SCAP NO. 17-0000367

IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

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IN THE MATTER OF THE TAX APPEAL OF PRICELINE.COM, INC.
Appellants/Appellees-Cross-Appellants

vs.

DIRECTOR OF TAXATION, STATE OF HAWAI‘I,
Appellee/Appellant-Cross-Appellee

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APPEAL FROM THE CIRCUIT COURT OF THE FIRST CIRCUIT
T.A. 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)

# APPELLANTS-APPELLEES/CROSS-APPELLANTS' OPENING BRIEF

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## I. INTRODUCTION

This appeal and cross appeal arise from the second of several attempts by the Director of Taxation, State of Hawai'i (the "Director")[1] to extract hundreds of millions of dollars of excessive tax, penalties and interest from the online travel companies ("OTCs"[2]). After this Court rejected the Director's attempt to impose both Transient Accommodations Tax ("TAT") and General Excise Tax ("GET") on the full amounts the OTCs collect from travelers in merchant model[3] hotel reservations without offset for amounts remitted to the hotels, the Director sought a second bite at the apple, this time assessing GET on the gross amounts collected by OTCs in merchant model car rental transactions, including for tax years already litigated to final judgment after remand from this Court.

This appeal raises two key issues arising out of the Director's abuse of her taxing authority: (1) Can the Director issue and litigate subsequent assessments of the *same tax* against the *same taxpayers* for the *same tax years* on which final judgment *previously has been entered*, and (2) Can the Director impose tax liability on an OTC for the entire amount it collects from the customer in a car rental reservation transaction, including amounts remitted to the car rental company, even though this Court has previously ruled that OTCs are "travel agencies" entitled to the benefit of the income apportioning provisions of the GET statute?

As to the first question, principles of res judicata bar the Director from taking a seriatim approach to tax assessments for tax years already litigated to conclusion. As to the second question, even for assessments issued for tax years not barred by res judicata, double taxation – or "pyramiding" – of the GET on car rental transactions is squarely prohibited by the plain terms

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[1] The Director is the Appellee/Appellant-Cross-Appellee.

[2] Appellants/Appellees-Cross-Appellants are Expedia, Inc., Hotwire, Inc., Orbitz, LLC, Trip Network, Inc. (d/b/a Cheaptickets.com), and priceline.com, Incorporated. Five other OTCs were Appellants in the underlying consolidated tax appeals, but are not parties to this appeal or cross-appeal. TVL LP (f/k/a Travelocity.com LP) and Site59.com, LLC were dismissed by stipulation filed on November 29, 2016. R31:397. Judgment was entered in favor of Hotels.com L.P., Internetwork Publishing Corp. (d/b/a Lodging.com) and Travelweb LLC. R25:431 at 434. No party has appealed from the judgment in favor of these entities.

[3] "Merchant model" refers to a reservation in which the OTC collects all amounts owed by the traveler for the reservation, and serves as merchant of record on the transaction.

of the apportioning provisions of the GET statute. For these reasons, the Tax Appeal Court's ("Tax Court") rulings must be overturned and judgment granted in favor of the OTCs.

***The 2000-2011 GET Assessments are Barred by Res Judicata.*** For more than two years, the Tax Court presided over contentious litigation between the Director and the OTCs regarding assessments for GET and TAT for tax years 2000 - 2011. Those assessments were litigated to final judgment, including a decision by this Court in *Travelocity.com, L.P., et al. v. Director of Taxation,* 135 Hawai'i 88, 346 P.3d 157 (2015) ("*Travelocity*").

When the Director issued the original *and* amended Final Assessments of GET in 2011 and 2012 for the OTCs' merchant model hotel transactions (for tax years 2000-2011), she had full knowledge that the OTCs also engaged in other lines of business, including merchant model car rental reservations (referred to as "merchant car transactions"). Nonetheless, the Director *twice* made the strategic decision to issue Final Assessments of GET based on *only* the OTCs' merchant model hotel transactions. Then, *only after the Tax Court entered final judgment* against the OTCs for *GET liability* for tax years *2000 through 2011*, the Director, on December 9, 2013 and July 18, 2014, issued new, additional assessments against each OTC (the same taxpayers) for purported *GET liability* (the same tax) based on merchant car transactions covering the tax years *2000 through 2011* (the same tax years) and also 2012 and 2013.[4]

The Director's seriatim assessments of the same taxpayer for the same tax and for the same tax years on which final judgment has been entered makes a mockery of her pledge, in the preamble to the Hawai'i Taxpayer Bill of Rights, that "the tax laws will be administered with fairness, uniformity, courtesy, and common sense," and are barred by res judicata. The Tax Court, having recognized a "legitimate concern about how many times the taxpayers are going to have to come back to this court to defend general excise tax issues," nonetheless concluded res judicata did not bar the subsequent assessments because they were brought two years later and

[4] On January 25, 2016, the Director issued yet another set of "final" assessment notices, ***again*** assessing the OTCs (the same taxpayers) for GET (the same tax) for periods including 2000 through 2011 (the same tax years), this time with respect to agency model transactions. *See* Statement of Related Cases. Those assessments, which involve some of the very same transactions that were the subject of prior assessments (i.e. those in which agency hotel or car were combined with merchant hotel or car in a package), are not before this Court, but are barred for the same reason.

were based on a different activity, albeit one he agreed the Director was aware of when the initial assessments were issued. This was error.

***The Tax Court Erred in Failing to Apply the GET's Express Income Apportioning Provisions.*** Even if the Director's merchant car assessments for 2000-2011 were not barred in their entirety (they were), reversal is required because the Tax Court independently erred by concluding, with respect to the 2000-2013 merchant car assessments, that HRS § 237-18(f), a subsection of the "GET Apportioning Provision,"[5] does not apply to rental car transactions unless they are part of a package transaction (*i.e.*, a transaction in which a rental car reservation is made together with a reservation for one or more additional travel services, such as a hotel or airline reservation). In *Travelocity*, this Court carefully analyzed § 237-18(f), which provides:

> Where tourism related services are furnished through arrangements made by a travel agency or tour packager and the gross income is divided between the provider of the services and the travel agency or tour packager, the tax imposed by this chapter shall apply to each such person with respect to such person's respective portion of the proceeds, and no more.
>
> As used in this subsection "tourism related services" means catamaran cruises, canoe rides, dinner cruises, lei greetings, transportation included in a tour package, sightseeing tours not subject to chapter 239, admissions to luaus, dinner shows, extravaganzas, cultural and educational facilities, ***and other services rendered directly to the customer or tourist***, but only if the providers of the services other than air transportation are subject to a four per cent tax under this chapter or chapter 239.

HRS § 237-18(f).[6] This Court observed that "[s]ubsection (f) has the same purpose between a travel agency and a provider of tourism related services, as does subsection (g) between a travel agency and the hotel operator." *Travelocity*, 135 Hawai'i at 109-10, 346 P.3d at 178-79. The Apportioning Provisions in §§ 237-18(f)-(h) were added by the Legislature in recognition of the vital role the tourism industry plays in Hawai'i's economy, and the need to foster and preserve that industry by mitigating the burden imposed by a pyramiding tax. *Id.* at 110-11, 346 P.3d at 179-80. This Court also noted that "arranging the rental vehicle transportation for a person" can be a travel service offered by a travel agency, and held that "for the purposes of the GET Apportioning Provision, the OTCs operate as travel agencies." *Id.* at 107-08, 346 P.3d at 176-

[5] See *Travelocity*, 135 Hawai'i at 106, 346 P.2d at 175.

[6] All emphasis in quotes is added and all internal citations are omitted, unless otherwise stated.

77. Those rulings, and the plain language of the statute, dictate that HRS § 237-18(f) applies to limit the OTCs' GET liability in merchant car transactions to only their retained portion of the gross amounts collected (and not the portion forwarded to the car rental company for providing the car). The Tax Court's conclusion that the applicability of HRS § 237-18(f) depends on whether the car rental was part of a travel package is error, and must be overturned and judgment entered in favor of the OTCs.

## II. STATEMENT OF THE CASE

### A. Factual Background

#### 1. The OTCs' Merchant Model Business

In *Travelocity* this Court considered in depth the OTCs' merchant model business,[7] and the Director acknowledges that "merchant car rental transactions operate in the same basic manner as the merchant hotel transactions at issue in *Travelocity*." R19:163. *See also* R25:395, fn. 2. Specifically, the OTCs provide a one-stop Internet shopping experience where travelers can search options, compare prices and amenities and book reservations with multiple travel service providers—including hotels, airlines, and rental car companies—all at once. *Travelocity*, 135 Hawai'i at 93-94, 346 P.2d at 162-63. As the Director has long been aware, travelers who use the OTCs' websites often arrange airline flights, hotel accommodations, and rental cars simultaneously, in a "package" transaction. R23:40, ¶ 5, 43-49 at 45 (Department's May 9, 2008 information request to the OTCs for transactional data[8] seeking, *inter alia*, their package transactions, including "the amount remitted to the hotel for the hotel room portion of the package, [and] the amount remitted to other suppliers for each constituent portion of the package (i.e., ***car rental***, airline ticket)."

[7] Additional details regarding the OTCs' merchant model business and merchant car transactions are set forth in the Affidavits of Paul Tomasiello, R29:43-57, Susan Shields, R29:59-70, and William Jose, R29:72-86, attached as Exhibits A to C to the Declaration of Michael S. Lewis, R29:40-41, and the Affidavit of Matt Lee, R23:741-51, attached as Exhibit "A" to the Declaration of Michael Green, R23:739. Citations to the Record on Appeal are designated as "R[JEFS Docket No.]:[pdf Page Number(s)]." Unless otherwise indicated, citations to a docket number refer to the docket in CAAP-17-0000367.

[8] *See Travelocity*, 135 Hawai'i at 95-96, 346 P.2d at 164-65.

The OTCs do not themselves provide any of these travel services—they do not own or operate hotels or actually furnish accommodations, *see Travelocity*, 135 Hawai‘i at 94, 127, 346 P.3d at 163, 196, and they do not own or operate car rental companies or actually provide cars to travelers, R29:52, ¶¶ 25-26; 68-69, ¶¶ 29-30; 84, ¶ 39; R23:748, ¶¶ 25-26. Rather, in their merchant model business, the OTCs facilitate reservations for travelers with various travel service providers for a noncommissioned negotiated contract rate, *Travelocity*, 135 Hawai‘i at 113, 346 P.3d at 182, and later those travel service providers provide the reserved service to the customers, R29:52, ¶ 26; 69, ¶ 30; 75, ¶ 12; R23:748, ¶ 26. An OTC charges the traveler's credit card a total amount for the transaction, which is allocated as follows: (1) the amount the travel service provider charges for its service ("Net Rate"), which the travel service provider collects through the OTC, (2) an amount to cover the travel service provider's anticipated tax liability on the Net Rate (the "Tax Recovery Charge"), which the travel service provider receives from the OTC and remits to the taxing authority, plus (3) amounts charged and retained by the OTC for its facilitation services (commonly referred to as the "Margin," "Markup" or "Facilitation Fee") and fees retained as additional compensation for servicing the traveler's reservation (the "Service Fee"). *Travelocity*, 135 Hawai‘i at 94, 346 P.3d at 163.

### 2. The Director Previously Assessed And Litigated To Final Judgment The OTCs' GET Liability For Tax Years 2000 Through 2011

On January 31, 2011 and February 3, 2011, the Director issued "NOTICE[S] OF FINAL ASSESSMENT OF ADDITIONAL GENERAL EXCISE AND/OR USE TAX" to the OTCs for tax years 2000 through 2010.[9] R23:51-422.[10] The amounts assessed therein were based on merchant model hotel reservation transactions only, although the OTCs openly and obviously assisted travelers in making reservations with providers of other travel services, including rental cars–a fact well known to the Department of Taxation R23:40, ¶ 5, 43-49 at 45. Each of those Notices was labeled as a notice of "Final Assessment" of General Excise and/or Use Tax for the years stated. R23:51-422. The OTCs filed timely appeals to the Tax Court (Tax Appeals 11-1-0020 through 11-1-0034), *id.*, which were consolidated, R23:424-28.

[9] Certain OTCs were assessed starting in tax year 1999, rather than 2000.

[10] The record citation is to the OTCs' March 1, 2011 Notices of Appeal to the Tax Court. Exhibit "A" to each is the Notice of Final Assessment appealed from.

While the consolidated tax appeals were pending, on June 8, 2012, the Director issued a new set of "NOTICE[S] OF FINAL ASSESSMENTS OF ADDITIONAL GENERAL EXCISE AND/OR USE TAX" to the OTCs for the same tax years (2000 to 2010) and one additional tax year (2011). R23:438-649.[11] That new set of assessments substantially increased the amount of tax allegedly due by assessing tax on the gross amount collected from the traveler in the hotel reservation transactions. *See id.* Again, each of those Notices was labeled as a notice of "Final Assessment" of General Excise and/or Use Tax for the years stated. *Id*. The OTCs filed timely appeals to the Tax Court (Tax Appeals 12-1-0286 through 12-1-0300) on July 3, 2013, *id.*, which were consolidated with the already-pending case involving the prior assessments, R23:651-57.

The Tax Court issued its "FINAL JUDGMENT DISPOSING OF ALL ISSUES AND CLAIMS OF ALL PARTIES" in the consolidated cases on August 15, 2013. R23:660-63. An appeal and cross-appeal were filed after the OTCs paid first all amounts alleged to be due under the Tax Court's final judgment. This Court accepted transfer, affirmed in part and vacated in part, holding that the OTCs are not liable for TAT and are only liable for GET on the amounts they retained in merchant model hotel reservation transactions. This Court remanded to the Tax Court for a final determination as to each OTC's GET liability for each tax year at issue. *Travelocity*, 135 Hawai'i at 127, 346 P.3d at 196. On September 21, 2015, the Tax Court entered a set of "STIPULATED FINAL JUDGMENT[S] ON REMAND" setting forth the amount of each OTC's GET liability and the "overpayment pursuant to HRS § 232-24" due back to each OTC. R23:665-87.

### 3. After Litigating To Final Judgment The OTCs' GET Liability For Tax Years 2000 Through 2011, The Director Issued New Assessments For Purported Additional GET Liability For The Very Same Tax Years

On December 9, 2013, *after* the Tax Court entered its final judgment in the prior litigation, the Director issued a new set of "NOTICES[S] OF FINAL ASSESSMENT OF ADDITIONAL GENERAL EXCISE AND/OR USE TAX" to the OTCs for the same exact tax years (and also including 2012), based on the OTCs' merchant car transactions ("2000-2012 Car Assessments"). *See* Exhibit "A" to Notices of Appeal filed on January 7, 2014 in Tax Appeals 14-1-0001

[11] The record citation is to the OTCs' July 3, 2013 Notices of Appeal to the Tax Court. Exhibit A to each is the Notice of Final Assessment appealed from.

through 14-1-0010.[12] The GET assessments were based on the gross amount each OTC collected from its customers in Hawai‘i merchant car rental transactions during the period 2000 through 2012, without applying HRS § 237-18(f). *Id.* Then, on July 18, 2014, the Director issued an additional set of "NOTICE[S] OF FINAL ASSESSMENT OF ADDITIONAL GENERAL EXCISE AND/OR USE TAX" to the OTCs for the 2013 tax year based on the OTCs' merchant rental car transactions and merchant hotel transactions. *See* Exhibit "A" to Notices of Appeal filed on August 14, 2014 in Tax Appeals 14- 1-0243 through 14-1-0251.[13]

**4. The Department Historically Applied HRS § 237-18(f)'s Income-Apportioning Provision To Car Rental Transactions, Yet The Director's Assessments Here Do Not**

The Department has a history of applying § 237-18(f)'s income-apportioning provision broadly to every travel agency transaction, but did not do so here. According to the former Director of Taxation, Kurt Kawafuchi:

- "[T]he Department's policy and procedure was that the splitting rule applied generally to arrangements made by travel agents and tour packagers for visitors to Hawaii. Activities could qualify for splitting even if they were not expressly and specifically listed in HRS 237-18(f)." Declaration of Kurt K. Kawafuchi dated July 7, 2016 ("Kawafuchi Decl."), R23:760-63 at 761, ¶ 5.

- "[I]n general, if the service was arranged by a traditional travel agency and was tourism-related, then, as I recall, the Department's policy and procedure was that the service would qualify for income splitting." *Id.*

- "[T]he Department's view was that car rentals arranged by a traditional travel agency for customers who were renting cars in Hawaii qualified for the splitting rule . . . ." *Id.*, ¶ 6.

[12] R31:23-33 at 29-32; R33:21-31 at 27-30; R31:107-17 at 113-16; 184-94 at 190-93; 270-80 at 276-79; 344-54 at 350-53; 417-27 at 423-26; 460-500 at 496-99; 558-68 at 564-67, 630-40 at 636-39.

[13] R35:19-39 at 30-33; R37:18-39 at 30-33; R37:440-61 at 453-55; R39:18-39 at 30-33; R39:430-51 at 442-45; R41:18-39 at 30-33; R41:405-26 at 417-20; R43:18-39 at 30-33; R43:367-87 at 379-81. These appeals also challenged the Director's Assessment of TAT on the OTCs' 2013 merchant hotel transactions. Although the Tax Court already had entered final judgment that the OTCs are not liable for TAT, the Director not only assessed the OTCs for TAT, but also assessed the maximum penalties for failure to file and failure to pay. *Id.*, Exhibit "B" to each Notice of Appeal. Given that this Court affirmed the Tax Court's TAT ruling, *see Travelocity*, 135 Hawai‘i at 127, 346 P.3d at 196, the TAT assessments were ultimately cancelled by stipulation, R25:356-358.

- "I am not aware of any instance (prior to the present case) where the Department took the position that providing a rental car did ***not*** qualify for splitting under the GET. To the best of my knowledge, while I was the Director, no one ever questioned the application of splitting to rental car transactions arranged by travel agents." *Id.* at 762, ¶ 7 (emphasis in original).

Letter rulings from the Department between 2000 and 2003 confirm the Department's broad application of the GET income-apportioning provision to tourism-related services arranged by travel agents:

- A June 7, 2000 letter ruling addressed the taxability of underwater activities, scuba diving and seawalker tours [redacted] R29:88-89 (filed under seal.)
- An April 25, 2002 letter ruling applied the income-splitting provision to scuba diving services booked through an "activity agent" or tour packager: [redacted] R29:91-92 (filed under seal.)
- A January 13, 2003 letter ruling applied the income-splitting provision to jet ski services booked through a travel or tour agent: [redacted] R29:94-95 (filed under seal.)

**B. <u>Procedural History</u>**

This appeal and cross-appeal concern only the assessment of GET related to the OTCs' merchant car rental transactions for the period 2000 through 2013,[14] which was decided on cross motions for partial summary judgment.

[14] The disposition of the other consolidated tax appeals is set forth in the STIPULATED ORDER AND FINAL JUDGMENT DISPOSING OF ALL ISSUES AND CLAIMS OF ALL PARTIES ("Final Judgment"). R25:421.

The Director filed her MOTION FOR PARTIAL SUMMARY JUDGMENT ON THE OTCS' LIABILITY FOR GET ON MERCHANT CAR RENTAL TRANSACTIONS on May 9, 2016 (the "Director's Motion"), seeking an order that the OTCs are liable for GET on the total amount collected from the customer in merchant car transactions, and not just on the amounts they retain. R19:155-512 ("Director's Motion").

On July 7, 2016, the OTCs filed their CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT IN CASES 14-1-0001 THROUGH 14-1-0010 AND 14-1-0244 THROUGH 14-1-0251, seeking an order: (1) that the GET assessments for 2000 through 2011 are barred by res judicata, and (2) that even for years not barred by res judicata, HRS § 18(f) applies to the OTCs' liability for GET with respect to merchant car rentals because car rentals are "tourism-related services" since they are "services rendered directly to the customer or tourist" and the service provider, the rental car company, also is subject to GET. R23:4-767; R29:6-95 ("OTCs' Motion").

At the August 5, 2016 hearing on the cross-motions, the Tax Court recognized:

> [W]e're talking about the same taxpayers and their business activities, so there is a legitimate concern about how many times the taxpayers are going to have to come back to this court to defend general excise tax issues. So that's clearly a concern of the Court and something that weighs heavily on the Court's mind.

DKT. 51 at 30, ll. 7-13.

The Tax Court also stated, "I think there's very little dispute that people in the world, *including the tax director in Hawaii*, knew that car rental services were part of the services that these online travel companies offered." *Id.* at 30, l, 20-24. While it was an undisputed fact that the 2000-2011 merchant car transactions were the subject of new and separate GET assessments issued *after* the Tax Court had entered final judgment determining the OTCs' GET liability for the same tax years, the Tax Court concluded: "it is not inappropriate for the director to initiate the case at bar with a separate notice of assessment, albeit general excise tax, but a completely different activity giving rise to the alleged tax liability. So as to the res judicata question, the Court will deny the taxpayers' motion for partial summary judgment." *Id*. at 31, ll. 15-21.

With respect to the applicability of HRS § 237-18(f), the Tax Court opined that the commonality shared by the ten specific services identified in the statutory definition of "tourism related services" is that "'tour package' is the item of commonality that bind all ten items. All ten items are part of tour package." Tr. 8/5/16 (DKT. 51) at 67, ll. 23-25. According to the Tax Court:

> [W]hen the legislature drafted their amendments in 1991 and added the six items to the pre-existing list of four, they were all contemplating – the legislature was contemplating that all of these items listed are items that are bound together in a tour package that is sold by the online travel company, and that transportation that connects all of these destinations in the tour package that is sold should be part of transportation.

*Id.* at 67, ll. 7-16.[15]

Having concluded that "transportation included in a tour package" is the only transportation that falls within the definition of "tourism related services," the Tax Court determined it was "unnecessary" to consider whether merchant car transactions fall within what the Tax Court described as HRS § 237-18(f) "all-inclusive" catch-all provision – "and other services rendered directly to the customer or tourist." *Id.* at 71, ll. 6-7.

Based on its interpretation of HRS § 237-18(f), the Tax Court granted the Director's Motion and denied the OTCs' Motion with respect to "standalone" merchant car rental transactions (*i.e.*, those booked independently of any other travel service), and granted the OTCs' Motion and denied the Director's Motion with respect to merchant car transactions booked as part of a "package." *Id.* at 71, l. 10 – 73, l. 5.

The Tax Court entered its ORDER GRANTING IN PART AND DENYING IN PART 1) DIRECTOR OF TAXATION'S MOTION FOR PARTIAL SUMMARY JUDGMENT ON THE OTCS' LIABILITY FOR GET ON MERCHANT CAR RENTAL TRANSACTIONS, FILED MAY 9, 2016, AND 2) APPELLANTS' CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT IN CASES 14-1-0001 THROUGH 14-1-0010 AND 14-1-0244 THROUGH 14-1-0251 FILED JULY 7, 2016 on October 25, 2016 (the "Summary Judgment Order"). R25:393-97.

The Parties reached agreement on the dollar amounts that would be applicable to each OTC under the Summary Judgment Order and agreed to the STIPULATED ORDER AND FINAL JUDGMENT DISPOSING OF ALL ISSUES AND CLAIMS OF ALL PARTIES ("Final Judgment") without

[15] Prior to the 1991 amendments, there were four "tourism related services" identified in HRS § 237-18(f): Catamaran cruises, canoe rides, dinner cruises, and sightseeing tours not subject to chapter 239. *See* Act 287, Session Laws of Hawai'i,. Act 287 added "lei greetings, transportation included in a tour package, . . . admissions to luaus, dinner shows, extravaganzas, cultural and educational facilities," as well as the residual, or "catch-all" provision. *Id.*

prejudice to any party's right to appeal; the Final Judgment was entered by the Tax Court on April 25, 2017. R25:431.

The Director filed her Notice of Appeal on April 26, 2017. DKT. 1. After each of the OTCs against whom judgment was entered made payment into the litigated claims fund of the amount set forth in the Final Judgment, the OTCs timely filed their Notice of Appeal on May 22, 2017. DKT. 11. The Record on Appeal was docketed on June 9, 2017 and, on June 19, 2017, the Parties filed a Joint Statement of Jurisdiction. DKT. 49. This Court's ORDER GRANTING APPLICATIONS FOR TRANSFER was entered on August 11, 2017. SCAP-17-1-0000367, DKT. 9.

## III. STATEMENT OF POINTS OF ERROR

(1) The Tax Court erred by concluding the GET assessments for the 2000-2011 merchant car transactions were not barred, where prior to issuing these assessments the Director previously had issued, and litigated to final judgment, "final" assessments of the same tax (GET) to the same taxpayers (the OTCs), for the same tax years (2000-2011), and was fully aware that the OTCs also facilitated rental car transactions. The error, which resulted in the Tax Court erroneously granting, in part, the Director's Motion and erroneously denying, in part, the OTCs' Motion, appears in the Summary Judgment Order, R25:393-97. The OTCs objected at, *inter alia*, R29:24-30, 176-77; R25:235-39.

(2) The Tax Court erred by concluding that HRS § 237-18(f) is not applicable to merchant car transactions unless the rental car is booked as part of a package with at least one other travel service because "standalone" car rentals are not "tourism-related services" and are therefore subject to double taxation due to GET pyramiding. The error, which resulted in the Tax Court erroneously granting, in part, the Director's Motion and erroneously denying, in part, the OTCs' Motion, appears in the Summary Judgment Order, R25:393-97. The OTCs objected at, *inter alia*, R29:30-36, 177-91; R25:230-34.

## IV. LEGAL STANDARDS

### A. Appellate Standard of Review

"A motion for summary judgment is reviewed de novo, viewing the evidence in the light most favorable to the nonmoving party, under the same standard applied by the trial court." *Hawaiian Ass'n of Seventh-Day Adventists v. Wong*, 130 Hawai'i 36, 45 305 P.3d 452, 461 (2013). Issues of statutory interpretation also are reviewed *de novo*. *Weinberg v. City & Cnty. of*

*Honolulu*, 82 Hawai‘i 317, 322, 922 P.2d 371, 376 (1996) (“In a tax appeal context, . . . [q]uestions of law . . . are reviewed under the right/wrong standard . . . The interpretation of a statute is a question of law reviewable *de novo*.”).

### B. Rules of Construction for Tax Statutes

The fundamental rule of statutory construction is to ascertain and give effect to the intention of the legislature, “which is to be obtained primarily from the language contained in the statute itself.” *Narmore v. Kawafuchi*, 112 Hawai‘i 69, 80, 143 P.3d 1271, 1282 (2006). *See also, e.g.*, *In re the Tax Appeal of Cent. Union Church Arcadia Ret. Residence*, 63 Haw. 199, 206, 624 P.2d 1346, 1351 (1981) (quoting *In re the Tax Appeal of Hawaiian Tel. Co.*, 61 Haw. 572, 578-79, 608 P.2d 383, 388 (1980)). Thus, “[s]tatutory analysis begins by examining the plain language of the statute at issue. Where the language of the statute is plain and unambiguous, the *court's only duty is to give effect to its plain and obvious meaning*.” *Ahn v. Liberty Mut. Fire Ins. Co.*, 126 Hawai‘i 1, 11, 265 P.3d 470, 480 (2011).

Further, tax statutes are to be construed strictly against the taxing authority and liberally in favor of the taxpayer: “It is the general rule that statutes providing for taxation are to be construed strictly as against the state and in favor of the taxpayers, and the burdens and liabilities which they impose are to be kept within the strict letter of the law, and not extended beyond its clear terms by any inference, implication or analogy.” *Apokaa Sugar Co., Ltd. v. Wilder*, 21 Haw. 571, 577 (1913). Accordingly, “if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer.” *In re Fasi*, 63 Haw. 624, 629, 634 P.2d 98, 103 (1981).

## V. THE DIRECTOR IS BARRED FROM ISSUING SERIATIM ASSESSMENTS OF THE SAME TAX FOR THE SAME TAX YEARS THAT HAVE BEEN LITIGATED TO FINAL JUDGMENT AND THE TAX COURT ERRED IN CONCLUDING OTHERWISE

It is well established under Hawai‘i law that “the judgment of a court of competent jurisdiction is a bar to a new action in any court between the same parties or their privies concerning the same subject matter, and precludes the re-litigation not only of the claims which were actually litigated in the first action, *but also of all grounds of claim . . . which might have been properly litigated in the first action but were not litigated or decided*.” *E. Sav. Bank, FSB v. Esteban*, 129 Hawai‘i 154, 159, 296 P.3d 1062, 1067 (2013) (quoting *Kauhane v. Acutron Co.*,

*Inc.*, 71 Haw. 458, 463, 795 P.2d 276, 278 (1990)). The purpose of the res judicata doctrine is "to prevent a multiplicity of suits and to provide a limit to litigation." *Id.*

The doctrine of res judicata applies in tax cases. *Baptiste v. Comm'r*, 29 F.3d 1533, 1539 (11th Circuit, 1994) (citing *United States v. Int'l Bldg. Co.*, 345 U.S. 502, 506, 73 S. Ct. 807, 809, 97 L. Ed. 1182 (1953)) ("It is well settled that the doctrine of res judicata is applicable in tax cases.").[16] Res judicata bars the Director's assessments of the same tax (GET) against the same taxpayers (the OTCs) for the same tax years (2000-2011) that already have been litigated to a final judgment on the merits.

### A. Res Judicata Bars Re-Litigation Of Claims That Actually Were Litigated Or That "Could Have Been" Litigated In A Prior Action

Res judicata bars subsequent litigation of previously adjudicated tax liability, "including those claims and defenses that could have been, but were not, raised in the earlier proceeding." *Finley v. United States*, 612 F.2d 166, 170 (5th Cir. 1980). The doctrine applies where four conditions are satisfied:

> (1) the prior judgment must have been a final judgment on the merits, (2) the prior judgment must have been rendered by a court of competent jurisdiction; (3) the parties, or those in privity with them, must be identical in both suits; and (4) the same cause of action must be involved in both cases.

*Batchelor-Robjohns, v. United States*, 788 F.3d 1280, 1285 (11th Cir. 2015).

The first three factors are straightforward and often not in dispute. The fourth factor—whether the same cause of action is involved in both actions—is evaluated differently depending on the context. In tax cases, courts have consistently held that "a taxpayer's total tax liability for a particular type of tax and particular tax year constitutes a single cause of action" and "there can only be one suit related to a taxpayer's tax liability for a particular year and particular tax (*e.g.*, a taxpayer's year 2014 income tax liability)." *Id.* at 1288. This is true regardless of how many different income sources could be included in the final computation. *Finley*, 612 F.2d at 170. Indeed, "[i]n federal tax litigation[,] one's total income tax liability for each taxable year constitutes a single, unified cause of action**,** *regardless of the variety of contested issues and*

[16] *See also Comm'r of Internal Revenue v. Sunnen*, 333 U.S. 591, 598 (1948) (same).

*points that may bear on the final computation*." *Id.*[17] As one court aptly stated, res judicata bars subsequent litigation where "the Tax Court acquired jurisdiction to decide the entire gamut of possible issues that controlled the determination of the amount of tax liability for the year in question." *Russell v. United States*, 592 F.2d 1069, 1072 (9th Cir. 1979) ("A party cannot, in such a case, by failing to raise an issue, or by asking the court not to consider it, escape the Res judicata effect of the decision").

Numerous other tax cases bear out these hornbook principles. In *U.S. Bancorp v. Department of Revenue*, Tax Court No. 4141 (Or. Mar. 12, 1999), *see* R23:689, for example, the court granted the taxpayers' motion for summary judgment on res judicata grounds where the Department of Revenue sought to re-litigate liability for excise tax owed in particular tax years that already had been litigated to final judgment. The court explained: "In the *US Bancorp I* litigation, the court determined taxpayers' corporate excise tax liability for the tax years 1984 through 1987. The court's decision in that case became final. Consequently, the doctrine of claim preclusion bars the department from re-litigating taxpayers' corporate excise tax liabilities for 1984 and 1985." *Id.*

Likewise, in *Baptiste, supra*, the petitioner, one of three beneficiaries, received $50,000 from his father upon his death. 29 F.3d. at 1535. The IRS determined the father's estate owed additional estate tax, which the estate contested in Tax Court, and the court entered a judgment in the amount ultimately stipulated by the estate and the IRS. *Id.* at 1535-36. After the estate failed to pay the tax, the government attempted to collect from the beneficiaries as transferees under a statute that made them jointly liable for the estate tax and the petitioner sought to challenge the amount of estate tax due. The Eleventh Circuit held that res judicata barred the issue from being re-litigated: "The estate's liability [for the estate tax] and [the petitioner's] liability [as transferee] both embrace the same determination—the amount of estate tax imposed by chapter 11." *Id.* at 1539; *see also Sunnen*, 333 U.S. at 598 ("Income taxes are levied on an annual basis.

[17] *See also Estate of Hunt v. United States*, 309 F.2d 146, 147-49 (5th Cir. 1962) (affirming dismissal of taxpayer's suit for refund of estate taxes because a prior refund suit involved estate taxes and was res judicata as to any additional issues that could have been raised with respect to the estate tax); *Erickson v. United States*, 309 F.2d 760, 767-68 (Ct. Cl. 1962) (holding that "the Tax Court's jurisdiction, once it attaches, extends to the entire subject of the correct tax for the particular year" and that a decision bars further litigation as to that tax year, including "issues which could have been presented").

Each year is the origin of a new liability and of a separate cause of action. Thus, if a claim of liability or non-liability relating to a particular tax year is litigated, a judgment on the merits is res judicata as to any subsequent proceeding involving the same claim and the same tax year.").

And in *United States v. Davenport*, 484 F.3d 321 (5th Cir. 2007), the Tax Court had previously held that an estate was liable for unpaid gift taxes. 484 F.3d at 324. The estate, however, failed to pay the taxes owed. *Id.* The IRS later filed suit in federal court against both the estate and the recipients of the gifts as transferees. The Fifth Circuit found that the two suits involved the same tax liability (*i.e.*, the estate's gift tax liability), and therefore "the doctrine of res judicata applies to preclude Gordon Davenport *and the government* from litigating matters arising from the same nucleus of operative facts that were or could have been raised in the previous proceeding." *Id.* at 329.

Where a final decision resolves litigation regarding tax liability for one type of tax for a particular tax year, res judicata bars any new litigation of that same tax for that same tax year.

### B. The Director's Tax Assessments Involve The Same Tax (GET) For The Same Tax Years (2000-2011) As Was Previously Litigated, And Therefore Those Claims Are Barred By Res Judicata

The OTCs' GET liability for the tax years 2000 through 2011 was previously adjudicated. *See Travelocity*, 135 Hawai'i at 92, 346 P.3d at 161. All four requirements for application of res judicata are satisfied in this case, so the doctrine bars the Director's effort to relitigate that liability.

The first three requirements are undisputedly present: (1) final judgment was entered on the merits of the OTCs' GET liability for the tax years 2000-2011 (R23:660); (2) the Tax Court is unquestionably a court of competent jurisdiction; and (3) the parties in the present action were parties in the prior action.

The fourth requirement, that the cause of action presented in this case—the GET liability of each OTC for tax years 2000 to 2011—is the same as the cause of action decided in the prior case, is equally beyond genuine dispute. The Director knew about the OTCs' car rental line of business as early as 2008—long before she issued *any* assessments against the OTCs, much less took those assessments (limited to merchant hotel transactions) to final judgment. R23:40, ¶ 5, 43-49 at 45. Indeed, with respect to package transactions, the *exact same transactions* are being assessed here as were assessed and litigated to final judgment previously (i.e. transactions in which travelers booked both a hotel and a rental car), and in such transactions, the OTCs'

customers *made a single payment*.[18] The Department was well aware that such package transactions took place. *Id.*; R23:760- 63 at 763, ¶ 11. The Department chose to proceed to final judgment on the merchant hotel portions of such transactions, and affirmatively subtracted out the merchant rental car portions of those transactions for seriatim assessments and litigation at a later date. As explained in the cases discussed above, "there can only be one suit related to a taxpayer's tax liability for a particular year and particular tax (*e.g.*, a taxpayer's year 2014 income tax liability)." *Batchelor-Robjohns*, 788 F.3d at 1288. That suit was brought and litigated to final judgment.

While the Director made a conscious decision to include only merchant hotel transactions in the original GET "final" assessments, as a matter of law, *all* issues relating to the OTCs' liability for a particular type of tax (GET) for a particular tax year (or years) constitute *a single cause of action*, which may only be litigated once. *Finley*, 612 F.2d at 170 ("[O]ne's total [] tax liability for each taxable year constitutes a single, unified cause of action, regardless of the variety of contested issues and points that may bear on the final computation"); *U.S. Bancorp*, (R23:689) (granting summary judgment in favor of taxpayer on excise tax liability for 1984 and 1985, where same taxpayer's excise tax liability for tax years 1984 through 1987 had been adjudicated to finality); *Davenport*, 484 F.3d at 329; *Baptiste*, 29 F.3d. at 1539. Thus, the Director's attempt to bring a subsequent claim regarding the OTCs' GET liability for tax years 2000 through 2011 is barred by res judicata.

### C. Public Policy Supports Res Judicata Barring The Director's Assessments

Res judicata "serves to relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication." *E. Sav. Bank*, 129 Hawai'i at 159, 296 P.3d at 1067. "It is a rule of fundamental and substantial justice, of public policy and private peace." *Id.* The goals furthered by the doctrine are so important that, in the tax context, courts have made clear that a supposed need for additional tax revenue is not a valid basis for allowing a taxing authority to re-litigate questions

[18] The final judgment in the merchant hotel litigation determined the OTC's tax liability for the hotel portions of package transactions involving a hotel stay and a car rental. The Director's attempt to impose additional tax *on these same transactions* further highlights why the subsequent assessment is barred by res judicata.

of tax liability: "[B]usinesses also need to have finality regarding their tax liabilities, which is a competing policy concern and one recognized in our caselaw [sic]." *In re Application of Fleet for Relief from a Tax Grievance in Shawnee County*, 293 Kan. 768, 784, 272 P.3d 583, 593 (Kan. 2012). Indeed, "finality in matters of taxation is critical." *Id.* And even where additional tax revenue might otherwise go unrecovered, public policy demands a vigilant application of res judicata: "We will not abandon the doctrine of res judicata simply because its application may be costly to a party…." *Int'l Union of Operating Engineers–Employers Const. Ind. Pension, Welfare and Training Trust Funds v. Karr*, 994 F.2d 1426, 1432 ((th Cir. 1993).

Here, allowing the Director to pursue additional GET liability against the OTCs after this Court previously decided the OTCs' GET liability for the very same tax years would fly in the face of the strong public policy behind the doctrine of res judicata. In effect, a ruling in the Director's favor would mean that the Director could make an endless series of separate GET assessments against the same taxpayer for the same tax year. This is no mere hypothetical. The Tax Court entered a final judgment on GET liability with respect to hotel room reservations, which was appealed to and resolved by this Court in *Travelocity*. The Tax Court has now entered a final judgment on GET liability with respect to rental car reservations, which is the subject of this appeal. And currently pending in the Tax Court are the Director's GET assessments for *agency model* hotel and rental car transactions (for the same tax years), which the OTCs anticipate also will be appealed to this Court.[19] Under the Director's theory, she could continue to make seriatim GET assessments for the 2000 – 2011 tax years for scuba excursions, kayaking tours, and so forth, *ad infinitum.*

The Director was fully aware of the OTCs' various business lines when she issued the *first* assessments, and there was no valid reason to proceed in this seriatim manner. The OTCs, the Tax Court and this Court should not be forced to litigate in piecemeal and costly fashion how the same tax applies to each category of transactions that makes up a single business model. This is precisely what the doctrine of res judicata prohibits.

[19] As this Court may recall, at the 2014 oral argument in *Travelocity*, the Director's attorney said, regarding agency model transactions, "we've not assessed the OTCs either for TAT or GET on that commission. We've not assessed that. We haven't taken a position one way or another on that, but I'm just saying those have not been assessed." SCOA_100214_13_2896, available at http://www.courts.state.hi.us/courts/oral_arguments/archive/oasc13_2896, at 1:28:27-40.

## VI. THE TAX COURT ERRED IN HOLDING THAT STANDALONE CAR RENTAL TRANSACTIONS ARE NOT SUBJECT TO HRS § 237-18(F)'S INCOME-APPORTIONING PROVISION

The Tax Court's ruling cannot stand for the additional reason that the Tax Court erred in concluding that the income-apportioning provision of HRS § 237-18(f) applies only to rental car transactions that are part of a package.

### A. Merchant Car Transactions Meet All Requirements For Apportioning Under HRS § 237-18 (f)

Section 237-18(f) applies to travel accommodations where three elements are present: (i) the arrangements are made through a "travel agency or tour packager"; (ii) the gross income from the transaction is divided between the travel agency or tour packager; and (iii) the service being provided is a "tourism related service." *See* Section 237-18(f). And where the elements of section 237-18(f) are met, the GET imposed "shall apply to each such person with respect to such person's respective portion of the proceeds, *and no more*." *Id.*

In light of this Court's *Travelocity* decision, there is no dispute that the first two elements are met with respect to merchant car transactions facilitated by OTCs. When analyzing substantially similar merchant hotel transactions, this Court concluded the OTCs are "travel agencies" as that term is used in HRS § 237-18(f), and the "gross income is divided" between the OTCs and the hotel. 135 Hawai'i at 106, 109, 346 P.3d at 175. The Director does not dispute that same analysis applies to merchant car transactions; the OTCs are "travel agencies" and the proceeds are divided between the OTC and the rental car company. *See* R19:166, fn.14; R25:39. The Court's ruling in *Travelocity*, as well as the undisputed evidence, also demonstrates that car rentals are "tourism related services" within the meaning of § 237-18(f).

#### 1. Like The Other Subsections of HRS § 237-18, Subsection (f) Apportions Income To Prevent Pyramiding

While the GET Statute is generally understood as a "pyramiding" tax—where tax is essentially paid more than once on the same "gross proceeds"—it has several express provisions aimed at eliminating the pyramiding in certain circumstances. As this Court has explained, the anti-pyramiding nature of the GET in those circumstances reflected the Legislature's intent "*that multiple taxation of the same gross proceeds will not occur*". *In re the Tax Appeal of Subway Real Estate Corp.*, 110 Haw. 25, 34 n.10, 129 P.3d 528, 537 n.10 (2006). Chief among the GET's anti-pyramiding provisions is HRS § 237-18, which articulates how "the tax imposed by

this chapter shall apply" to a broad array of business activities. In each instance, where income from those business activities is divided between two parties, GET is apportioned such that it is imposed on each person's "portion of the proceeds, and no more." HRS § 237-18.

Section 237-18 contains three subsections added to protect the tourism industry in Hawai'i by preventing the pyramiding of GET. HRS §§ 237-18(f), (g), & (h). Subsection (f) was drafted to capture all "tourism related services" arranged by travel agencies in which the gross proceeds are shared with the travel service provider:

> Where tourism related services are furnished through arrangements made by a ***travel agency or tour packager*** and the ***gross income is divided*** between the provider of the services and the travel agency or tour packager, the tax imposed by this chapter shall apply to each such person with respect to such person's ***respective portion of the proceeds, and no more***.
>
> As used in this subsection "tourism related services" means catamaran cruises, canoe rides, dinner cruises, lei greetings, transportation included in a tour package, sightseeing tours not subject to chapter 239, admissions to luaus, dinner shows, extravaganzas, cultural and educational facilities, and other services rendered directly to the customer or tourist, but only if the providers of the services other than air transportation are subject to a four per cent tax under this chapter or chapter 239.

HRS § 237-18(f).

The definition of "tourism related services" in HRS § 237-18(f) originally listed only four tourism related services, but was amended in 1991 to include additional listed services and, more significantly, to add the residual, or catch-all provision to make sure the definition of "tourism related services" was broad enough to include "***other services rendered directly to the customer or tourist*** . . . ." HRS § 237-18(f). As the Department explained in a Tax Information Release issued shortly thereafter:

> Amendments [to §237-18(f)] have the effect of taxing both the travel agencies or tour packagers and the service providers only on the amounts earned by each person. Gross income received by travel agencies or tour packagers is reduced by amounts paid for services provided directly to the customer of the travel agency or tour packager which are subject to a 4 percent tax.

TIR No. 91-8 at 1.

#### 2. Car Rentals are "Tourism Related Services" Within the Plain Meaning of HRS § 237-18(f)

As this Court observed, the GET Statute sets forth "a *class of transactions* between travel agencies and providers of tourism-related services" that receive "preferential tax treatment."

*Travelocity*, 135 Hawai‘i at 110, 346 P.3d at 179. Car rental in Hawai‘i is plainly a "tourism-related service" entitled to such treatment under HRS § 237-18(f).

To begin, the plain meaning of "tourism" broadly captures "the business or industry of providing information, accommodations, *transportation*, and other services to tourists." *Dictionary.com* Unabridged, Random House, Inc. (June 2016). Due in part to Hawai‘i's unique geography, there can be no question that car rental is a transportation service that is vital to Hawai‘i's tourism industry. Publications inform travelers that: "The best way to get around Maui is by car . . . . Renting a car is the best option if you're looking to see more of Maui than your hotel and the beach." R23:696; *see also id* at 700 ("Unless you plan to hole up in Waikiki, you'll find a rental car a practical necessity.").

The Hawai‘i Tourism Authority ("HTA") – Hawai‘i's official state tourism agency[20] – offers the same advice to tourists on its website: "To really experience all that Hawaii offers, you should consider renting a car. Reserve your rental vehicles in advance because quantities can be limited on some islands." R23:703. Further, the HTA's website offers the following advice to travelers to the Big Island:

> While there is mass transit in the for[m] of the Hele On bus, *we recommend a rental car* for flexibility and ease. We strongly suggest booking before you arrive as sometimes cars aren't immediately available when you step up to the counter without a reservation. All the major rental companies are found on Hawaii Island.

R23:706. *See also id.* at 709 (similar advice for Oahu).

More specifically, in its Hawai‘i Strategic Tourism Plan (the "Plan"), the HTA stated that "[w]hen speaking about the 'visitor industry,' what generally comes to mind are those directly involved in hotels and other accommodations, airlines, *car rental agencie*s, visitor attractions, tour operators, and restaurants and retail operations." R23:714. The HTA identifies car rental as one of the "primary transportation modes used by visitors." *Id.* at 715. Further, in discussing ground transportation issues, the HTA stated that (i) "nearly all visitors … rely on tour buses, taxis, *or rental cars*; and (ii) an issue negatively affecting a "visitor's experience" is the "level of

[20] By statute, the HTA is empowered to (i) "[d]evelop, coordinate, and implement state policies and directions for tourism and related activities"; and (ii) "[c]oordinate all agencies and advise the private sector in the development of tourism-related activities and resources." HRS § 201B-3(a)(14), (17).

service provided by *rental car* agencies." *Id.* at 716. Indeed, "rental vehicles" is one of the sub-categories of "total transportation" for which the HTA tracks "visitor personal daily spending," and the HTA's statistics show that visitor daily spending on rental vehicles is currently about two/thirds of the daily spending on total transportation. *See* R23:718-25.[21]

Not surprisingly then, courts have recognized that car rentals are part of the tourism industry in Hawai'i:

> *[C]ar rental agencies are part of the tourist industry*. Obviously, v*isitors coming to Hawai'i rent automobiles.* Imposing primary coverage on the rental agency's insurer increases the insurance burden on rental agencies, and eventually increases the cost of renting a car in Hawai'i. Inasmuch as tourism is the driving force behind Hawaii's economy, the legislature was probably concerned about the detrimental impact of increased insurance costs on the tourist industry.

*Bowers v. Alamo Rent-a-Car, Inc.*, 88 Hawai'i 274, 282 (1998) (J. Ramil concurring) (construing Hawai'i Motor Vehicle Insurance Law related to rental cars). The Ninth Circuit similarly concluded car rentals were part of the tourism industry when deciding the scope of a tax rebate granted to "resort hotels with related tourist and recreational facilities": "All of the Guam Hilton's sources of revenue for which it sought a rebate fall within this business category. Hotel shops, travel and tour desks, *car rentals,* foreign exchange and services for hotel guests *clearly are tourist and recreational facilities* of a resort hotel." *Hotels of the Marianas, Inc. v. Gov't of Guam*, 71 F.3d 1455, 1460 (9th Cir. 1995).

The OTCs' merchant car transactions satisfy all the requirements of the apportioning provision under HRS 237-18(f).

### B. <u>As This Court Explained, the Legislature Intended to Protect The Tourism Industry Through The Apportioning Provision in HRS § 237-18(f)</u>

This Court previously addressed the Director's claim that the OTCs should be denied the benefit of income-apportionment in *Travelocity.* In that case, the Director asserted, with respect to GET, that hotel reservations facilitated by the OTCs using the merchant model should be subject to double taxation, such that the gross amount collected by the OTC from the traveler *and* the net rate passed through to the hotel should both be taxed at the rate of 4 percent. *See*

[21] The U.S. Department of Commerce's Office of Travel and Tourism Industries likewise considers rental cars to be part of the tourism industry, as it is one of the sectors about which the Office profiles and for which it records statistics. *See* Office of Travel and Tourism Industries' *2011 Sector Profile: Rental Car*, R23:727-34.

*Travelocity*, 135 Hawai‘i at 101-02, 346 P.3d at 170-71. The Tax Court agreed with the Director, *see id.* at 97-98, 346 P.3d at 166-67. This Court reversed.

In rejecting the Director's position, this Court noted "the GET is imposed on the gross income derived from the sale of services or rental income resulting from all service activities that occur within the state," *id.* at 106, 346 P.3d at 175, but explained the "inherent pervasiveness" of the GET "is mitigated by limited categories of income-reducing provisions," *id.* This Court identified three subsections of the GET Statute that mitigate the impact on the tourism industry – § 237-18(f), (g) and (h). *Id.* at 109-11, 346 P.3d at 178-80.

As this Court explained, the reason those apportioning provisions were included was the vital role the tourism industry plays in Hawai‘i's economy, and the need to foster and preserve that industry. In passing § 237-18(f) "the legislature recognized a class of transactions between travel agencies and providers of tourism-related services that it wanted to provide preferential tax treatment." *Id.* at 110, 346 P.3d at 179. Similarly, with regard to § 237-18(h), this Court noted that legislative history makes clear it was passed to protect the "visitor industry's significant contributions to Hawaii's economy." *Id.* (quoting H. Stand. Comm. Rep. No. 3, in 2001 Spec. Sess. Senate Journal, at 100; S. Stand. Comm. Rep. No. 3, in 2001 3rd Spec. Sess. Journal, at 53). Thus, the legislative history of § 237-18(f) reflects the legislature's view that "the use of gross up in the area of certain tourism-related services does not serve the interests of the State in encouraging tourism." *Id.* (quoting Conf. Comm. Rep. No. 70-86, in 1986 House Journal, at 962, 1986 Senate Journal, at 765-66). Similarly, this Court explained that in passing § 237-18(h) "the legislature identified transportation as an element of the Hawai‘i visitor industry that needed protection and provided special tax treatment . . . .", and that it was added to the statute to "support the State of Hawaii as a visitor destination." *Id.*, and fn. 32.

Having explained the protective purpose of §§ 237-18(f) and (h), this Court held the same purpose applied to § 237-18(g), which was at issue in *Travelocity*:

> HRS § 237-18 illustrates the legislature's intent to protect certain categories of business transactions from the pyramiding effect of the GET …. Notably, ***the legislature repeatedly sought to protect tourism-related industries in three separate provisions: tourism-related services in HRS § 237-18(f),*** the furnishing of transient accommodations in subsection (g), and the furnishing of transportation services by motor carriers in subsection (h). In light of the special tax treatment that the legislature sought to provide to transactions between travel agencies and hotel operators in HRS § 237-18(g), [the provision] should not be

> given a constrained interpretation that would frustrate ***the legislative intent to protect the tourism industry***.

*Id.* at 111, 346 P.3d at 180. Accordingly, this Court held that in merchant hotel transactions, the income-splitting provision applied, and the travel agency (the OTC) and the hotel supplier were each responsible for GET on their respective portion of the proceeds, *and no more*. *Id.* at 113, 346 P.3d at 182.

This intent to protect the tourism industry requires the relevant apportioning provision, HRS § 237-18(f), be applied to merchant car transactions in the same way this Court applied HRS § 237-18(g) to merchant hotel transactions in *Travelocity*. Taxing the gross amount charged by the travel agency *and* the net rate charged by the car rental company would have devastating consequences to the car rental industry in Hawai‘i, frustrate the legislative intent to protect the tourism industry, and leave Hawai‘i as the *only* State imposing such a scheme of double taxation on rental cars. The Tax Court plainly erred in authorizing double taxation for standalone rental car transactions, and this Court should apply the holding in *Travelocity* to make clear the GET in all merchant car transactions is limited to each party's respective portion of the proceeds, *and no more.*

### C. The Tax Court Erred In Holding That Rental Car Transactions Must Be Included in a Tour Package To Qualify for Apportioning Under Section 237-18(f)

The Tax Court's ruling that the apportioning provision, Section 237-18(f), applies only to car rentals that are booked as part of a package transaction was plainly erroneous and contrary to this Court's direction in *Travelocity*.

#### 1. The Tax Court Wrongly Disregarded the "Catch-All"

In concluding that apportionment did not apply to standalone rental car transactions, the Tax Court erred by failing properly to apply the catch-all provision. As explained by this Court in *Travelocity*, the Legislature intended for Section 237-18(f) to protect a certain "*class of transactions*" that fall within the category of "tourism-related service." *Travelocity*, 135 Hawai‘i at 110, 346 P.3d at 179. The Legislature thus listed certain specific items in Section 237-18(f) which are a non-exhaustive list of examples of tourism-related services commonly arranged by a travel agency or tour packager. The catch-all, or residual, provision, which broadly captures all "other services" rendered directly to the customer or tourist, must be read with this same legislative intent in mind. So long as the service is (1) arranged by a travel agency or tour

packager; (2) rendered directly to the customer or tourist; and (3) the proceeds are divided between the travel agency and travel supplier, each entity is taxed on its respective portion of the proceeds, *and no more.*

Car rentals facilitated by OTCs, whether arranged as part of a package or on a standalone basis, meet all of the specified criteria. This plain language interpretation of the catch-all provision is the only way to effectuate the Legislature's intent to protect the tourism industry, and the Tax Court's failure to apply the catch-all provision was plainly erroneous.

**2. The Tax Court Misapplied the Rule of *Ejusdem Generis***

Rather than focus on the plain language of the catch-all provision or the legislative intent, the Tax Court relied on *ejusdem generis* to justify its conclusion that only car rentals included in a package qualified for income-apportioning. That rule requires that a residual, or catch-all, provision at the end of a list in a statute be construed to include only things that are "similar in nature" to the specific items that precede it. *Asato v. Procurement Policy Board*, 132 Hawai'i 333, 352, 322 P.3d 228, 247 (2014).[22] Applying the *ejusdem generis* rule requires one to identify the commonality between the items on the list – the tie that binds them together – and then use that commonality to determine the scope and extent of the catch-all phrase – here, "other services rendered directly to a customer or tourist." *See, e.g.*, *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 163, 132 S. Ct. 2156, 2171, 183 L. Ed. 2d 153 (2012); *State v. Kahalewai*, 56 Haw. 481, 489, 541 P.2d 1020, 1026 (1975). The Tax Court misapplied the rule.

After examining the ten examples of "tourism-related services" in section 237-18(f), the Tax Court concluded that the commonality or tie that binds them together is that "[a]ll ten items are part of a tour package." Tr. 8/5/16 (DKT. 51) at 67, l. 25. But that is plainly incorrect. While a catamaran cruise, for example, can be part of a tour package, it also can be (and often is)

[22] In *State v. Yan*, 44 Haw. 370, 376-77, 355 P.2d 25, 29 (1960), the Hawai'i Supreme Court explained "the purpose of the rule is to give effect to both the particular and general words, by treating the particular words as *indicating the class*, and the general words as extending the provisions of the statute to *everything embraced in that class*, though not specifically named by the particular words." The rule applies "when the following conditions exist: (1) the statute contains an enumeration by specific words[;] (2) the members of the enumeration *constitute a class*; (3) the class is not exhausted by the enumeration; (4) a general term follows the enumeration[;] and (5) there is not clearly manifested an intent that the general term be given a broader meaning than the doctrine requires." *Id.* at 377.

sold as a standalone item. The same is true for a dinner show, luau, lei greeting, *and a rental car*. The apportioning provision applies to catamaran cruises that are sold as standalone items, as well as catamaran cruises that are sold as part of a package. The same is true for rental cars; the rule of *ejusdem generis* dictates that rental car transactions are entitled to the apportioning provision whether sold as a standalone item or as part of a tour package.

Indeed, during the summary judgment hearing, the Tax Court acknowledged that the specified tourism related services (i.e., a catamaran cruise, luau or lei greeting) need *not* be part of a package to get the benefit of apportioning. *Id.* at 74, l. 25 – 75 l. 5. The Tax Court nevertheless persisted in his ruling, stating that only transportation, "item 5" in the list, needs be included in a package to fall within the definition of a "tourism related service." *Id.* at 74, ll. 5-7. The Tax Court's position cannot be reconciled with the fundamental principle of *ejusdem generis*, the need to identify a *commonality*. The rule does *not* apply when "the enumerated list do[es] not constitute a discernible class." *Richardson v. City & County of Honolulu*, 76 Hawai'i 46, 75, 868 P.2d 1193, 1222 (1994) (Klein, J., dissenting). Here, the Tax Court's position that to qualify for apportioning only one of the specified items had to be part of a package (while the others *might or might not be* part of a package) meant that the Tax Court's view of the purported criterion for "commonality" was invalid, and its application of *ejusdem generis* was improper.

The reference to "transportation included in a tour package" as one of the ten specified items does not limit the transportation that can qualify as a "tourism related service." To the contrary, a number of the other listed examples are also "transportation," including "catamaran cruises," "canoe rides" and "dinner cruises." Yet, as the Tax Court ultimately acknowledged, these items need not be part of a package to be eligible for apportioning. Further, the inclusion of a specific item was not intended to exclude all similar (but not listed) tourism-related services. Thus, the reference to a "dinner cruise" was not intended to exclude from apportioning a sunset, lunch, cocktail, breakfast or whale-watching cruise, nor was the reference to a "canoe ride" evidence of an intent to exclude kayak, jet-ski, power boat or sailboat rides.[23] The catch-all provision ensures that all such tourism related services are protected from double taxation.

[23] As discussed above, the Director specifically concluded that jet ski rentals were a tourism related service subject to apportionment, and nowhere suggested that the jet skis had to be part of a package to qualify for apportioning. *Supra*, at 9.

The defining factor that *actually* provides the common link between the ten specifically identified items in § 237-18(f), which the Tax Court failed to recognize, is dictated by the plain language of the statute: All of them are (1) frequently (albeit not exclusively) engaged in by tourists; (2) frequently (albeit not exclusively) arranged by a travel agency or tour packager; (3) rendered directly to the customer or tourist; and (4) transactions in which the proceeds are divided between the travel agency and travel supplier. These are the only applicable criteria under the statute, and the only criteria that must be met to trigger apportionment.

Car rentals meet all of these elements. As shown, rental cars are frequently used by tourists. *Supra*, Section VI.A.2. The car rental transactions at issue were each arranged by an OTC (a travel agency), each rental car was provided directly to the customer or tourist by the rental car company, and the proceeds were divided between the OTC and rental company. *Supra* at 19. Pursuant to the plain meaning of the statute, aided by the proper application of *ejusdem generis*, rental cars, whether standalone or part of a package, are tourism related services entitled to the apportionment afforded by HRS § 237-18(f). [24]

### 3. The Tax Court's Ruling, if Allowed to Stand, Would Harm the Tourism Industry

The Tax Court's ruling with respect to standalone car rental transactions also should be reversed because it would lead to absurd results that are inconsistent with the legislative intent to protect the tourism industry. *See, e.g.*, *Richardson*, *supra*, 76 Hawai'i at 60, 868 P.2d at 1207 ("departure from a literal construction of a statute is justified when such a construction would produce an absurd result and the literal construction in the particular action is clearly inconsistent with the purposes and policies of the act" (citations, internal quotation marks and ellipsis omitted).) Although certain travelers to Hawai'i take advantage of tour packages to enjoy the Islands, many others book travel services separately, including rental cars. By creating a

[24] This conclusion is affirmed by the doctrine of *noscitur a sociis*, which "requires that . . . the general words are restricted to a meaning that should not be inconsistent with, or alien to, the narrower meanings of the more specific words of a statute." *Kaheawa Wind Power, LLC v. County of Maui*, 135 Hawai'i 202, 209, 347 P.3d 632, 639 (App. 2014). In light of the legislative intent to protect the tourism industry, the phrase "other services rendered directly to a customer or tourist" must be read to capture all other services that – like the ten specified examples listed before it – are tourism related. As shown, rental cars are tourism related (*supra* at 21-22), and thus, share the natural association with the ten listed services.

disproportionate tax burden on car rentals that are booked on a standalone basis, the Tax Court's ruling unreasonably hampers that important sector of Hawai'i's tourism industry. The Tax Court provided no logical explanation for why the Legislature would single out this specific type of tourism related service for adverse tax treatment (essentially double taxation), and the Tax Court's ruling cannot be squared with this Court's rejection of a similar approach taken by the Director for merchant hotel transactions in *Travelocity*.

In addition, if allowed to stand, the Tax Court's ruling would have devastating effects on other forms of transportation that are frequently sold as standalone items and not as a package. For example, one very popular tourist activity is a helicopter ride to view the volcano. Many such trips are arranged through travel agencies or at kiosks where the income is divided between the service supplier (the helicopter company) and the travel agency, with the bulk of the payment received by the service supplier. If, as the Tax Court held, GET on such standalone transactions applies to the gross amount charged by the travel agency *and* the amount passed through to the service supplier, such double taxation would threaten the viability of this economic model. If all modes of transportation must be included as part of a package to qualify for apportioning, then an entire industry centered around standalone helicopter rides, diving excursions, bicycle rentals, sailboats, jet skis, rental cars and the like would be jeopardized. This is not what the Legislature intended, nor is it how the Department previously applied the apportionment provision.

To the contrary, this threat to the tourism industry is precisely what the Legislature sought to protect against by enacting three separate provisions to provide "special GET treatment" to the tourism industry. *Travelocity*, 135 Hawai'i at 109-10, 346 P.3d at 178-79. *See also id.* at 111, 135 P.3d at 180 (observing that "the legislature repeatedly sought to protect tourism-related industries" and admonishing that a constrained interpretation "would frustrate the legislative intent to protect the tourism industry").

### D. The Tax Court Erred By Ignoring The Legislative History and the Department's Guidance With Respect to Apportioning

While the apportioning rule is plain on its face, its legislative history and the Department's past guidance and letter rulings belie the Tax Court's narrow interpretation of "tourism related services." In analyzing § 237-18(f), this Court explained that §§ 237-18(f)-(h) were added to protect the "tourism industry" in Hawai`i by preventing the pyramiding of tax. (*Supra*, Section VI.B.) Specifically, subsection (f) was ***"was added . . . to prevent the Department from 'grossing up' the income of tourism-related service providers***." *Travelocity*,

135 Hawai‘i at 109-10, 346 P.3d at 178-79. The Court explained the reasoning for such preferential treatment: "the use of gross up in the area of certain tourism-related services does not serve the interests of the State in encouraging tourism." *Id.* at 110, 346 P.3d at 179 (quoting Conf. Comm. Rep. No. 70-86, in 1986 House Journal, at 962, 1986 Senate Journal, at 765-66). The Tax Court's ruling permitting the Department to "gross up" the income of tourism-related transportation service providers cannot be squared with this legislative intent.

Moreover, the Department's past guidance counsels against the overly restrictive interpretation of § 237-18(f) adopted by the Tax Court. In 1991, the Department issued a Tax Information Release ("TIR") supporting a broad understanding of § 237-18(f). TIR No. 91-8 was released shortly after the definition of "tourism-related services" was expanded in 1991. The TIR explained that, while the old provision applied only to a few listed tourism related services, the amendments made apportioning more broadly applicable:

> Act 287, Session Laws of Hawaii (SLH) 1991, amended section 237-18(f), Hawaii Revised Statutes (HRS), to *expand* the definition of "tourism related services."

R23:757 (TIR No. 91-8 at 1). Act 287 expanded the definition of tourism related services not only by adding items to the list, but also, and more significantly, by adding the words "and other services rendered directly to the customer or tourist." Those words must be given meaning and effect.

The TIR examples demonstrate the broad application of the provision, making clear the general rule that travel agencies can deduct from the gross income they receive from travelers the amounts remitted to the travel service providers for actually providing the services to the travelers – so long as tax is paid by those providers (other than airlines) on their portion of the proceeds. Thus, for example, the travel agent who receives $600 for a tour consisting of, among other things, a lei greeting, hotel accommodations, meals,[25] transportation and admissions to attractions is responsible for GET only on the $100 it retains as compensation for its services, and not on the $500 it pays to the actual providers of the various tourism related services. *Id.*

[25] "Meals" are not expressly listed in Section 237-18(f), but the Department's example in the TIR includes "certain meals" as an item that qualifies for apportioning under the statute.

The Department's TIR is entirely consistent with former-Director Kawafuchi's testimony regarding how the GET Statute's apportioning provision applies to car rental transactions: "[W]hile I was the Director, the Department's policy and procedure was that the splitting rule applied generally to arrangements made by travel agents for visitors to Hawaii. Activities could qualify for splitting even if they were not expressly and specifically listed in HRS 237-18(f)." R23:761 (Kawafuchi Decl.), ¶ 5. As he further explained: "[T]he Department's view was that car rentals arranged by a traditional travel agency for customers who were renting cars in Hawaii qualified for the splitting rule." *Id.*, ¶ 6.

The Department's letter rulings between 2000 and 2003 further confirm that the GET Statute's apportioning provisions apply to the OTCs' merchant car transactions. To start, the Department recognized that *all* services provided by travel agents are subject to apportioning. R29:88-89 ("[redacted]"). Further, the Department broadly applied the apportioning provisions to "tourism related services," extending the definition to scuba diving services and jet skiing, neither of which are specifically listed in HRS § 237-18(f). *See* R29:94-95 and R29:91-92.

### E. Even If The GET Statute Is Ambiguous (It Is Not), It Must Be Construed In Favor Of The OTCS

The OTCs' construction of the GET Statute is compelled by the plain meaning of its express terms and numerous opinions by this Court, including *Travelocity*. In light of this authority, the OTCs' construction is, at a minimum, reasonable. The Tax Court's construction -- that standalone rental car transactions are not tourism related services and thus not protected from GET pyramiding -- is not. But even if it was (indeed, even if it was the ***most*** reasonable construction), the resulting ambiguity (competing reasonable constructions) would have to be resolved against the Director and in favor of the OTCs. *See supra* at Section IV. Therefore, under either a plain meaning construction or application of the ambiguity rule, the GET Assessments must be vacated in their entirety.[26]

[26] The Director has incorrectly argued before that other subsections of HRS § 237-18 are exemptions and thus should be construed in her favor. The Department itself, however, has recognized that HRS § 237-18(f) does not create a tax exemption, it prescribes how "the tax imposed by this chapter shall apply." *See* Dep't of Taxation Announcement No. 2011-27,

## VII. CONCLUSION

For the foregoing reasons, the Tax Court's judgment against the OTCs is contrary to law, and must be reversed insofar as it (1) upheld the Directors GET assessments for the 2000-2011 tax years, and (2) failed to apply HRS § 237-18(f) to standalone rental car transactions.

DATED: Honolulu, Hawai'i, August 21, 2017.

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available at http://files.hawaii.gov/tax/news/announce/annll-27.pdf ("sections 237-18(a), (b), (c), (f), (g), and (h) are divisions of income, *not exemptions or deductions.*"). Thus, any ambiguity in HRS § 237-18(f) must be construed in the OTC's favor, *Hawaiian Tel.*, 61 Haw. at 578, 608 P.2d at 388, such that HRS § 237-18(f) applies.

## STATEMENT OF RELATED CASES

Pursuant to Rule 28(b)(11) of the Rules of Appellate Procedure, Appellants/Appellees-Cross-Appellants Expedia, Inc., Hotwire, Inc., Orbitz, LLC, Trip Network, Inc. (d/b/a Cheaptickets.com), and priceline.com, Incorporated hereby identify the following related cases known to be pending in the Hawai‘i courts or agencies:

- *In the Matter of the Appeal of Expedia, Inc.*, TX No. 1 T.X. 16-1-0276
- *In the Matter of the Appeal of Hotels.com, LP*, TX No. 1 T.X. 16-1-0277
- *In the Matter of the Appeal of Hotwire, Inc.*, TX No. 1 T.X. 16-1-0278
- *In the Matter of the Appeal of Internetwork Publishing Corp.(d/b/a Lodging.com)*, TX No. 1 T.X. 16-1-0279
- *In the Matter of the Appeal of Orbitz, LLC*, TX No. 1 T.X. 16-1-0280
- *In the Matter of the Appeal of priceline.com Incorporated*, TX No. 1 T.X. 16-1-0281
- *In the Matter of the Appeal of Site59.com, LLC*, TX No. 1 T.X. 16-1-0282
- *In the Matter of the Appeal of Travelocity.com LP (n/k/a TVL LP)*, TX No. 1 T.X. 16-1-0283
- *In the Matter of the Appeal of Trip Network, Inc. (d/b/a Cheaptickets.com)*, TX No. 1 T.X. 16-1-0284

The above-listed matters are related cases in that they are the OTCs’ appeals to the Tax Appeal Court, State of Hawai‘i, from the Department of Taxation’s January 25, 2016 NOTICE[S] OF FINAL ASSESSMENT OF ADDITIONAL GENERAL EXCISE AND/OR USE TAX. The OTCs are informed that the assessments purportedly include tax on “agency hotel” and “agency car” transactions for the tax years ended December 31, 2000 through December 31, 2014, and on “merchant hotel” and “merchant car” transactions for the tax year ended December 31, 2014.

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that, on the date and by the methods of service noted below, a true and correct copy of the foregoing was served as described on the following:

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DATED: Honolulu, Hawai`i, August 21, 2017.

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