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October 9, 2018

TAX INFORMATION RELEASE NO. 2018-07

Re: Act 211, Session Laws of Hawaii 2018 - Transient Accommodations Tax and Allocation of Gross Rental Proceeds to Transient Accommodations Brokers, Travel Agencies, and Tour Packagers

This Tax Information Release discusses the amount of transient accommodations tax (TAT) imposed on a transient accommodations broker, travel agency, or tour packager (hereinafter collectively referred to as “travel agency”) who sells transient accommodations at noncommissioned negotiated contract rates.

Pursuant to Act 211, Session Laws of Hawaii 2018, when transient accommodations are furnished through arrangements made by a travel agency at noncommissioned negotiated contract rates¹ and the gross income is divided by the operator and the travel agency, the TAT applies to both the operator and travel agency with respect to each person’s respective portion of the proceeds.

Standalone Transactions

In standalone transactions, where a travel agency books or sells transient accommodations at noncommissioned negotiated contract rates that are not part of a travel package, gross rental proceeds of the travel agency are determined by subtracting the amount paid to the operator from the total sales price.

Example 1: Travel Agency sells a hotel room for \$100. Pursuant to a noncommissioned negotiated contract with the hotel, Travel Agency remits \$75 to the hotel and keeps \$25. Travel Agency’s gross rental proceeds are \$25.

¹ A booking is made on a noncommissioned basis if the travel agency has a contract with an operator of a transient accommodation that specifies the rate the operator will receive for the booking and the travel agency may unilaterally determine the mark-up and the total price charged to the customer. See Hawaii Administrative Rules § 18-237-29.53-01.

Travel Packages

In packaged transactions, where a travel agency books or sells transient accommodations at noncommissioned negotiated contract rates as part of a travel package, gross rental proceeds of the travel agency shall be determined by an allocation based upon the fair market value (FMV) of the transient accommodation or by a reasonable allocation that falls within the safe harbor or is approved by the Director. Regardless of which allocation method is used, the method must be consistently used by the travel agency and must be supported by verifiable data.

A. Allocation Based on the FMV of the Transient Accommodation

The method of calculating the gross rental proceeds of a travel agency based on the FMV of the transient accommodation shall be as follows: FMV of the transient accommodation divided by the FMV of all components in the travel package (including the transient accommodation), multiplied by the difference of the sales price of the package minus the total amount paid to vendors for the components in the travel package. Vendors include operators, airlines, and sellers of other travel related bookings. This is represented by the following formula:

$$\frac{\text{FMV of transient accommodation}}{\text{FMV of all components}} \times (\text{Sales Price} - \text{Total Paid to Vendors}) = \text{Gross Rental Proceeds}$$

In determining the FMV of the components in the travel package, the following principles shall apply:

- (1) If the vendor of a component sells the component individually, the FMV of the component shall be the fair market price of the component when sold individually.
- (2) If the vendor does not sell a component individually, the FMV of the component shall be determined by the comparable sales price of similar components sold by other vendors as determined by the Department.
- (3) If the travel agency provides a component, the FMV of the component shall be determined by either the fair market price of the component if sold individually or, if the component is not sold individually, the comparable sales prices of similar components sold by other vendors as determined by the Department.

Note that the FMV formula may only be used to determine gross rental proceeds where transient accommodations are sold as part of a travel package; the formula shall not be used for standalone transactions.

Example 2: Travel Agency sells a package consisting of hotel accommodations, a rental car, and admissions to a luau for \$750. Travel Agency has an agreement with the hotel to sell rooms at noncommissioned negotiated contract rates. The FMV of the room is \$500, the FMV of the rental car is \$200 and the FMV of the luau tickets are \$100. Travel Agency paid a total of \$650 to the vendors (hotel, rental car company, and luau promoter). The gross rental

proceeds of Travel Agency based on the FMV of the transient accommodation are calculated as follows:

$$\text{Gross Rental Proceeds} = \frac{\$500}{\$800} \times (\$750 - \$650) = \$62.50$$

B. Safe Harbor

Notwithstanding the foregoing, the Department will not challenge a formula used by a travel agency to determine gross rental proceeds for its package sales if the travel agency's margin for the tax year is 20% or more. The margin is calculated by dividing the gross rental proceeds of the travel agency for its package sales by the sum of the gross rental proceeds of the travel agency for its package sales and the amount paid to the operators for its package sales.

$$\text{Margin} = \frac{\text{Gross Rental Proceeds of Travel Agency}}{\text{Gross Rental Proceeds of Travel Agency} + \text{Amount Paid to Operators}}$$

Note that the safe harbor only applies where transient accommodations are sold as part of a travel package; it does not apply to standalone transactions. Further, even if the criteria for the safe harbor is met, the travel agency must still consistently use the same formula and must be able to provide verifiable data in support of the formula.

Example 3: Travel Agency sells packages that include transient accommodations at noncommissioned negotiated contract rates, among other components. Travel Agency does not use the allocation method based on the fair market value of the transient accommodation, as described above, and has not obtained approval from the Director to use its own allocation method. Nevertheless, Travel Agency has consistently used the same formula and has verifiable data to support its formula. In tax year 2019, Travel Agency paid \$750,000 to operators for transient accommodations sold at noncommissioned negotiated contract rates as part of travel packages. Further, the formula Travel Agency uses results in gross rental proceeds of \$250,000. The Department will not challenge Travel Agency's formula because Travel Agency's margin for transient accommodations for 2019 is 25% (\$250,000 divided by (\$250,000 + \$750,000)).

C. Other Reasonable Allocation Approved by the Director

In lieu of allocating gross rental proceeds based on the FMV of the transient accommodation, a travel agency may use any reasonable allocation method approved by the Director to determine the gross rental proceeds of transient accommodations sold as part of a travel package. The allocation method must consistently be used by the travel agency, be supported by verifiable data, and reasonably reflect the gross rental proceeds attributable to the travel agency.

To obtain approval, please submit a written request to the Rules Office with the following information:

- (1) Description of the proposed formula;
- (2) List of all components available in the travel packages you sell (e.g., airfare, bus transportation, luau tickets, hotel room, etc.);
- (3) Calculation of gross rental proceeds based on the proposed formula using actual data from the last quarter;
- (4) Calculation of gross rental proceeds based on the FMV of the transient accommodation, as described in section A, using actual data from the last quarter;
- (5) Calculation of your margin for transient accommodations, as described in section B, based on the proposed formula and using actual data from the last quarter;
- (6) Explanation of why the formula based on the FMV of the transient accommodation is inappropriate or unreasonable;
- (7) Explanation of why the proposed formula better reflects the gross rental proceeds or why the proposed formula is reasonable;
- (8) A declaration signed and dated by the taxpayer (not a representative) in the following form:

I declare, under the penalties set forth in section 231-36, HRS, that I have personal knowledge of the facts involved in this request and that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of this request are true, correct and complete. I understand that if any of the facts presented are later found to be in error, any approval received will be void.

Please mail your completed request to the following address:

State of Hawaii
Department of Taxation
Rules Office
P.O. Box 259
Honolulu, HI 96809-0259

For more information, please contact the Rules Office at (808) 587-1530 or by email at Tax.Rules.Office@hawaii.gov.

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Director of Taxation