

Analysis & Perspective

Cities, States Change Hotel Tax Laws to Address Online Company Practices

LOS ANGELES—A growing number of cities, counties, and even some states have gone to court in recent years seeking cumulatively millions of dollars in hotel occupancy and/or sales taxes that the localities claim are owed by online travel companies (OTCs) like Expedia Inc. and Orbitz LLC.

But more than six years after the first such case was filed in Los Angeles in December 2004, the cities and counties (and the contingency fee law firms representing them) have recovered almost none of the money they seek. The OTCs have settled a small number of the lawsuits but, for the most part, they have mounted an aggressive legal challenge to such claims, with the result that many of the cases are still in some phase of litigation.

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Attorneys for the cities and counties still believe they will eventually recoup the tens, maybe hundreds, of millions of dollars in allegedly unpaid hotel occupancy taxes; but in the past 18 months, some municipalities have shifted—or at least split—their focus, and are now working to make sure they receive those taxes going forward.

In June 2009, New York City amended its Hotel Room Occupancy Tax (HROT) specifically to force OTCs to collect and remit taxes based upon the full prices paid by customers booking rooms on the companies' internet websites, and not on the lower, discounted rates the OTCs negotiate with hotel operators.

In the waning days of 2010, hotel-rich Washington, D.C., did the same thing, passing an ordinance, the Payment of Full Hotel Taxes by Online Vendors Clarification Act of 2010, that took aim at the OTC practice of not remitting taxes on the markup—the difference between what the companies pay hotels in order to list their rooms on the websites, and what they charge customers for the actual room rental (244 DTR H-3, 12/22/10).

'Facilitation' Fees at Issue

And at the end of 2010, North Carolina's Department of Revenue issued a notice on a new law, effective Jan. 1, to modernize sales tax on accommodation rentals

and make it clear that the basis for calculating accommodation taxes includes "charges designated as facilitation fees and any other charges necessary to complete the accommodation rental."

OTCs argue that the difference between the price they negotiate with hotels and what they charge customers on their websites represents a fee for "facilitating" the transaction, and thus should not be subject to hotel occupancy taxes.

The cities and counties disagree, and essentially believe the companies use terms like "facilitation fee" to avoid paying their full share of hotel occupancy taxes.

While the difference in taxes collected amounts to only a few dollars on an individual hotel room transaction, cities and counties—particularly those with large hotel industries—claim lost taxes can total millions of dollars a year.

Court decisions have been mixed, with the precise language of occupancy tax statutes, many of which were written long before the advent of internet-based commerce, often the key. The OTCs insist most courts looking at the merits of the argument have ruled in their favor.

'Pitt County' Impact

In one of the leading cases on the issue, the U.S. Court of Appeals for the Fourth Circuit in January 2009 affirmed a U.S. district court dismissal of a proposed class action lawsuit brought by Pitt County, N.C. (*Pitt County, N.C. v. Hotels.com LP*, 4th Cir., No. 07-1900, 1/14/09) (10 DTR K-2, 1/16/09). The three-judge appellate panel concluded, as did the lower court, that the OTCs did not meet the definition of "retailer" under the state's enabling legislation, which targeted "operators of hotels, motels, tourist homes, tourist camps and similar type businesses."

The opinion marked the first appellate decision, at either the state or federal level, in any of the dozens of similar cases brought by cities and counties against the OTCs for the alleged failure to pay occupancy taxes. The U.S. Court of Appeals for the Sixth Circuit rendered a nearly identical decision in a separate case in December 2009 (244 DTR K-1, 12/23/09).

The *Pitt County* decision may have prompted North Carolina to change its law, several attorneys noted.

In its decision, the Fourth Circuit panel noted that it was preferable for the state Legislature to close any loophole created by internet-based businesses, rather than to have courts expand the interpretation of "similar type businesses" language in the tax statute.

Similarly, U.S. District Judge Terrence Boyle, who presided at trial of the *Pitt County* case, in his August 2007 decision in favor of the OTCs pointed out that the state of North Carolina had not intervened in the law-

suit (*Pitt County, N.C. v. Hotels.com LP*, E.D. N.C., No. 4:06-CV-30-BO, 8/12/07) (210 DTR K-1, 11/3/09) (161 DTR K-2, 8/21/07). "It would be highly unusual if Plaintiff could reach funds with the Occupancy Tax which North Carolina could not with the relevant provisions of its Sales Tax, even more so given that counties may only tax to the extent that the state allows them to do so," Boyle wrote.

The new North Carolina statute makes it clear that the OTCs are covered by both sales and occupancy taxes.

Similar Amendments Possible Elsewhere

The success of such law changes may prompt other municipalities to amend their statutes, several attorneys for the cities and counties predicted.

While few municipalities have seen any money from the ongoing lawsuits over the alleged underpayment of past taxes, North Carolina expects a gain of \$1.7 million this fiscal year, and \$4.9 million next year, as a result of its new law, according to the state's Department of Revenue.

When New York City passed its HROT amendment in June 2009, a spokesman for Mayor Michael Bloomberg (D) told BNA the city expected the new law to bring in an additional \$14 million in just the first fiscal year after its effective date.

In contrast, a federal jury in San Antonio found in October 2009 that the OTCs owed some 173 Texas cities \$20.5 million in unpaid occupancy taxes but the judge in the case has yet to issue the final order (*San Antonio v. Hotels.com LP*, W.D. Tex., No. SA-06-CA-381-OG, jury verdict 10/30/09).

Similarly, a South Carolina administrative law judge almost two years ago, in February 2009, ordered a unit of Expedia to pay more than \$4.7 million in sales tax owed on margins and fees the company collected over five years from internet-based hotel room reservations (31 DTR H-2, 2/19/09). But Expedia appealed that ruling, and while the state's Supreme Court heard arguments in May 2010, no judgment has yet been rendered.

The appeal for cities and counties of amending laws to collect the taxes, at least in the future, is that litigation over past taxes can be—and has been—tied up for years in the courts. On the other hand, OTCs are far more likely to comply with new laws explicitly targeting their business model, several sources told BNA.

That includes in Atlanta, where a court in July 2010 enjoined the companies going forward to collect and remit occupancy taxes on the full price paid by customers, even while court battles continue over the issue of back taxes (*Atlanta v. Hotels.com LP*, Ga. Super. Ct., No. 2006CV114732, injunction filed 7/22/10) (149 DTR K-3, 8/5/10).

Several sources told BNA the OTCs also are remitting according to the new law in New York City, despite having filed a lawsuit challenging the city's authority to make the changes. In October 2010, a New York state Supreme Court judge dismissed part of that lawsuit, finding that the city had the right to change its HROT to require that the tax now be imposed on the entire amount paid by a consumer, including any "fees" charged by travel intermediaries (*Expedia Inc. v. City of New York Department of Finance*, N.Y. Sup. Ct., No. 650761/2009, motion to dismiss filed 10/22/10) (205 DTR K-1, 10/26/10).

Some Jurisdictions Not Pursuing Taxes

Andrew Weinstein, a spokesman for the Interactive Travel Services Association, a Washington, D.C.-based trade group that represents the OTCs, acknowledged that a number of states are reviewing online travel tax issues. But he pointed out that a number of places—he named Las Vegas and Virginia—had looked at the issue and decided not to pursue it.

And in Missouri the state Legislature went the other way, passing legislation that expressly prohibits the levy of taxes on the difference between what OTCs pay hotels and the "marked-up" price the companies charge customers, Weinstein noted.

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"Hopefully, most of these states will realize that the negative consequences of doing it [changing laws to include the facilitation fee in the base of sales/occupancy taxes] are going to far outweigh any benefits," Weinstein told BNA.

But critics of the OTCs' business model simply do not agree with the companies' claims that taxing facilitation fees will have adverse consequences for cities' and states' tourism and hotel industries.

"The only thing that is going to happen is they [the OTCs] will pay the taxes they owe, and no longer be able to add them to their bottom line," one plaintiff's attorney predicted.

And at least in Washington, D.C., the hotels upon which OTCs depend were on the opposite side of the debate. The Hotel Association of Washington, D.C. (HAWDC) was a strong supporter of the amendment to include OTCs' facilitation fees under the tax ordinance, and rejected the dire warnings of lost jobs and hotel reservations.

"They [OTCs] produced no evidence that business would be diverted or that people would lose their jobs. They said that, but they never backed it up with any credible evidence," Solomon Keene, president of HAWDC, told BNA Dec. 21.

Reporting, Recordkeeping Burdens Spur Federal Legislative Efforts

Another potential pitfall the online travel companies face is that any widespread amendment of state occupancy tax laws would likely force the OTCs to become far more involved in the details of tax collection and remittance, said John Murray, an attorney with Sandusky, Ohio-based Murray and Murray, which has represented municipalities in Ohio and North Carolina in lawsuits against the OTCs.

Under current ordinances, hotels generally handle most of the tax details but new laws will inevitably im-

pose new reporting and recordkeeping responsibilities on the OTCs, Murray explained. "That's exactly where they don't want to go," he told BNA.

And that is precisely why a federal solution to the dispute is needed, ITSA's Weinstein said.

The OTCs for some time have been calling for federal legislation to avoid what Weinstein called "crazy-quilt, overlapping, and contradictory laws" that, in the end, will have a severe and negative impact on the tourism industry. Several sources said that draft versions of an Internet Travel Tax Fairness Act have circulated on Capitol Hill, though no such law has yet been formally introduced.

In the meantime, more lawsuits seeking back occupancy taxes from the OTCs continue to be filed. Montana, after what state Department of Revenue Director Dan Bucks told BNA was years of study and review—and at the prodding of the governor—filed suit in state court in November 2010 (*Montana Department of Revenue v. Priceline.com Inc.*, Mont. Dist. Ct., No. CDV-2010-1056, filed 11/8/10).

The state believes the OTCs are covered by both a lodging facility tax and a sales tax on lodging, Bucks said. While the DOR does not yet have a clear idea of the taxes owed, Bucks said it was "millions of dollars" over several years, and increasing as online companies boost their market share of hotel room rentals.

Montgomery County, Md., filed a similar lawsuit in federal court in December 2010, Acting County Attorney Marc Hansen told BNA (*Montgomery County, Md. v. Priceline.com Inc.*, D. Md., No. 8:10-CV-03558-AW, filed 12/21/10). The county in 2009 amended its ordinance to make clear that either the hotel or OTC had a duty to collect the occupancy tax on the full price paid by the customer, but the OTCs have not complied, Hansen told BNA.

"I think they're counting on Congress to bail them out," he said.

By TOM GILROY