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If You Rent Your Home Short-Term, Can You Choose Your Tenants?

Court of Appeals rules that vacation rental home is a "public accommodation," and owner cannot discriminate based on sexual orientation of guests, even if owner has religious objection.

By Gregory W. Kugle and Robert H. Thomas

Hawaii property owners who use their homes for vacation rentals, Airbnb, and other short-term rentals should pay attention to a recent decision by the Hawaii Intermediate Court of Appeals, because it clarifies what rights you have as a property owner to control to whom you rent.

In *Cervelli v. Bufford*, No. CAAP-13-896 (Feb. 23, 2018), the three-judge court considered whether homeowners who rented out rooms in their home to the public—but who refused to do so to a lesbian couple on the basis of the homeowners' religious beliefs—violated Hawaii's public accommodation laws. The court also considered whether the owners were sheltered from the requirements of the statute by the First Amendment's Free Exercise of Religion Clause and other constitutional provisions.

The court held the owners could be held liable, even though it is their home, concluding that renting out a room in a home qualifies as offering a "public accommodation" under Hawaii law (Hawaii Revised Statutes chapter 489) even though it is also the owners' residence. A home qualifies as a "place of public accommodation" when it fits within the definition of "a business, accommodation, . . . recreation, or transportation facility of any kind whose goods, services, facilities, privileges, advantages, or accommodations are extended, offered, sold, or otherwise made available to the general public as customers, clients, or visitors." That's very broad, and includes hotels, motels, or "other establishment[s] that provide lodging to transient guests." And that could include a home. Or, in the court's view, at least not automatically *exclude* a home.

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Section 489-3 prohibits "discriminatory practices" in a "place of public accommodation," and includes "sex," and "gender identity or expression," and "sexual orientation" as protected classifications:

> Unfair discriminatory practices that deny, or attempt to deny, a person the full and equal enjoyment of the goods, services, facilities, privileges, advantages, and accommodations of a place of public accommodation on the basis of race, sex, including gender identity or expression, sexual orientation, color, religion, ancestry, or disability are prohibited.

The owners advertised and offered rooms to the general public on their website and through third-party websites, rented to a large number of people—up to 200 nights per year—and pretty much took all comers "aside from same-sex couples and smokers," as the court's opinion noted.

The potential renters inquired if a room was available, were told it was, and then informed the property owner they were a same-sex couple, after which the owner denied them a reservation. The only reasons provided was the same-sex relationship, and the owners' religious beliefs.

The owners asserted that as "strong Christians," they were opposed to renting a room in their home to a couple in a same-sex relationship and had a First Amendment right to refuse to do so.

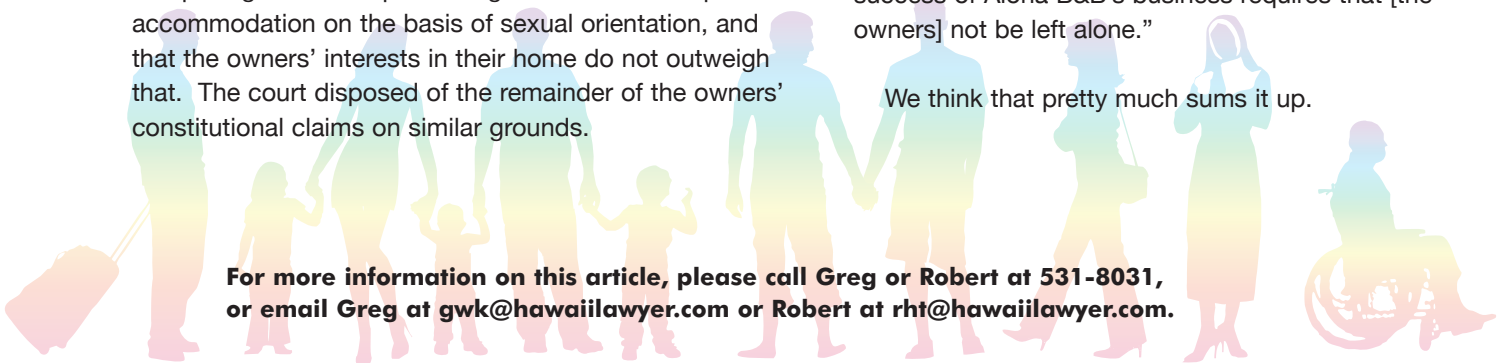
That argument resulted in what we think is the most interesting portion of the opinion—the court's analysis of the property owners' Free Exercise and other constitutional defenses. The court acknowledged a homeowner's right to be left alone, to privacy, and free association and religion, but concluded that the owners "opened up" their home to over 100 customers per year for money, and thus had effectively forfeited those rights in the rooms. In more technical terms, the court concluded that even applying strict scrutiny, the State of Hawaii has a compelling interest in prohibiting discrimination in public accommodation on the basis of sexual orientation, and that the owners' interests in their home do not outweigh that. The court disposed of the remainder of the owners' constitutional claims on similar grounds.

The opinion doesn't discuss the *Masterpiece Cakeshop* case now pending before the U.S. Supreme Court, which presents a similar, but not identical issue. There, the U.S. Supreme Court is considering whether Colorado's similar law prohibits a bakery from refusing on similar religious grounds, to bake a custom wedding cake for a same-sex marriage. Unlike that case, the Hawaii case doesn't involve claims that the proprietor is an "artist" and is being required to perform some unique personal service, only allow short-term renters to stay in their home.

The Hawaii court also discussed the memorably-named "Mrs. Murphy" doctrine which is set out in Hawaii Revised Statutes section 515-5. This provision establishes an exemption to the anti-discrimination requirements, "[t]o the rental of a room or up to four rooms in a housing accommodation by an owner or lessor if the owner or lessor resides in the housing accommodation." The doctrine is named the "Mrs. Murphy" exception because of its roots in exempting the owners of boarding houses and similar accommodations from anti-discrimination laws. The court concluded this exemption did not apply here because it only governs rentals where there is a "landlord and tenant" relationship established—in other words, a longer term relationship than overnight guests.

We've been asked if homeowners still have the right to be left alone, or whether they have to right to privacy. The court addressed that question: if you open your home to short-term occupants, you have "voluntarily given up the right to be left alone," and if your home is used for business purposes, "it is no longer a purely private home." The long and the short of this decision seems to be that if you use your home like a hotel, you are going to be treated like a hotel under the law. As the court's opinion noted responding to the argument the owners should be left alone to exercise their religious beliefs, "In other words, the success of Aloha B&B's business requires that [the owners] not be left alone."

We think that pretty much sums it up.



For more information on this article, please call Greg or Robert at 531-8031, or email Greg at gwk@hawaiilawyer.com or Robert at rht@hawaiilawyer.com.

How do we balance medical marijuana users' and non-smokers' interests in condominium buildings and planned communities?

By Na Lan

On March 16, 2018, the State's fifth licensed medical marijuana dispensary received official approval to begin selling medical cannabis. For people living in condominium buildings or planned communities, more often we have to deal with the following questions:

1) As a resident, can I protect my family from secondhand pot smoke by stopping a neighbor from smoking marijuana?
2) As a landlord, can I evict a tenant who smokes marijuana in my unit?
3) As a property manager, what should I do after I receive a complaint from a resident against a marijuana smoker in my project?
4) As a Board Director, what can our Association do to avoid any violation of law and prevent such disputes?

The first step is to figure out whether the marijuana smoker has a valid certificate for medical use of marijuana, also known as the 329 Card. This card is required for one to legally possess, use and grow cannabis for medical use subject to statutory limitations. It has to be issued by the State of Hawaii, as Hawaii does not offer reciprocity for out-of-state medical marijuana cards. The card has an expiration date that is one year from issuance, but may be renewed.

If the marijuana smoker has a valid 329 Card, the next question is whether your building has adopted a no-smoking policy, or whether your rental agreement has a smoking ban provision if you are a landlord. If the answer is no, you cannot treat a medical marijuana smoker in a way different from a tobacco smoker. Otherwise, you would be engaging in illegal discrimination under HRS § 514B-113 (condominiums), HRS § 421J-16 (planned communities), and HRS § 521-39 (residential tenant eviction).

HRS § 328J-3 prohibits smoking in common areas of condominiums and other multiple-unit residential facilities. This also applies to prohibit the use of an electronic smoking device. If a condominium association wants to also ban smoking in individual owners' units or lanais, it usually needs to pass and record an amendment to the Bylaws requiring 67% of ownership approval. Associations may attempt to regulate smoking inside the units through its power to control nuisances by simply adopting house rules, but this may lead to contests by certain owners or tenants and even legal battles.

However, that is not the end of the legal analysis here. Despite the project-wide smoking ban, a medical marijuana user may claim he or she is disabled and request for a reasonable accommodation under the Fair Housing Act from the Association or landlord. Under such circumstances, the board of directors of an association or the landlord is permitted to request documentation of the need for an accommodation, including but not limited to a copy of the 329 Card, and a signed note from a doctor documenting the medical need for marijuana. Until the marijuana user provides satisfactory evidence, the Association can enforce its project rules and regulate/fine the marijuana smoking. To avoid being dragged into a possible Hawaii Civil Rights Commission claim, the Association Board should follow lawful steps to correctly handle a reasonable accommodation request and adopt a written policy if none has yet been established.

Due to possible neighbors' conflicting interests, (e.g., a pregnant woman, a newborn baby, someone who has an allergic reaction, or a pilot who would fail his employer's drug test due to second hand pot smoking), the Association may request the user of medical marijuana to ingest in a non-smoking form. If smoking is the only medically necessary way for the patient to consume marijuana, then the Association could request the medical marijuana user install filters within his or her unit, and seal all possible penetrations and points of seepage in walls, ceilings, doors, windows, and floor so as not to spread the odor throughout the building.

For more information on this article or condominium and community law, please call Na at 531-8031, email her at nl@hawaiilawyer.com or scan the code with your smartphone.

CONSTRUCTION LAW ALERT

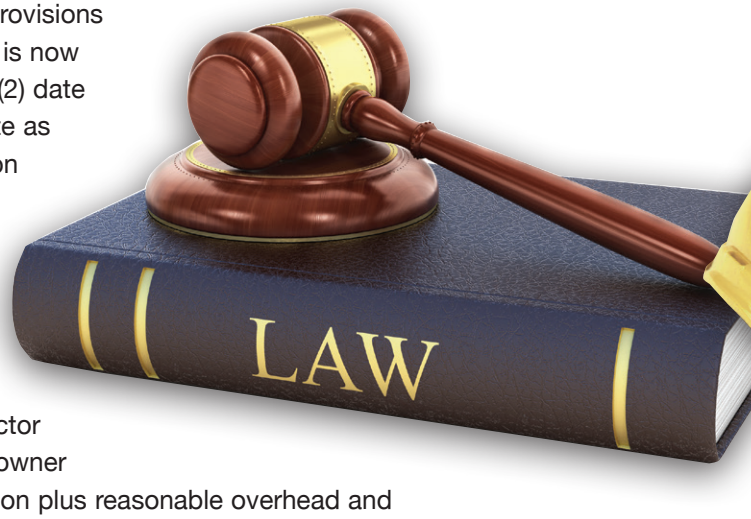
AIA Releases Changes to Widely Used Construction Documents

By Gregory W. Kugle

Every decade, the American Institute of Architects ("AIA") updates its widely used construction contract documents, and the 2017 edition includes changes to the owner-contractor agreements, owner-architect agreements, contractor-subcontractor agreements, as well as the general conditions document. The 2017 updates have been described as "evolutionary, rather than revolutionary" during an unveiling at the ABA Forum on Construction Law Fall Meeting in Boston last October, which was attended by Damon Key construction lawyers Ken Kupchak, Anna Oshiro and Greg Kugle.

One of the most significant changes to the documents is the creation of a standardized, comprehensive insurance and bonds exhibit, which is now Exhibit A to any of the AIA full-service construction contracts. No longer are insurance requirements buried within the A201 General Conditions of the Contract; rather the project's insurance requirements are now segregated into a separate stand-alone exhibit. The editors' intent is to cause the parties to the contract to specifically focus on the insurance requirements of the project, to provide greater flexibility for provisions that are frequently tailored to specific projects, and to facilitate coordination with insurance brokers. Contracting parties should thoroughly review the required and optional insurance coverages that are tailored to their projects in order to comprehensively complete the seven-page insurance exhibit and its multiple check boxes.

The A201 General Conditions document also changes the "date of commencement" and "date of substantial completion" provisions from the prior version of A201. Date of commencement is now a check box option, allowing (1) date of the Agreement, (2) date of issuance of a notice to proceed, or (3) some other date as agreed to by the parties. Similarly, substantial completion is determined by a check box to allow the parties to choose between a specific date, or a specified number of days from the date of commencement.



In addition, the 2017 A201 General Conditions document alters the remedies for "termination for convenience" from prior versions. No longer is a contractor whose contract is terminated for the convenience of an owner automatically entitled to costs incurred through termination plus reasonable overhead and profit on unperformed work. Under the 2017 form, profit on unperformed work is removed and the parties are required to negotiate a reasonable termination fee in lieu of lost profit.

Of the many other revisions to the A201 General Conditions document, a third notable change shortens the notice provision for "differing site conditions." The prior version required the contractor, upon encountering differing site conditions, to provide notice to the owner and architect before the conditions are disturbed, and in no case less than 21 days after the conditions were first observed. The updated version now shortens that notice period from 21 days to 14 days, meaning the contractor now has significantly less time to provide notice of differing site conditions.

The Owner-Contractor agreements now contain blanks to allow the parties to specify amounts for liquidated damages for late completion, as well as bonuses to reward early completion. The forms reflect a deference to the parties' agreement as to these contractual incentives.

There are also changes to the AIA Owner-Architect Contract, services beyond "Basic Services" and identified at the time of agreement are now categorized as "Supplemental Services," to avoid confusing them with "Additional Services" that arise during the course of the project. The 2017 update also provides for compensation to the architect for construction document modifications whenever the budget is exceeded due to market conditions that could not have been reasonably anticipated by the architect.

Finally, the 2017 updates include specific exhibits for Sustainable Projects and BIM. The E2014 Sustainable Projects Exhibit compiles the contractual provisions that are specifically applicable to a sustainable project. And the E203 Digital Data Protocol Exhibit is required for projects utilizing building information modeling ("BIM"), which governs the use and exchange of digital information.

This article highlights just several of the many changes between the 2017 AIA construction documents and the 2007 documents. The AIA publishes a red-lined comparison of the 2017 editions and the 2007 edition, which can be found at https://www.aiacontracts.org/contract-doc-pages/67216-2017-document-release.

This material is informational only. This article is not intended for and should not be solely relied on as legal advice in dealing with any specific situation.

For more information about the updated 2017 AIA documents, or for any construction law needs, please contact Damon Key's construction lawyers: Kenneth Kupchak, Anna Oshiro, Gregory Kugle, Mark Murakami and Matthew Evans at 531-8031.

What Does the New Tax Cuts and Jobs Act Mean for Businesses?

By Ross Uehara-Tilton

The Tax Cuts and Jobs Act of 2017, Public Law No. 115-97, enacted sweeping reforms to the Internal Revenue Code. In his New York Times article, "Democrats Attack Tax Bill as a 'Middle-Class Con Job,'" journalist Jim Tankersley took stock of the Act, noting that Republican proponents of the Act characterize it as a simplification of the tax code, while Democratic opponents criticize it as a giveaway to corporations at the expense of the middle class. In its Cost Estimate for the Conference Agreement on H.R. 1, the non-partisan Congressional Budget Office estimated that the Act would reduce revenues by about $1,649 billion, leading to an overall increase in the deficit of $1,455 billion over the next ten years.

Far from a "simplification," the Act made major modifications by revising tax rates for companies and individuals, increasing the standard deduction and eliminating personal exemptions, and making it less beneficial to itemize deductions by imposing limitations on deductions for state and local income taxes, property taxes, and mortgage interest deductions. Of particular note is the Qualified Business Income Deduction for pass-through entities (such as S-Corporations and Limited Liability Companies), which raises the question of whether existing C-Corporations could benefit from making an S-Election. The reduction in corporate tax rates also raises the question of whether existing pass-through entitles should consider terminating their S-Elections or electing to be taxed as C-Corporations to take advantage of the newly-lowered corporate tax rates.

Reduction in Corporate Tax Rates

"Reduction" is an imprecise term, because the Act results in a lower tax rate for some corporations, and a higher tax rate for other corporations. Previously, corporations were taxed on income on a progressive scale—the higher the corporation's income, the higher the tax rate. Under the Act, all corporations are subject to a flat tax rate of 21%. The following chart illustrates the difference:

Taxable Income	2017	2018
Less than $50,000	15%	21%
$50,000 to $75,000	25%	
$75,000 to $10 million	34%	
More than $10 million	35%	

Accordingly the Act only provides a "reduction" for corporations with annual income of greater than $50,000, but actually results a rate increase for corporations with annual income of less than $50,000.

Qualified Business Income Deduction

The Act introduces a Qualified Business Income (QBI) deduction, which effectively allows pass-through entities to deduct up to 20% of qualified income. Because income from pass-through entities is generally taxed at the higher individual income tax rates of shareholders or members, which start at 22% for individuals earning over $38,700 per year, and increase up to a maximum rate of 37%, the purpose of the QBI deduction is in part to keep the tax rates for pass-through entities in line with the reduction of corporate tax rates from the old maximum rate of 35% to the new flat tax rate of 21%. However, professionals like lawyers and accountants (who clearly were not involved in drafting the new legislation), and other high-income individuals may be unable to take advantage of some or all of the available QBI deduction, because the pass-through income may not be "qualified."

C-Corporation or Pass-Through Entity

Given the complexity of the Act, there are no bright-line rules for determining whether a C-Corporation should elect to be taxed as a pass-through entity (assuming other requirements for S-Corporations are met), or whether a pass-through entity should elect to be taxed as a C-Corporation.

For example, it may be more advantageous for entities that have significant real property holdings to be taxed as C-Corporations, because C-Corporations can fully deduct state and local taxes, including real property taxes, whereas an individual's deduction is limited to a maximum of $10,000. On the other hand, C-Corporations are still subject to double taxation—at the corporate level at a 21% rate, and at the shareholder level at the maximum qualified dividend rate of 20% (and potentially the additional 3.8% net investment income tax)—for an effective maximum federal tax rate of 39.8%. If a company is to be sold in the near future, there are additional tax considerations depending on whether the company is taxed as a C-Corporation or a pass-through entity, and there are even more moving parts where a business is owned by a non-U.S. Citizen.

Overall, the choice of entity is best determined on a case-by-case basis, with guidance from a company's attorneys and accountants.

For more information on this article, please call Ross at 531-8031, email him at rut@hawaiilawyer.com or scan the code with your smartphone.

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Attorneys in the News

Tred R. Eyerly was featured recently at the ABA's Insurance Coverage Conference in Tucson, Arizona. Tred is one of their regular presenters, taking the national stage. His presentation was really on the cutting edge of the law, on "Cyber Policies – the New Wave."

Na Lan was interviewed on the web-based *ThinkTech Hawaii* discussing condominium law and comfort animals, and other related legal issues.

Christine A. Kubota and **Megumi Honami** at Damon Key with the women executives from NBC Tokyo.

Christopher J.I. Leong was recently quoted in the *Pacific Business News*, commenting on the state of the judiciary's electronic documents website.

Mark M. Murakami recently conducted a seminar about eminent domain law, relocation, and land valuation litigation for commercial real estate brokerage Newmark Grubb CBI Honolulu.

Veronica "Nica" Nordyke is on Blue Planet Foundation's Young Professional Ambassador Board.

Ross Uehara-Tilton is an owner of the newly opened coffee shop The Curb Kaimuki, and was recently featured in *Pacific Business News* story "From barista to business owner."

Kelly Y. Uwaine participated in UNITE HERE Local 5's Citizen Workshop, which provided one-on-one assistance for nearly 150 legal permanent residents who want to apply for U.S. Citizenship.