SCAP No. 17-0000367

IN THE SUPREME COURT OF THE STATE OF HAWAI'I

IN THE MATTER OF THE TAX APPEAL OF PRICELINE.COM, INC., *et al.*, Appellants.	T. X. No. 13-1-0269 (AND CONSOLIDATED CASES: 13-1-0261 through 13-1-0270; 14-1-0001 through 14-1-0010; 14-1-0243 through 14-1-0251) APPEAL AND CROSS-APPEAL FROM THE STIPULATED ORDER AND FINAL JUDGMENT DISPOSING OF ALL ISSUES AND CLAIMS OF ALL PARTIES FILED ON APRIL 25, 2017 (AND UNDERLYING ORDERS) TAX APPEAL COURT HONORABLE GARY W.B. CHANG

REPLY BRIEF OF DIRECTOR OF TAXATION, STATE OF HAWAI'I, TO APPELLANTS/APPELLEES-CROSS-APPELLANTS' ANSWERING BRIEF

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I. INTRODUCTION

This is a statutory construction case in which the core issue is whether the income-reducing provision applicable to "tourism related services" in HRS §237-18(f) applies to the OTCs'[1] merchant car rental transactions. If not, the OTCs owe GET on their gross income. If so, the OTCs owe GET only on their retained amounts.

At trial and on appeal, the Director's position and analysis has been clear and consistent. The Director has rigorously applied the applicable rules of statutory construction to the plain language of HRS §237-18(f) and demonstrated that rental car transactions – which are nowhere mentioned in the definition of "tourism related services" – are simply outside the scope of HRS § 237-18(f). Thus, the OTCs owe GET on their gross income for the assessed transactions.

By contrast, the OTCs' position is inherently contradictory and is bereft of any meaningful statutory analysis. On its face, the term "rental cars" is not used in HRS §237-18(f). The OTCs nonetheless urge that somehow the plain language of HRS §237-18(f) demands that "rental cars" get the benefit of two different provisions of the statute by implication. The OTCs argue that rental car transactions are included within the "transportation included in a tour package" language ***and*** within the "residual" or "catch-all" clause for "other services rendered directly to the consumer or tourist." But, as a matter of basic statutory construction principles, the OTCs cannot have it both ways. If the legislature intended for the OTCs' merchant rental car transactions to be included within the "transportation included in a tour package" language, then there would be no reason for the legislature to also include rental cars as part of the residual clause. The OTCs have no explanation for this inherent conflict in their position.

In fact, neither provision applies. The "transportation included in a tour package" language does not apply because the OTCs' merchant rental car transactions are not "transportation" as used in HRS §237-18(f) and there is no evidence that a single assessed transaction was part of a "***tour*** package." See Dir. OB 10-21.[2] Further, the "residual" clause does not apply as demonstrated by the application of the *ejusdem generis* and *noscitur a sociis* rules of construction. The *ejusdem generis* rule requires that rental cars be "similar in nature" to the Ten Tourism Services listed in HRS §237-18(f), but they are not. The requisite "commonality" is

[1] Unless otherwise noted, defined terms used herein have the same meaning as used in the Director's Opening and Answering Briefs.

[2] The OTCs acknowledge that this provision would only apply to their rental car transactions that are part of a "package" and would not apply to their "stand-alone" rental car transactions.

missing because each of the Ten Tourism Services is an activity that people *primarily do for enjoyment or recreation* in Hawai‘i whereas people do not primarily rent cars for enjoyment or recreation. Similarly, the *noscitur a sociis* rule requires that the general words in the residual clause be restricted to the more specific words represented by the Ten Tourism Services. Here, the Ten Tourism Services are specifically and narrowly confined to pleasure-seeking activities, and the OTCs improperly attempt to broaden the residual clause to capture rental cars which have a practical and functional (not recreational) purpose.

II. THE GET IS A PYRAMIDING STATUTE AND, ABSENT AN EXCEPTION OR EXCLUSION, PYRAMIDING APPLIES TO A TAXPAYER'S GROSS RECEIPTS

The OTCs refer repeatedly to the "evils" of pyramiding. Yet, pyramiding is a core and "accepted feature" of the GET, the primary source of tax revenues for Hawai‘i.[3] The GET "is a gross receipts tax on the privilege of doing business in Hawai‘i." Travelocity.com v. Director of Taxation, 135 Hawai‘i 88, 103, 346 P.3d 157, 172 (2015) ("Travelocity"). The receipts of taxation under the GET are described in "expansive terms" and apply to the gross income received by the OTCs unless "the expansive definition of income is mitigated by limited categories of income-reducing provisions." Travelocity, 135 Hawai‘i 88, 106, 346 P.3d 157, 175. Here, because HRS §237-18(f) does not apply, the OTCs owe GET on their gross receipts from the assessed merchant rental car transactions.

Littered throughout the OTCs' Opening and Answering Briefs is their plea that the rental car industry (and other industries including helicopter rides, jet ski rentals, and diving excursions) will be devastated if the OTCs' merchant rental car transactions are subject to GET pyramiding. First, this case has no impact whatsoever on activities such as helicopter rides, jet ski rentals, and diving excursions since the Director does not dispute that these are classic "tourism related services." Second, there is no evidence, just OTC hyperbole, that it will be their ruination if this Court declines to grant the OTCs an "income-reducing" tax break under HRS §237-18(f) for their rental car transactions that the legislature itself has never seen fit to grant. Third, in light of the OTCs' history of failing to pay *any* GET (or even file GET returns), their professed concern for Hawai‘i's tourism industry rings hollow.

[3] 'Pyramiding' is an informal term referring to multiple tax assessments on different persons or entities on the same or related revenue and is an accepted feature of certain implementations of the GET." Travelocity, 135 Hawai‘i 100, 346 P.3d 169, n. 19 (citing In re Tax Appeals of Busk Enters., Inc., 53 Hawai‘i 518, 497 P.2d 908, 910 (1972) and In re Tax Appeal of Subway Real Estate Corp. v. Director of Taxation, 110 Hawai‘i 25, 34 129 P.3d 528, 537 (2006)).

The OTCs use an unrepresentative hypothetical transaction in which they keep only $10 from a $100 merchant rental car transaction (their actual margins are closer to 30% than 10%) and urge that pyramiding would result in a "crippling ***40%*** of the $10 it retains."[4] OTC Answering Brief ("OTC AB") 2, n.3 (emphasis is OTCs). What the OTCs fail to note is that under their hypothetical they have been paying "***0%*** of the $10 [they] retain[]." It is not the OTCs who are being crippled, it is the State of Hawai'i. The OTCs have been doing business in Hawai'i for years, raking in tens of millions of dollars annually, and paying *nothing* (and reporting nothing) to the State. If every business conducted itself this way, the State would be bankrupt.

III. THE "TRANSPORTATION INCLUDED IN A TOUR PACKAGE" LANGUAGE OF HRS §237-18(f) DOES NOT APPLY TO THE OTCS' MERCHANT RENTAL CAR TRANSACTIONS

The OTCs' "Answering Brief" is a misnomer as only five pages are directly responsive to the Director's Opening Brief. The lone issue upon which the Tax Court ruled against the Director – and thus the only issue the Director appealed and addressed in her Opening Brief – was that "package transactions" involving rental cars qualified as "transportation included in a tour package," pursuant to HRS §237-18(f). In their 25-page Answering Brief, the OTCs only address this issue at pages 19 through 24. The rest of the OTCs' Answering Brief is a rehash of their Opening Brief, repeating the same arguments and often using identical language.

A. Rental Cars Are Not "Transportation" As Used In HRS §237-18(f).

Although the words "rental cars" do not appear in HRS §237-18(f), the OTCs argue that "transportation" as used in HRS §237-18(f) includes rental cars. It does not. See Dir. OB 10-18. There is nothing in the text of HRS §237-18(f), nor its legislative history, nor the Department's rules or regulations to remotely suggest that the legislature intended "rental cars" to be included within "transportation" as the OTCs urge.

The Department's Tax Information Release ("TIR") 91-8 accompanied the passage of the 1991 amendments to HRS §237-18(f). The two "transportation" examples included in TIR 91-8 are an airport shuttle service included in a tour package and a tour bus used as part of a tour package. These two transportation examples, both involving commercial services in which a

[4] The GET "casts a wide and tight net" but imposes tax at a very low tax rate of 4% on gross income. This compares favorably to much higher sales tax rates in other states, and to the top federal income tax rate of 39.6% or the corporate tax rate of 35%.

tourist is transported by a service provider, bear no relationship to renting a car. In response, the OTCs argue that the Director's reliance on TIR 91-8 is "misplaced" because TIRs are "merely announcements" and "do not have the force and effect of law." OTC AB 20, n.14. Yet, the OTCs themselves rely upon TIR 91-8 in their Opening and Answering Briefs. See OTC OB 28-29, OTC AB 11. Moreover, this Court relied upon this same TIR 91-8 as an interpretive aid in Travelocity. 135 Hawai'i 107-08, 346 P.3d at 176-77. The OTCs also argue that the two examples in TIR 91-8 are merely illustrative. OTC AB 20-21. While that may be true, it is also true that the Director, in explaining the 1991 amendments to HRS §237-18(f), chose transportation examples having nothing to do with rental cars.

The OTCs also rely on a dictionary definition of "transportation" as "a means of conveyance or travel from one place to another," citing the online version of Merriam-Webster. OTC AB 19. While the OTCs couch this definition as one "among other" definitions, they fail to note that this is part (a) of the *second* definition for "transportation" in Merriam-Webster. Part (b) of the second definition is the "*public conveyance of passengers* or goods especially as a commercial enterprise." Moreover, the *first* definition in Merriam Webster defines "transportation as "an act, process, or instance of *transporting or being transported*." The two definitions omitted by the OTCs support the Director's interpretation.

Next, the OTCs assert that the legislature recently recognized that rental cars constitute "transportation" when it enacted Act 137 earlier this year. OTC AB 19-20. But, the OTCs ignore that the stated purpose of this recent legislation was to "amend the prorated amount of vehicle license and registration fee and weight taxes that rental car companies are allowed to pass on to lessees, and to expand the categories of government fees that the companies are permitted to collect." Act 137 (July 10, 2017, § 1). Thus, Act 137 had nothing to do with HRS § 237-18(f) and sheds no light on what the 1991 legislature intended twenty-six years ago in amending HRS §237-18(f). In fact, the amendment to Act 137 is another example of the legislature addressing the taxation of rental cars, but making no effort to amend HRS §237-18(f) to include rental cars.

Finally, the OTCs strive in vain to respond to the Director's reliance on the Rental Motor Vehicle Tax (HRS Ch. 251), which was enacted by the same 1991 legislature that amended HRS §237-18(f). As the Director noted, the Rental Motor Vehicle Tax is significant because it shows that (1) the legislature knew how to draft a tax that applied to rental cars when that was its intent, as it was with Chapter 251, and (2) "transportation," as used throughout Chapter 251 and the

accompanying administrative rules, is always used in the context of a tour vehicle driven by a third party and never in the context of a rental car. See Dir. OB 14-16.[5] The OTCs' response – that the Rental Motor Vehicle Tax is a separate tax from the GET – is both true and irrelevant. OTC AB 21. The point is that the 1991 legislature enacted major tax legislation relating to the rental car industry, yet chose not to amend HRS §237-18(f) to add rental cars. As to this relevant point, the OTCs have no response.

B. The OTCs Submitted No Evidence That Any Of The Assessed Transactions Involved "Tour Packages."

Assuming for sake of argument that rental cars qualify as "transportation" (they don't), the OTCs must also prove that the rental cars were not merely part of a "package" transaction, but rather part of a "*tour* package." For purposes of HRS §237-18(f), this distinction is critical. Not every rental car package offered by the OTCs is a "tour package." For example, assume a businessman from the mainland books a hotel and rental car through an OTC for a purely business trip to Oahu. That may be a "package," but it is not a "tour package." The express terms of HRS §237-18(f) apply to "transportation included in a tour package" and the qualifier "tour" cannot be ignored, notwithstanding the OTCs' invitation to do that very thing. See Travelocity, 135 Hawai'i 121, 346 P.3d 191 ("This court presumes that every word of a statutory definition has meaning and effect"). The OTCs have no cogent response to HRS §237-18(f)'s requirement of a "tour" package, but rather offer several non-sequiturs.

First, the OTCs state that "[m]any of the OTCs and other travel agencies book packages including some combination of airfare, accommodations, and rental car to journey to Hawai'i for pleasure," and the Director offers no explanation why this would not qualify as a "tour package." OTC AB 23. The OTCs miss the point. Even if these types of transactions qualified as tour packages, the OTCs failed to submit any *evidence* that a single one of the assessed transactions contains the elements in the OTCs' hypothetical package transaction. Importantly, whether any of the assessed transactions is a "tour package" is a question of evidence, not law. "[T]he Department's assessments are prima facie correct" and "it is the taxpayer's burden to prove

[5] The OTCs also draw some unexplained distinction between the term "transportation" and "transporting" as used in Chapter 251 and the accompanying administrative rules, but it remains unclear to the Director what point the OTCs are trying to make. See OTC AB 21-22.

otherwise." Travelocity, 135 Hawai'i 115, 346 P.3d 184.[6] Here, the OTCs suffer from a failure of proof. The Director's assessments necessarily presume that none of the assessed rental car transactions involved "tour packages," and the OTCs have failed to rebut this prima facie case; indeed, they have not even attempted to do so.

Second, the OTCs assert that "***[b]oth*** of the TIR [91-8] examples are consistent with the commonly understood meaning of 'tour,' ***as are the packages the OTCs facilitate***." OTC AB 23 (emphasis is OTCs). The Director agrees that both examples in TIR 91-8 are prototypical tour packages. Example 1 was a "package tour[] consisting of air travel from the mainland to Hawaii, a lei greeting, ground transportation from the airport to the hotel, hotel accommodations, certain meals, and admissions from independent vendors and suppliers." Example 2 was "a tour of Honolulu" including "stops at a pineapple cannery (cannery) and the Arizona Memorial Visitors Center." But, the OTCs' statement that "the packages the OTCs facilitate" are likewise tour packages is mere *ipse dixit*. In fact, the OTCs submitted zero evidence that the OTCs' package transactions are "tour packages" similar to the two examples in TIR 91-8.

Third, the OTCs (correctly) note that the definition of "tourism related services" includes both a "customer or tourist," but (incorrectly) argue that the Director attempts "to limit the reach of HRS §237-18(f) to services reserved by 'tourists.'" See OTC AB 24. That is not the Director's position; rather, the Director agrees with the OTCs' statement that it is the "nature of the services" that is the focus of HRS §237-18(f). Thus, a catamaran cruise is, by definition, a "tourism related service" whether enjoyed by a Hawai'i resident or mainland tourist. On the other hand, a businessman who rents a car to attend a business meeting is not engaged in a "tourism related service," regardless of whether that person is a Hawai'i resident or a visitor.

The OTCs then make the strawman argument that "[b]y the Director's logic, a travel agency would have to inquire of each customer whether his or her purpose was tourism related or for some other purpose. It would be absurd to require travel agencies to engage in such intrusive questioning to qualify for income apportioning." OTC AB 25. Again, the OTCs miss the point. As just discussed, it is the "nature of the transaction" that determines whether an activity qualifies as a tourism related service. Thus, there is no need to question *why* a person is engaging

[6] Contrary to the OTCs' statement that this presumption only relates to the "calculation of the ***amount***" of tax, penalties, and interest (see OTC AB 9 (emphasis is OTCs)), the Travelocity Court stated it was an "***evidentiary*** presumption." 135 Hawai'i 115, 346 P.3d 184 (emphasis added).

in any of the Ten Tourism Services because (assuming the other criteria in HRS §237-18(f) are met), such activities qualify as "tourism related services." But, a car rental – unlike, for example, a lei greeting – is not entitled to the same presumption that it is a "tourism related service." People rent cars for a myriad of reasons – many having nothing to do with tourism or tour packages[7] – and there is nothing to suggest rental car transactions were the type of transactions that the legislature intended to benefit from the tax break afforded by HRS §237-18(f).

IV. THE "RESIDUAL CLAUSE" OF HRS §237-18(F) DOES NOT APPLY TO THE OTCS' MERCHANT RENTAL CAR TRANSACTIONS

The OTCs criticize the Director for "ignoring," "conspicuously omit[ting]," and "pretend[ing] the catch-all provision does not exist." See OTC AB 3, 12, 13. This argument is intentionally misleading. As the Director noted in her Opening Brief, the Tax Court rejected the OTCs' argument that the "catch-all" or "residual" clause applied to any of the OTCs' merchant rental car transactions. Because the Director prevailed on this issue, she did not appeal it. Thus, she stated that her Opening Brief did not address the residual clause, but rather would address this issue in the Director's Answering Brief, which she has done in detail. See Dir. OB 4, n.11; Director's Answering Brief ("Dir. AB") 17-30.

A. The OTCs Base Their Arguments On Numerous Factual Misrepresentations.

The OTCs' Answering Brief contains a discussion of the "residual" clause that is largely duplicative of their prior discussion in their Opening Brief. Compare OTC OB 18-29 to OTC AB 10-18. The OTCs' discussion of the residual clause rests on several patent misrepresentations.

First, the OTCs state that "the Director asserts that *only* the ten examples of tourism related services explicitly referenced in §237-18(f) are entitled to apportionment" and that "the tourism related service must be *specifically* listed." OTC AB 2, 3 (emphasis added). The OTCs then argue that "the Director's interpretation would expose many other tourism related services not expressly listed in HRS §237-18(f), including helicopter and jet ski rides, bicycle tours, and scuba and seawalker excursions, among countless other activities, to double taxation." OTC AB 3. The OTCs' argument is based on a false premise. The Director has stated that she "embraced

[7] The Director's Opening Brief gives three such examples (there are many more): (1) a Hawai'i resident's car breaks down, and the resident rents a car from an OTC to get to work, run errands, take the kids to school, or the like; (2) a businessman travels to Hawai'i for business only, and rents a car to take him from the airport to his business meeting and back to the airport; and (3) a Hawai'i attorney files from Maui to Oahu to attend a court hearing or deposition and rents a car in Oahu. Dir. OB 19.

these letter rulings as being exactly the type of 'other services' that the residual clause was intended to capture. Scuba diving and jet ski rentals are classic Hawai'i vacation activities that tourists do for *enjoyment*." Dir. AB 28 (emphasis in original). See also R25:37.

Second, under the heading "The Department Historically Applied HRS §237-18(f)'s Income-Apportioning Provision To Car Rental Transactions," the OTCs quote *verbatim* the same excerpts from the declaration of former-Director Kurt Kawafuchi as in the OTCs' Opening Brief. See OTC OB 7-8 and OTC AB 5.[8] The OTCs' argument is false. This is a case of first impression, and the Department has never taken the position that HRS §237-18(f) applies to rental car transactions. See Dir. AB 3.

Third, the OTCs distort this Court's Travelocity decision beyond all recognition. The OTCs' Answering Brief contains a heading entitled "The Court's *Travelocity* Decision ***Confirms*** That Rental Car Transactions Are 'Tourism Related Services' Entitled To Apportionment Under HRS §237-18(F)." OTC AB 10 (emphasis added). But, the assessed transactions in Travelocity were transient accommodations and had nothing to do with rental car transactions. For the OTCs to argue that this Court has already "confirm[ed]" that rental car transactions are entitled to apportionment under HRS §237-18(f) is fanciful.[9] The OTCs likewise claim that "the Court's ruling in Travelocity, as well as the undisputed evidence, establishes that the third element [of HRS §237-18(f)] is satisfied, as car rentals are 'tourism related services" within the meaning of HRS § 237-18(f)." OTC AB at 13. There is nothing in Travelocity that remotely establishes this as evidenced by the OTCs' lack of citation to this Court's decision.

The OTCs emphasize that the Director "ignores the ***most central***" ruling from Travelocity; namely, to "***protect the tourism industry*** 'from the pyramiding effect of the GET.'" OTC AB 10 (emphasis in original). The OTCs' argument begs the question. The relevant

[8] The Director has already addressed the misleading nature of the OTCs' references in their Opening Brief to Mr. Kawafuchi's declaration, including the OTCs' replacement of key contextual language from his declaration with an ellipsis. See Dir. AB 3. The OTCs continue this same dubious practice in their Answering Brief. See OTC AB 5.

[9] The only mention of HRS §237-18(f) in Travelocity is found in a discussion whether gross income is "divided" in merchant hotel transactions for purposes of the income-reducing provision applicable to "transient accommodations," HRS §237-18(g). In that section of the Court's opinion, it discussed all six applicable subparagraphs of HRS §237-18 – subparagraphs (a), (b), (e), (f), (g), and (h) – in concluding that OTCs "divide" income with the hotels in their merchant hotel transactions. 135 Hawai'i 108-11, 346 P.3d 177-80. This is not a disputed issue in the present case. See Dir. OB 8.

question is whether the OTCs' merchant rental car transactions fit within the definition of "tourism related services." Because they do not, the OTCs' rental car transactions are subject to the GET's pyramiding provisions, just like any other business for which the legislature has not granted an express exemption or exclusion.

B. The OTCs Virtually Ignore The Applicable Rules of Statutory Construction.

This is a statutory construction case, a point the OTCs effectively ignore. The two rules that are particularly germane to the interpretation of the residual clause are the *ejusdem generis* and *noscitur a sociis* doctrines. The Director has engaged in a searching statutory construction analysis of both doctrines, including an extended discussion of this Court's extensive jurisprudence. See Dir. AB 19-27. As the Director has discussed at length, what is "common" to the Ten Tourism Services listed in HRS §237-18(f) is that *each activity is something that people primarily do for enjoyment or recreation in Hawai'i*, including: water-based activities (catamaran cruises, canoe rides); dining & entertainment experiences (dinner cruises, dinner shows, extravaganzas); traditional Hawaiian activities (luaus, lei greetings); "cultural and educational" events; and tour related services (sightseeing tours, and transportation included in a tour package). Dir. AB 24-26. By contrast, *people do not primarily rent cars for enjoyment*. Id. People rent cars for the practical purpose of getting from one place to another.

The OTCs undertake virtually no statutory construction analysis. The OTCs mention the *ejusdem generis* doctrine only in passing; the rule of *noscitur a sociis*, not at all. See OTC AB 15-16.[10] Instead of a meaningful statutory construction analysis, the OTCs quote snippets from travel publications or tourism websites for such uncontroversial propositions such as "the best way to get around Maui is by car," "we recommend a rental car for flexibility and ease," and "nearly all visitors … rely on tour buses, taxis, or rental cars."[11] The OTCs make the Director's point for her as the OTCs highlight that people rent cars for a *practical* purpose, not for *enjoyment or recreation*, which is the common denominator to all Ten Tourism Services.

Finally, the OTCs find legislative intent where none exists. They maintain that "the Legislature did take care to protect rental car transactions from being grossed up" by adding the

[10] The OTCs cite a single *ejusdem generis* case, State v. Yan, 44 Hawai'i 370, 355 P.2d 25 (1960). Further, they cite Yan for nothing more than the rule's basic purpose and do not discuss the facts of the case, in which the Court held that *ejusdem generis* did not apply. 44 Hawai'i 378, 355 P.2d 30.

[11] This section of the OTCs' Answering Brief is a near verbatim repeat of its Opening Brief. Compare OTC AB 13-15 to OTC OB 19-21.

residual clause to the 1991 amendment to HRS §237-18(f). OTC AB 17. But if the legislature truly intended to "take care" of such a major industry as the rental car industry, surely it would have specified rental cars somewhere in HRS §237-18, rather than relying on the generic wording "and other services rendered directly to a customer or tourist." According to the OTCs' reasoning, the 1991 legislature thought it important to "take care" of businesses that offer luaus and lei greetings by adding them to the list of tourism related services, but felt that the catch-all phrase was somehow sufficiently clear to cover rental cars. That simply defies common sense.

V. CONCLUSION

The assessments are prima facie correct. The OTCs have failed to meet their burden of showing that either the "transportation included in a tour package" or "residual clause" applies to their merchant rental car transactions. As such, the OTCs owe GET on the gross receipts for all the assessed rental car transactions, both "stand-alone" and "package" transactions. The Director asks that judgment be entered in her favor as stated in the conclusion to her Opening Brief.

DATED: Honolulu, Hawai‘i, November 13, 2017.

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I certify that on this date, a copy of the *Reply Brief of Director of Taxation, State of Hawai‘i’s to Appellants/Appellees-Cross–Appellants Answering Brief*, was served on the following persons via JEFS at the following email address:

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