartments for rent, meets the guests for check-in on arrival, and generally manages rental operations. Acting as agent, Taxpayer also engages a maid service to clean and service the apartments prior to and after a guest's occupancy, pays for necessary supplies, and pays the fees charged by credit card companies for processing rental payments. Also as agent, Taxpayer pays all providers for products and maintenance, repair, and other services provided to the rental units. Although Taxpayer provides a recommended rate schedule, each owner sets the rental rates for the owner's apartment, and the owner is free to terminate the RPA and withdraw from the rental program at any time.

Taxpayer deposits all rental receipts into a trust account for its owner-members. Monies in the trust account are designated to the owner whose apartment was reserved or rented, by accounting records maintained in accordance with the RPA. Taxpayer withholds a percentage of the receipts from each rental as a deposit against actual costs and expenses, including for the rental manager, cleaning service, supplies, and credit card charges, and remits the entire net

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balance of rental proceeds to the owner whose apartment was rented. These withholdings are reconciled to actual expenses and, at least annually, the net difference is remitted or charged to the respective owner, depending upon whether the actual expenditures are less or more than the estimated amount withheld. Taxpayer has no funds of its own and receives no compensation or consideration for its management services. Although Taxpayer withholds a percentage of the receipts from each rental as a deposit against anticipated costs and expenses, owner-members have the power to demand the withheld amount be paid to them immediately, less applicable expenses incurred.

Taxpayer's accounting expenses are allocated between and among the owner-members, pro rata according to the rental proceeds received for each apartment.

[redacted text].

RULING REQUESTED

You have requested that the Department rule that, based upon the representations above, Taxpayer's receipts of rental deposits and payments from guests are properly treated as receipts of the owner-members, and not separately as receipts of Taxpayer. Thus, based upon your representation that Taxpayer acts always as agent, you request the Department rule that amounts Taxpayer withholds from these receipts to pay expenses on behalf of the owners are not income of Taxpayer for general excise tax purposes. Rather, you request the Department rule that the gross amounts received on behalf of each owner are income of that owner, meaning that the owner – not Taxpayer – owes general excise tax on those amounts.

APPLICABLE LAW

Under common law principles as developed by the Hawaii Supreme Court, an agent is not a separate party to a contract (e.g., a rental contract) that the agent makes on behalf of its principal. The Court recently stated:

It is well-settled that "unless otherwise agreed, a person making or purporting to make a contract with another as agent for a disclosed principal does not become a party to the contract ... in absence of other facts, the inference is that the parties have agreed that the principal is, and the agent is not, a party."¹

Where one party acts solely as agent for another, transfers between those parties carried out within the scope of the agency ordinarily do not provide a basis for assessment of general excise tax because the agent is only a conduit for the principal.²

¹ *Laeroc Waikiki Paradise v. K.S.K. (Oahu)*, 115 Haw. 201, 212-213 (Hawaii 2007). *Corps. Constr. Ltd. v. Hasegawa*, 55 Haw. 474, 476 (1974). See also, *Restatement of the Law*, Third, Agency, §§ 1.01(g), 6.01 (2006).

² See, *In re Taxes, Aiea Dairy, et al.*, 46 Haw. 292, 307 (1963).

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In *In re Taxes, Gay & Robinson*,³ Olokele Sugar Company reimbursed Gay & Robinson for expenses incurred by Gay & Robinson in growing a crop for Olokele. The Hawaii Supreme Court held that, although other, lease-related receipts were taxable, Gay & Robinson was not subject to tax on the amount refunded by Olokele, because the payment received was merely a refund of money to Gay & Robinson by the owner Olokele, for payments advanced by Gay & Robinson, as agent for Olokele. The expenditure was incurred by the agent in carrying out its obligations to the owner, and so, when the principal reimbursed the expenditure, the payment was not income of the agent and therefore not subject to the GE tax. Such receipts are actually receipts by the owner, and not separately by the agent. Such reimbursements are also exempt under HRS § 237-20.

In the context of a rental program for an apartment complex, the following circumstances, among others, tend to indicate that one entity or person is the agent for a group of apartment owners:

1. The agent and each apartment owner enter into a written agreement whereby the owner appoints the entity as the owner's agent, and the entity agrees to act as agent.
2. The written agreement provides that the entity-agent's transactions with third parties involving the rental property (e.g., engaging maid or repair service) in every case are as agent and not on its own behalf. In the event of breach of contract, the third party seeks restitution from the owner-principal and not the entity-agent.
3. The entity-agent deposits all monies received on behalf of each apartment owner into a trust account, and maintains accounting records which track and allocate the funds to each owner to whom the monies belong. The owner has the right to demand this money at any time, less the owner's share of expenses incurred to date pursuant to the terms of the written agreement.
4. Each owner has the right to terminate, at any time, the entity as agent for rental of that owner's apartment.
5. Each owner has the ultimate prerogative in setting rental rates and agreeing to expenditures for repairs and improvements to his or her apartment.
6. All expenses of rental operations are allocated and charged to the owners in accordance with the rental activity and usage of each owner's apartment.

The above-listed circumstances tend to indicate the existence of an agency relationship. However, it is entirely possible an agency relationship could exist even where the parties' relationship fails to contain one or more of the above circumstances. Further, it is conceivable the relationship between two parties could contain all of the above-listed circumstances and yet still fail to be a true agency relationship for other reasons.

³ *In re Taxes, Gay & Robinson*, 40 Haw. 722, 729 (1955).

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The Department will not determine whether an agency relationship exists due to the highly fact-intensive nature of such determinations.⁴

ANALYSIS & CONCLUSION

Taxpayer represents that it is agent for the individual apartment owners, specifically representing that the six circumstances enumerated in the previous section apply to its relationship with the various owners in its rental program.

The Department makes no determination of whether Taxpayer is or is not agent for the owners of the rental program. However, the Department acknowledges that where an agency relationship exists such that an agent collects rental income on behalf of its principal, such amounts are income of the owner and he or she is liable for the general excise tax on those amounts – not the agent.

Based solely upon Taxpayer's representation that it is agent for the owners of its rental program, Taxpayer's receipts of rental deposits and payments are income of the owners and not Taxpayer. Therefore, based solely upon Taxpayer's representations that it is an agent, it does not owe general excise tax on rental amounts it collects from guests and forwards along to the owners. Instead, the owners owe general excise tax on those amounts. Further, based solely upon the representation that Taxpayer is an agent, amounts Taxpayer withholds from rental receipts in order to pay expenses on behalf of the owners are not income of Taxpayer. Further still, based solely upon the representation that Taxpayer is an agent, amounts Taxpayer receives from owners in reimbursement for expenses of owners paid by Taxpayer are exempt reimbursements under common law and HRS § 237-20.

This ruling is applicable only to Taxpayer. It may not be used or cited as precedent by any other taxpayer, and is based on our understanding of the facts that you have represented. If it is later determined that our understanding of these facts is not correct, the facts are incomplete, or the facts later change in any material respect, the conclusion in this letter will be modified accordingly. This ruling also may be subject to change due to future amendments to laws, rules, or official Department positions.

If you have any further questions regarding this matter, please call me at 808-587-5334. Additional information on Hawaii's taxes is available at the Department's website at **<http://www.hawaii.gov/tax>**.

⁴ See Tax Information Release 2009-01§4.03.

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Sincerely,

/s/ Jacob L. Herlitz

Jacob L. Herlitz
Administrative Rules Specialist

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