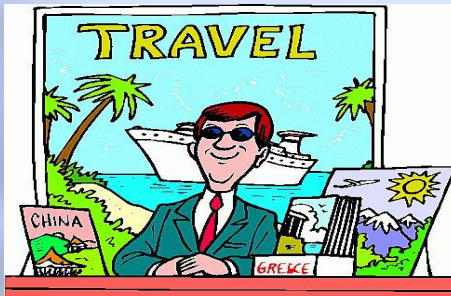


Revenue Laws Study Committee
January 6, 2010

Online Travel Booking and Taxes

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Traditional Business Model



- Consumer contacts hotel directly.
- Consumer uses travel agent to serve as intermediary. Consumer pays upon checkout. Hotel pays commission to travel agent (percentage of cost of room) based on full price paid by guest and remits tax to taxing authority without any reduction for agent's commission.

Merchant Model

priceline

ORBITZ

Expedia

hotels.com
WE KNOW HOTELS INSIDE AND OUT.

travelocity

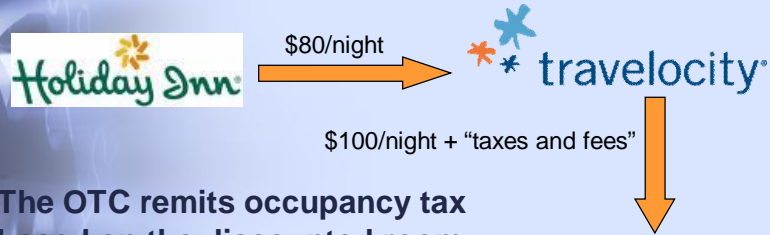
- OTCs contract with hotels for right to broker or facilitate room reservations at a discounted rate.
- No inventory risk.
- OTCs collect money from customer up front and transmit funds to hotel after occupancy. Hotel then remits occupancy tax, based on discounted rate, to taxing authority.

What Do They Collect?

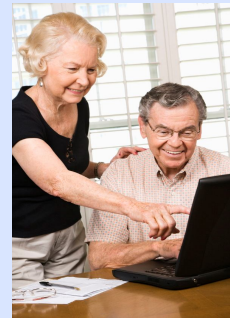
- **Room rate** – Discounted rate negotiated with hotel.
- **Service charge or “facilitation” fee** – A fee for their booking services and/or to compensate OTC for processing the reservation.
- **“Tax recovery charge”** - Amount they expect the hotels to bill them for applicable taxes.



What's the Problem?



The OTC remits occupancy tax based on the discounted room rate it negotiated with the hotel rather than the rate it charged the customer. Local governments are seeking to collect occupancy tax on the higher rate. To which rate do local occupancy tax ordinances apply?



Lawsuits

- Since 2004, there have been numerous lawsuits filed by cities and counties against OTCs seeking to collect occupancy tax on the difference between the discounted rate and the rate actually charged to the customer by the OTC.
- There are as many as 45 going on right now.



Government arguments



- Local occupancy tax ordinances require OTCs to collect tax on the full amount paid by customer.
- OTCs are collecting tax on the full amount charged to customer, disguised within “tax recovery charges” and “service fees,” and failing to remit them.

OTC Arguments

- They do not own, operate, manage, or control hotels.
- Unlike a traditional wholesale transaction, where a retailer purchases a product, owns it as inventory, and resells it to consumers, OTCs provide a nontaxable service by creating an intermediary market between hotels and customers.






Results

- Court decisions have been mixed because outcome turns on judicial interpretation of applicable statutes and ordinances.
- Only a few of the cases have made it fully through the legal process.
- Four federal district courts and the U.S. Court of Appeals for the Fourth and Sixth Circuits have ruled that state and local laws, as written, don't apply to OTCs, have dismissed lawsuits for lack of standing, or have required governments to exhaust administrative remedies before proceeding with lawsuit.
- Favorable verdicts for local governments have occurred in Georgia, California, Texas, and Washington, most of which are being appealed.



California

- In Feb. 2009, the City of Anaheim won an administrative proceeding resulting in a \$21.3 million award, for back taxes, interest and penalties.
- The Hearing Officer found that OTCs are both “operators” and “managing agents” of accommodations under city ordinance.
- On appeal.



Texas

- On October 31, 2009, the City of San Antonio (along with 172 other cities) won a \$20.6 million verdict against 11 major travel companies.
- The jury's decision hinged on its finding that OTCs had **control** over the hotel rooms. The cities' ordinances do not define what "controlling" means, but the judge instructed the jury "to use [their] common sense."

The case will be appealed.



Georgia

- The Ga. Supreme Court ruled in favor of the City of Columbus against Expedia in June 2009 and against Hotels.com in October 2009.
- Both enabling statute and city ordinance specifically imposed room tax on the "**lodging charges actually collected**" and the "**charge to the public.**"
- Court found that Expedia had contractually obligated itself to collect taxes on behalf of hotels.

Georgia



- **Dissent:** The tax calculation is based on the rental of the room by the innkeeper. Expedia is not different from the tourist who, after renting a room, hands the key over to a traveler in the parking lot in exchange for reimbursement and a fee. The ordinance simply does not govern transactions between a non-innkeeper entity and the users of the rooms. The tax is imposed on the transaction between the innkeeper and the room purchaser.

Kentucky

- 6th Circuit upheld dismissal of Louisville and Lexington's cases against 4 major OTCs.
- Decision hinged on whether OTCs constituted **like or similar accommodations businesses** as that phrase appeared in the enabling act following "motor courts, motels, hotels, inns."



South Carolina

- In Feb. 2009, the Administrative Law Court found that the entire room rate charged by Expedia to be subject to sales tax.
- Statute: Vendor to remit tax on the “gross proceeds derived from the rental or charges for any rooms furnished to transients by any hotel...or any place in which...sleeping accommodations are furnished...”
- The court also found that Expedia had nexus with SC by virtue of deriving income from booking hotel rooms located within the State and by relying heavily on services and other benefits provided by SC for carrying out its sales transactions.



Virginia

- As of Aug. 2009, no suits had been filed against OTCs in Virginia.
- In 2006, an OTC asked the Dept. of Taxation for a ruling on the issue.
- The DOT ruled OTCs do not owe sales tax on their markup/fee because they are not physically providing the room and because they are not located in Virginia.
- Commissioner lacks authority to rule on local occupancy tax issue.

North Carolina Law

- Local occupancy tax legislation refers to sales tax statute.
- The taxing authority *“may levy a room occupancy tax of up to three percent (3%) of the gross receipts derived from the rental of any room, lodging, or accommodation furnished by a hotel, motel, inn, tourist camp, or similar place within the [taxing authority] that is subject to sales tax imposed by the State under G.S. 105-164.4(a)(3).”*

North Carolina Law

- G.S. 105-164.4(a) imposes sales tax on a retailer. For purposes of the occupancy tax, (a)(3) states that:
 - *“**Operators** of hotels, motels, tourist homes, tourist camps, **and similar type businesses** and persons who rent private residences and cottages to transients **are considered retailers** under this Article...”*

North Carolina Cases

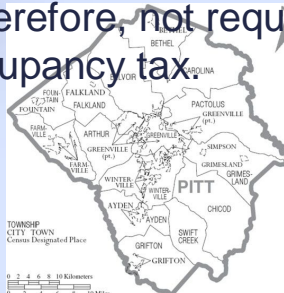
- *Pitt County v. Hotels.com* (4th Cir. Jan. 14, 2009)
- *Wake Co. et al. v. Hotels. Com* (2007 NCBC 35) - ongoing



Pitt County v. Hotels.com

(4th Cir. Jan. 14, 2009)

- **Holding:** An OTC does not meet the statutory definition of a “retailer” because they are not hotel operators under plain language of the statute and, therefore, not required to collect the occupancy tax.





Pitt County v. Hotels.com

Reasoning

1. **Plain meaning** - OTCs do not “operate” hotels as that term is defined in the dictionary because they do not participate in the day-to-day operation or management of hotels.
2. ***Ejusdem generis*** - OTCs are not “similar type businesses” when compared to others on the list.
3. **Policy** - Rejected county’s loophole argument.
4. **Tax statutes** - Applied principle of statutory construction that, if ambiguous, taxing statutes should be construed in favor of taxpayer.



Wake Co. et al. v. Hotels.com et al.

(2007 NCBC 35)

Plaintiffs

- The scope of the occupancy tax is broader than the scope of the state sales tax.
- Local ordinance applies to gross receipts derived by “any person, firm, corporation, or association” from the rental of any room furnished by a hotel...
- Phrase in local ordinance “subject to the State sales tax...” modifies “similar place within the County” only and not the preceding terms.

Defendants

- Sales tax and local occupancy tax are parallel taxation schemes like State sales tax and local sales tax.
- The phrase “subject to the State sales tax imposed under G.S. 105-164.4(a)(3)” limits scope of occupancy tax to hotel operators.
- The tax is limited to “gross receipts derived from the rental of rooms” and OTCs derive their receipts from providing online booking services.

New York

- New city legislation effective Sept. 1, 2009 (for rooms booked on or after).
- Two-remitter system. Tier one: the hotel itself must collect the tax based on the rate it charged the “room remarketer,” called the “net rent.” Tier two: the remarketer must collect and remit occupancy tax based on whatever it charges in addition to the “net rent,” called the “additional rent.”



- On Dec. 21, 2009, OTCs, the American Society of Travel Agents, and the U.S. Tour Operators Association filed a lawsuit against the city challenging the constitutionality of the tax.

Florida

- In 2008, SB 2788 would have required OTCs to collect tax only on wholesale price paid to hotels. Did not pass.
- Nov. 3, 2009: Attorney General filed suit against Expedia and Orbitz under Unfair and Deceptive Trade Practices Act.



- Three recent bills introduced attempting to clarify that OTCs should pay sales and tourist-related taxes on the higher retail rate they charge.

Congressional Action



- Industry has been seeking legislation to prevent state and local taxing authorities from imposing hotel taxes on OTC service fees.
- Amendment to Travel Promotion Act of 2009 failed but efforts will likely continue.

Mazerov Article

- The proposed amendment would:
 - Deprive states and localities of more than \$680 million in tax revenues they now receive from taxes imposed on “wholesale” room rate.
 - Prevent states and localities from establishing clearer laws and rules clarifying OTCs’ obligation to collect taxes on the full retail charge for room rentals.
 - Prevent states and localities from recovering millions in back taxes due to alleged non-compliance with existing tax laws.
 - Give OTCs an unfair competitive advantage by providing them with preferential tax treatment.
 - Place at risk the estimated \$7.5 billion in annual state and local hotel taxes by encouraging hotels to form their own captive OTC subsidiaries.



Mazerov Article

- “To enact it would set dangerous and far-reaching precedents and would be fiscally irresponsible.”
 - » Michael Mazerov, “Banning Taxation of Online Hotel Reservations Is Unwarranted and Could Cost States and Localities Billions of Dollars,” September 18, 2009
 - » (<http://www.cbpp.org/files/9-2-09sfp.pdf>)



Other Issues

- **Nexus:** If OTCs must pay tax on their margin, do they have nexus with taxing authority?
 - Is nexus with state in which customer resides/conducts online transaction?
 - Or with state in which the hotel is located?
- **Fair Apportionment:** To avoid violating the Commerce Clause, states may only tax fair share of an interstate transaction.
- **Internet Tax Freedom Act violations?** If online booking services are taxable, then must states tax services of “brick and mortar” travel agents to avoid e-commerce discrimination claims?

Looking Forward

- Walter Hellerstein – 3 options
- Not whether to tax, but how to tax
 - Tax OTC receipts as an integral part of the provision of accommodations, at the location and rate where the hotel is located (**MTC proposal**).
 - Tax OTC receipts as a service distinguishable from the provision of accommodations (**industry proposal**).
 - Require hotels to mark up price to OTC and collect tax on the marked up price (**Hellerstein's proposal**).



Differences Between MTC and OTC Model

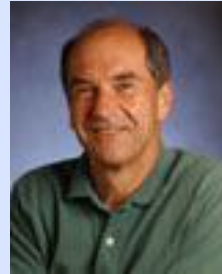
- Sourcing:
 - MTC: Full retail price paid by consumer (discounted room rate + accommodations fee) should be the basis for determining amount of tax due and sourced to hotel location.
 - OTC: OTC remits to hotel, tax on discounted room rate and to local taxing authority, tax on OTC's facilitation fee based on customer's billing address
- Separately state taxes and fees.

Hellerstein's View

- “The MTC proposal combines the worst of both worlds by (a) imposing an independent tax collection obligation on the travel intermediary and (b) subjecting their services to the high rates often applied to the provision of hotel accommodations.”

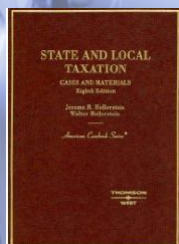
Hellerstein's View

- If taxed, OTC receipts should be taxed as a separate service and transaction should be sourced to the location of the customer, not the hotel.



Why?

- OTCs do not provide hotel accommodations. Sales taxation should reflect “common understanding.”
- Consumption should be taxed where it occurs.
- Reflects Streamlined rules.
- Administrative considerations.





Conclusion

- With the large number of ongoing lawsuits and variety of outcomes, it is unclear how this issue will turn out from a nationwide perspective. Could remain varied by jurisdiction.
- If states and/or local governments want to tax these transactions in the future, they may need to change their laws to tax the online booking fees explicitly.
- To Be Continued....Part II – Taxation of Internet Ticket Resales