Hawaii Vacation Rental Owners and Homeowners' Associations Face Increased Disclosure Requirements And Penalties Under New Law

On July 11, 2012, a new measure imposing increased disclosure requirements and penalties upon transient accommodation operators and defined "associations." "Transient accommodations" are short-term accommodations such as hotels, bed and breakfasts, and vacation rentals, customarily rented for less than 180 days. House Bill 2078 became law as Act 326 of 2012 without Governor Neil Abercrombie's signature on July 10, 2012.

Legislative Purpose. The measure is premised upon a Legislative finding that "although many operators of transient accommodations are in compliance with applicable state and county laws, there are a sizeable number who are not. Failure to comply denies the State and counties of the transient accommodations taxes and general excise taxes they are due."

Background: Many vacation rentals in Hawaii are condominiums or residences subject to residential associations. The Legislature found that requiring these associations "to provide relevant information to the department of taxation on all operators who may be leasing their property as a transient accommodation will help insure compliance with appropriate state and county tax laws." [The current transient accommodations tax rate is 9.25% and general excise tax is 4%. (July 2012)]

New Law. Act 326 added the following provisions to HRS 237D, "Transient Accommodations Tax":

- Same-Island Contact Required. Transient accommodation operators must designate a local contact resident on the same island that the accommodation is located;
- Same-Island Contact Listed In Contract and Posted In Unit. Transient accommodation operators must include the "local contact" information in any contract or rental agreement and prominently posted it in the accommodation;
- Transient Accommodation Number Listed On Internet. The transient accommodations registration/identification number must be provided on any (a) website; (b) on-line link; and, (c) displayed in all internet advertisements and solicitations.
- Provide Local Contact To Association. Transient accommodation operators must furnish the name, address, and contact information of the "local

contact" to the homeowner's association for the property, and keep information current within sixty days;

- Association Must Report "Relevant Information" To Department of Taxation. Homeowners associations must provide the department of taxation with "all relevant information" "maintained in its records" "related to all operators who may be leasing their property as transient accommodations" by December 31 of each year, or within sixty calendar days of any change in the information. "Relevant information" means the operator's name, address, contact information, registration number, and website address if advertising or soliciting on the internet.

An "operator" is the person required to pay the general excise tax upon the gross income or gross receipts from the furnishing of the transient accommodations. See, HAR Section 18-237-1-05. This is typically the owner or proprietor of the unit. Rental agents or management companies are not "operators." Id., Examples #1 & #2.

Associations are defined as nongovernmental entities formed pursuant to HRS Chapters 421J ("Planned Communities,"), 514A ("Condominium Property Regimes"), and 514B ("Condominiums.") An association must furnish information to the Department of Taxation on all "operators" "in its records" who "may be leasing."

There also does not appear to be any requirement for an "operator" to furnish the association with the transient accommodation number or website, as this is not listed in SECTION 2 (b). [I am unaware of any other provisions of law outside of HRS 237D that would require the submission of this information.] Associations are required however to provide this information to the Department of Taxation as part of the defined term "relevant information." See, Act 326 SECTION 2(h). This leaves open the question of whether the association has a duty to gather the relevant information and under what circumstances.

Penalty Provisions: Penalties are potentially serious for what could be minor omissions.

	Omission	**Penalty**
Operator	Wilfully fails to furnish same-island contact information to association	As provided in 231-35, but without probation or incarceration: meaning, a full misdemeanor with a fine of up to $25,000; corporate fine up to $100,00
Operator	Wilfully fails to furnish change in same-island contact information to association within sixty days	See above, up to $25,000; corporation up to $100,000
Operator (or "person")	Wilfully fails to list same-island contact information in contract	See above, up to $25,000; corporation up to $100,000
Operator (or "person")	Wilfully fails to post same-island contact information "prominently" in the transient accommodation	See above, up to $25,000; corporation up to $100,000
Association (or "person")	Wilfully fails to provide "relevant information" to Department of Taxation by December 31 of each year, or within sixty days of any change in relevant information, operation, or ownership of unit	See above, up to $25,000; corporation up to $100,000

Act 326 does not provide a penalty was provided for the failure to provide the Transient Accommodation number on website or internet advertisement or solicitation. All of the penalty provisions refer to their particular subsection, and subsection (f) does not contain a penalty provision.

Effective Date. Act 326 has an effective date of July 1, 2012, and an expiration date of December 31, 2015.

Legislative Intent & Governor's Message: HB 2078 had a convoluted legislative history; however, a consistent focus was on a desire to compel compliance with the tax laws. Committee Reports emphasize the intent to "enforce transient accommodations tax compliance." See, Conference Committee Report No. 64-12.

House Bill 2078 ultimately became Act 326 without Governor Abercrombie's signature. Interested parties are urged to read the Governor's Message 1443. Governor Abercrombie sets forth his understanding of HB 2078. It appears that Governor Abercrombie believes that HB 2078 did not impose penalties upon associations for "not providing relevant information that is not maintained in the nongovernmental entities' records." (page 1) And, even if Act 326 does have this effect, the penalties are only for "willful" failure to report.

Commentary:

Operators: Transient accommodation operators already in compliance with tax requirements have some additional burdens and a slip-up could be costly should it come to the attention of the tax authorities. Act 326 will prompt compliant operators familiar with its provisions to hire a same-island contact, change their rental contracts and in-unit postings to include the same-island contact information, and put their tax identification number on any internet listings and internet solicitations (presumably including emails.)

Operators in partial compliance, for example operators with a license number but that are not filing or paying taxes, are faced with increased informational reporting by a third party (if the property is part of an association.) In theory, more information increases the likelihood of partial or non-compliant taxpayers coming to the attention of the tax authorities. In the situation of vacation rentals, however, thorough review of federal income tax returns, especially Schedule E filings, might be more efficient than reviewing the submissions of hundreds of condominium associations. There is no assurance in any of the testimony by the Department of Taxation that the information compelled by Act 326 is actually intended to be used by the Department of Taxation.

The potential impact of Act 326 on unlicensed TA operators is difficult to determine. Advertising via the internet will presumably be more difficult as commercial websites are unlikely to permit advertisements without a tax number

as part of their business practice. This is probably the most important part of Act 326 in terms of encouraging compliance and is an indirect result. Some TA operators presumably will be reported by their associations to the Department of Taxation, but this only applies to TA units in an association. And it is hard to predict whether and how the Department will ultimately use that information.

Less certain in my opinion is whether non-compliant TA operators (that are part of an association) will be providing information to their associations. TA activities are not allowed in some associations, or under carefully circumscribed conditions, and it seems to me that a noncompliant operator would be loath to report improper activity as an association might be relatively likely to take action against an impermissible use.

Finally, the penalties for non-compliance with Act 326 are less than existing penalties for failure to file TA returns, and are therefore unlikely to act as an incentive to comply with the law for those already not in compliance.

Associations: Act 326 puts associations into a difficult situation with new duties and responsibilities.

The Act is deficient in that "operators" are not required to furnish to their associations the same information that associations are required to send to the Department. The Legislature could have required operators to furnish their associations with their license number and the websites that they advertised on, but the Legislative did not do so.

Associations have to report "relevant information" "maintained in its records" to the Department of Taxation. "Relevant information" is a defined term that means "the operator's name and address, contact information, registration identification number issued pursuant to section 237D-4, and website address if advertising or soliciting the transient accommodation on the internet." SECTION 2 (h.)

Compounding this ambiguity, the language of SECTION 2 (c) uses the phrase "may be leasing their property as transient accommodations" to suggest a duty beyond aggregating and remitting the information furnished by the operators to the Department.

Does an association have to fill the gap between the reporting duties of an operator and the reporting duty of the association? According to Governor Abercrombie's message, this was not the legislative intent, citing Committee

Report 64-12 [presumably at (6)]. Readers may not find the Committee Report as dispositive as hoped for due to the sentence structure:

> (6) Clarifying that a non-governmental entity with covenants, bylaws, and administrative provisions must provide the Department of Taxation with relevant information related to all owners of transient accommodations maintained in its records to avoid penalties;

Should a prudent association, when an operator notifies it of the same-island contact (Section 2 (b)), then ask the operator to provide its registration number and website information?

While this does not seem onerous for persons not paying for the data aggregation or facing substantial penalties, Act 326 may go further. Associations are now aggregators of relevant information for operators of rentals that "may" be transient (Section 2 (c)), and may have a duty of inquiry or reporting for which they face substantial liability for failing to comply.

If an association has complaints in its records about a unit being used as a vacation rental, must the association report to the Department of Taxation even in the absence of a same-island contact notification by the operator? The answer may be "yes" because Act 326 does not limit the association's reporting duty to that of the operator's and the information is already "maintained in its records" regardless of how you interpret the law and legislative history.

Governor Abercrombie's Message is not part of the Legislative intent and, to the extent it attempts to offer a legal interpretation of HB 2078, is not binding upon a court. Few associations will be eager to litigate in a criminal setting whether their failure to supply the information to the Department of Taxation was "wilful" (as opposed to negligent or inadvertent) at the hazard of a substantial fine.

Penalties. Act 326 adds to the list of tax crimes under Hawaii law. None of the duties imposed by Act 326 relates to tax returns or the filing of tax returns; rather, the duties are to furnish specified information and to include information on contracts and advertisements. The only duty involving the Department of Taxation relates to an association providing information relating to operators who "may be leasing their property as transient accommodations."

Whether the omissions of Act 326 should properly be considered as "crimes" is debatable. While the objective of increasing compliance with Hawaii's tax laws is

laudable, non-compliance with reporting requirements not related to tax filings might have more appropriately been the subject of an administrative fine or sanctions instead of the criminal sections.

This note is intended as an overview of Act 326 of 2012 and not as legal advice or to be relied upon as legal authority or applicable to any particular situation.

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