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## Cities Pursue Discriminatory Taxation of Online Travel Services

*Real Motivation Is to Shift Tax Burdens to Non-Residents; Result Is Harm to Interstate Commerce*

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### Introduction

In cities in 22 states, local officials have commenced legal action against online travel companies like Expedia, Hotels.com, Orbitz, Priceline and Travelocity for what they claim are uncollected taxes. Travelers pay these websites when they use them to book a hotel room, with

most of the payment going to the hotel but some to the website.

Every jurisdiction in the United States with a hotel has a tax on hotel rooms, and it often is imposed at a rate higher than taxes on other goods and services. The legal dispute centers on

### Key Findings

- Local officials in 22 states have sought to reinterpret hotel occupancy tax ordinances to apply to amounts paid by consumers for online travel booking services, with limited success.
- In traditional hotel transactions, travelers book a room and pay a hotel tax (and sometimes also sales tax) based on the amount they pay the hotel. Online travel companies facilitate such transactions between consumers and hotels, and keep part of what the consumer pays as a service fee.
- Online travel companies do not own or operate hotels and generally do not resell hotel rooms as wholesalers, placing their facilitation services outside the proper scope of hotel occupancy taxes. There is no evidence that companies collect taxes and “pocket” them.
- Taxation of retail services is justifiable, but when cities tax only Internet-based travel facilitation services (and do so at a high rate), such discriminatory taxation suggests that the real motivation is to shift tax burdens to non-residents, which burdens the free flow of interstate commerce.
- Cities should not expect easy revenue from pursuing such claims but rather extended litigation and a negative impact on tourism.
- Proposed federal action to establish hotel occupancy as the proper base would be in line with existing precedents, maintain settled tax practices, and prevent damage to the national economy. Such action would not jeopardize currently collected state and local hotel tax revenue.

<sup>1</sup> These companies are sometimes referred to as online travel companies (OTCs), third party intermediaries (TPIs), accommodations intermediaries, travel intermediaries, or travel booking facilitator.

whether hotel taxes should be assessed on travel booking services, which in turn depends on whether cities' hotel occupancy taxes should be calculated on the amount the hotel receives (which assumes that hotel taxes are paid only on the basis of hotel occupancy), or the amount the consumer pays (which assumes that the online companies are agents or resellers, not facilitators). Online travel companies neither own nor resell hotel rooms.

Taxes on hotel rooms are generally little more than a way of shifting the tax burden to non-residents (and nonvoters). When compared to taxes on other transactions, they are typically imposed at a much higher rate. These city litigation efforts are attempting to extract yet more revenue from travelers, this time by taxing Internet-based travel facilitation services.

Such taxes can be justified if they are neutral and do not discriminate between residents and non-residents. Unfortunately some state and local governments have demonstrated that their goal is more than just collecting taxes due; it is, as commentator William Hays Weissman conjectured, "to abolish an effective business model involving Internet commerce."<sup>2</sup>

Cities' litigation strategies also raise serious oversight questions because they hire contingency fee lawyers to pursue these lawsuits. Some cities have also backed off pursuing litigation, particularly because easy revenue is not forthcoming.

Far from leveling the playing field or collecting taxes already owed, recent state and local lawsuits against online travel companies impose new taxes in a way not justified by the principles of sound tax policy. Proposed federal legislation would halt this predation and preserve the status quo of hotel occupancy taxes based only on hotel occupancy, not other services.

## Innovations of the Online Travel Industry and Tax Law Implications

In a typical transaction, a traveler picks a hotel and books a room, stays there, and pays the hotel a room charge plus a local occupancy tax based on the room charge. The hotel keeps the room charge and forwards the tax money to the government.

Online travel companies like Expedia, Hotels.com, Orbitz, Priceline and Travelocity aggregate information that allows travelers to sort through hotels and book a room on a central website. The online travel companies do not reserve or resell hotel rooms themselves; the traveler is the purchaser of record of the hotel room.

Travelers who book the room pay an amount to the online travel company, part of which is forwarded to the hotel and part of which is kept as a facilitation or service fee. The rise of the online travel industry has allowed consumers to easily compare hotels based on different criteria (including price, location, and customer ratings) and at the same time book a reservation and pay for it. Hotels can reach a market through the online travel companies that they otherwise would not reach. Somewhere between 5 and 25 percent of hotel bookings are done through online travel companies.<sup>3</sup>

Customers pay one unified charge to the online travel companies, which encompasses the room rate agreed with the hotel (closely guarded, as hotels do not want other guests and competitors finding out the discount), the taxes owed on that amount, and the service fee for the company. After the hotel stay has occurred, the hotel bills the online travel company for the amounts owed, and the hotel is responsible for forwarding taxes to the appropriate authority.

The cities argue that online travel companies are hotel operators, hotel agents, or resellers of hotel rooms, and that they should

2 William Hays Weissman, "Taxing the Internet, Sort of," 54 *State Tax Notes* 261, 264 (Oct. 26, 2009).

3 See Billy Hamilton, "Shirt Tales and Online Travel Companies," 54 *State Tax Notes* 661, 664 (Nov. 30, 2009).

pay hotel occupancy tax on the “retail” amount paid by customers for the full transaction, not the lesser “wholesale” amount the hotels receive.

### Cities Experiencing Extended Litigation and Negative Impacts To Tourism Industry

Several dozen lawsuits across the country are pending on this issue, with consequent harm to the tourism industry in plaintiff cities. Officials in Fairview Heights, Illinois, settled with online travel companies, receiving a token amount in return for amending their statute to apply tax only to the amount received by the hotel operator.

In Georgia, the state supreme court ruled in a divided 4-3 opinion that Expedia would be enjoined from offering bookings where it did not agree to pay the city of Columbus’s 7% excise tax on the total amount paid by hotel guests.<sup>4</sup> The court held that because Expedia agreed to collect payments of tax from guests, it was obligated to pay the full amount demanded by the city. The dissenting justices argued that this obligation applies only to innkeepers. The lawsuit led Expedia and the other major online travel companies to stop doing business with hotels in the city.<sup>5</sup> The city has filed a court motion to force Expedia to relist the city’s hotels on its service and seeking damages for lost tax revenue from the delisting.<sup>6</sup>

In Texas, a lawsuit brought by 170 municipalities awaits a final ruling by the trial judge sometime in the next few months and then probable appeal. (A preliminary finding by the

jury concluded that the online travel companies control hotels and could owe up to \$20 million in taxes, but that they had not failed to remit taxes.) Elsewhere, either online travel companies have won or legal wrangling continues.<sup>7</sup> Notably, Clark County, Nevada, (home of Las Vegas) considered filing a lawsuit but decided that the damage to its travel industry would far outweigh any potential revenue gain.<sup>8</sup> In December 2009, the Sixth Circuit Court of Appeals upheld the dismissal of a suit brought by Louisville, Kentucky, concluding that the statute does not extend to online travel companies.<sup>9</sup> Similarly, earlier in 2009, the federal Fourth Circuit Court of Appeals held that hotel taxes are owed only by retailers that operate retail facilities, and that online travel companies are not hotel operators.<sup>10</sup>

### Online Travel Company Services Are Outside the Scope of Hotel Occupancy Tax Statutes

Typical hotel occupancy tax laws provide that hotel taxes are paid by hotel occupants, based on the amount the hotel receives. Amounts paid by guests to others aren’t subject to the hotel tax. (Companies must, however, pay income taxes on this amount.) Federal courts have thus been reluctant to extend hotel occupancy taxes to amounts paid to those not in the business of owning and operating rooms for rent. Also playing a role is the long-standing legal canon that holds that if a law imposing a tax is ambiguous, the ambiguity must be resolved in the taxpayer’s favor.<sup>11</sup>

4 See *Expedia, Inc. v. City of Columbus*, No. S09A0567 (Ga. Jun. 15, 2009).

5 Hotels in nearby Phenix City, Alabama, will come up instead. See Ansley Haman, “Rulings Threaten Expedia, Rivals With Paying Millions in Damages,” *Wall Street Journal* (Jun. 17, 2009).

6 Ben Wright, “City of Columbus, Georgia Files Motion to Force Expedia Inc. to Relist the City’s Hotels,” *Columbus Ledger-Enquirer* (Oct. 9, 2009).

7 See *City of Orange v. Hotels.com*, No. 1:06-CV-413 (U.S. District Court, Beaumont Division Sep. 5, 2007) (finding tax ordinance does not apply to fees paid to online travel companies); *Louisville/Jefferson County Metro Government v. Hotels.com*, No. 3:06-CV-480-R (W.D.Ky. Sep. 26, 2008) (same); *City of Oakland v. Hotels.com*, No. C 07-3432 SBA (N. Cal. Nov. 6, 2007) (dismissing case due to county’s failure to exhaust administrative remedies); *City of Atlanta v. Hotels.com*, No. A07A1376 (Ga. Ct. App., 3rd Div. Oct. 26, 2007) (same); *County of Nassau, New York v. Hotels.com*, 06 CV 5724 (E.D.N.Y. Aug. 17, 2007) (same).

8 Scott Wyland, “County won’t sue online firms to get room taxes,” *Las Vegas Review-Journal* (Nov. 18, 2009).

9 Associated Press, “Appeals court rejects Ky. online hotel tax suit,” (Dec. 22, 2009).

10 *Pitt County v. Hotels.com, LLP*, No. 07-1900 (4th Cir. Jan. 14, 2009).

11 See *United States v. Merriam*, 263 U.S. 179, 188 (1923) (“If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer”); *Bowers v. New York & Albany Lighterage Co.*, 273 U.S. 346, 350 (1927) (“The provision is part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers”).

Two cities (New York City, New York, and South San Francisco, California) responded by amending their laws to apply hotel taxes to amounts paid by the customer for the hotel room, but conceivably encompassing anyone remotely connected with a hotel transaction. Such broad statutes encompass not only online travel companies, but also travel agents, advertisers, and even paid secretaries or co-workers who help book travel. Changing laws is just as controversial: in December 2009, a lawsuit was filed against the New York City law on state constitutional grounds.<sup>12</sup> In January 2010, South San Francisco reversed course and agreed not to tax travel booking services after the online travel companies briefly removed hotels in the city from their websites.<sup>13</sup>

In an interview with tax information services provider Commerce Clearinghouse (CCH), attorney Richard Leavy of Mayer Brown LLP described three different models for travel services, the tour operator, the travel agent/provider agent, and the service provider:<sup>14</sup>

- *Tour Operator.* The customer pays the tour operator directly both for his administrative services and for a hotel room which the tour operator has previously rented from the hotel for a lower rate. If the check bounces, the tour operator bears the entire loss. The hotel is paid and the hotel tax is remitted to the city.
- *Travel Agent/Provider Agent.* The customer pays the hotel directly with administrative assistance of the agent. The hotel then pays the agent a commission according to previously agreed upon terms, but the hotel tax is calculated on the pre-commission amount. If the check bounces, the agent bears the loss of the commission, the hotel bears the loss of the room rental, and the city bears the loss of the tax revenue.
- *Service Provider/"Merchant Model."* The customer pays the agent to reserve a hotel room at a certain price which includes both

the cost of the hotel room and the agent's commission for administrative services. The agent acts as a personal shopper to the customer. If the check bounces, the losses are the same as in the second business model: the agent bears the loss of the commission, the hotel bears the loss of the room rental, and the city bears the loss of the tax revenue.

Leavy says most online travel companies are service providers as described in the third business model. In the context of hotel taxes, the critical distinction among these models is whether the agent is re-renting a hotel room that he has already contracted for or is merely facilitating the rental of a hotel room by a customer. And it is instructive to observe who bears the loss.

### Online Travel Companies Do Not Operate as Agents or Operators of Hotels

The tour operator is the most distinct business model. He bears all the risk. Having contracted for hotel rooms and other services, he then resells them to tourists. The hotel room is rented twice, first to the tour operator, then by the tour operator to the customer.

In the second business model, either the hotel or someone authorized to act on the hotel's behalf executes transactions, transferring all risk in the transaction to the hotel. Uncontroversial examples of agents would be front desk employees or contractors who answer the hotel's reservations hotline. If a customer fails to show for the reservation, the risk is borne entirely by the hotel, not by the employee who happened to take the reservation. Traditional travel agents also use this model, receiving commissions on each booking directly from the hotels, airlines, and railroads.

It is irrelevant for this travel agent business model that some tax laws are unclear as to whether the hotel tax applies to the amount paid by the customer or the amount received

12 MarketWatch, "Internet travel agents file suit against N.Y. tax," (Dec. 22, 2009).

13 Neil Gonzales, "South San Francisco tax tweaked after hotels balk," *San Mateo County Times* (Jan. 6, 2010).

14 Carol Kokinis-Graves, "Online Travel Companies v. Local Jurisdictions: Litigation, Legislation, and Draft Statutes," *State Tax Review* (Nov. 30, 2009).

by the hotel; the amounts would be the same. All amounts collected from the consumer go to the hotel provider; the hotel separately pays the agent for services, be it in the form of wages, salary, or commission. The nature of the agent's relationship makes it impossible to distinguish between the amount paid for the room and the amount paid for the agent. Some portion of a \$100 hotel room certainly pays for the front desk personnel and reservations hotline, but the customer pays the full amount to the hotel directly.

Online travel companies point out that they neither own nor operate hotels, nor do they have an inventory of rooms. Unlike the exclusive agreements or joint ventures that tour operators engage in with hotels, the online travel companies' search engines generally list a variety of hotel companies. While they have contracts with hotels that govern those online promotions, merely having an agreement with a hotel does not mean that one is an agent of the hotel. The online travel companies act more on behalf of their customers, like a personal shopper, than they do on behalf of the hotels.

However, at least one jury (in the Texas case) has found that the companies control hotels. The jury's finding there is perhaps referring to online travel companies' role in collecting taxes from consumers, but that alone should not amount to control over hotel operations. (The judge has yet to issue a ruling in the case.)

### **Online Travel Companies Do Not Generally Operate As Resellers But Rather As Service Providers**

A reseller takes title to a good or service and then sells it again to another individual, often at a higher price. There are really two transactions, each with a different seller and customer. Because tax statutes can tax only one or the other (otherwise double taxation would occur),

the default is usually to tax the retail sale, and not inputs or resales, for administrative ease.

A tour guide, for instance, might purchase admission tickets at a wholesale rate from a museum and then resell them at a higher retail rate to tour participants. As far as the museum is concerned, the tour guide is the customer despite subsequent resales. The tour guide holds title to the tickets and usually eats the loss if he or she cannot resell them. Any tax is usually collected on the museum's sale to the tour guide, although sometimes a statute will nebulously impose the tax on the "ticket price," similar to taxes on the "hotel room price" that have resulted in the current litigation.

While there may be exceptions, online travel companies do not generally operate as resellers. The companies operate by signing contracts with hotels whereby the hotels agree to make rooms available for online travel company bookings at a particular rate. The companies do not rent or take title to the rooms, and are not liable for any rooms that go unsold.

A typical lawsuit claims, "[T]he internet travel sites negotiate room prices with hotels at a wholesale rate, then charge travelers who book through their websites a higher retail rate. However, the companies remit taxes only on the lower wholesale rate."<sup>15</sup> It is a seductive argument that apparently won the day in the Texas case, as commentator Billy Hamilton describes:

"The jury was told, 'if you buy a shirt at J.C. Penney, you pay tax on the total price of the shirt not some wholesale price with part of the price carved out from tax.' It's an interesting analogy," Cindy Ohlenforst, an attorney for one of the online booking companies, told me...

"But suppose you hired a neighbor's teenager or a personal shopper to buy the shirt.

<sup>15</sup> Judy DeHaven, "Lyndhurst is suing travel websites for its local hotel tax," *New Jersey Star-Ledger* (Jun. 25, 2008). See also Jon Ralston, "Weighing the pros and cons of Clark County suing Web sites for room tax revenue," *Las Vegas Sun* (Aug. 2, 2009) ("The issue, which has been percolating for years, is starting to bubble up again on Grand Central Parkway as county commissioners may soon be asked to sue Internet travel sites to recoup room tax revenue lost because of a differential between what Expedia & Co. pay for blocks of rooms and what they sell them for to customers. That is, the companies buy blocks of rooms for \$100 each, sell them for, say \$150, and pay the room tax only on the \$100.")

Let's say the shopper found a shirt for \$80 at Walmart and charged you \$20 for her time. In that case, you haven't bought a shirt for \$100. You've bought an \$80 shirt and you've paid \$20 for nontaxable services."<sup>16</sup>

In the online travel company context, there is no "wholesale" purchase followed by a "retail" sale, but rather one retail transaction that has a room rental component and a service component. This service provider or "merchant model" existed long before online service providers, in the form of "bundled" packages of hotel accommodations with other services.

### **"Revenue Losses" Are A Misnomer Because the Cities' Lawsuits Seek New Tax Revenue, Not Revenue Currently Owed**

Proponents of the cities' lawsuits sometimes claim that the tax amounts are already owed and have gone uncollected. This is a disingenuous argument, since the collection of such taxes has not been expected prior to the lawsuits. In most cases the hotel tax law is being amended or its interpretation dramatically changed, so it cannot reasonably be said that the taxes are owed yet "uncollected." Even if a new law is not required for the city to press for payment, businesses (and ultimately, consumers) will be paying a higher rate of taxes to the government than before, and that is a tax increase.

Consequently, claims of "revenue losses" (unless the cities immediately press forward with aggressive litigation) are misplaced. The revenue was never to have been gained, so it cannot have been lost. In any event, good policy analysis goes beyond merely evaluating whether a proposal raises revenue or not. An idea might raise millions of dollars in new revenue but it would be a bad policy if it did

so in a damaging way, and vice versa. As one Nevada attorney said on the issue, "[T]he law doesn't change just because the economic times are tough right now."<sup>17</sup> It is cynical to equate "might raise revenue" with "preventing revenue losses," as it assumes what the analysis is meant to figure out: whether the taxation is lawful and justified.

The claim that online travel companies have collected taxes but have not remitted them is similarly problematic, as it ignores the economic effects of taxation.<sup>18</sup> Customers pay one total amount to the online travel companies, which then is divided among the hotel, the government, and the online travel company. The cities' claim is essentially that some portion of the profit kept by the online travel company is in reality "owed" taxes.<sup>19</sup>

But it is baseless to assert that only profits would be reduced to fund higher taxes. Consumers would pay higher prices and some transactions would not occur at all. The canard does, however, allow the cities to imply falsely that the companies are nefariously refusing to disgorge taxes. (Even the jury in the Texas case found that the companies did not neglect to pay taxes they owed.)

In any event, state and local governments have other revenue options beside taxes designed to discriminate against non-residents by applying to services primarily used by them, or only to online versions of services. As one commentator pointed out, "If states or localities want to raise more revenue, they could just raise the rate rather than argue about which price to apply it to... Whatever the solution, it should be a well thought-out, comprehensive approach, and not this case-by-case approach that is draining resources from the companies, the localities, and the courts."<sup>20</sup>

<sup>16</sup> Hamilton, 54 *State Tax Notes* at 661 (Nov. 30, 2009).

<sup>17</sup> Todd Bice quoted in Scott Wyland, "County won't sue online firms to get room taxes," *Las Vegas Review-Journal* (Nov. 18, 2009).

<sup>18</sup> Spokeswoman for the Florida Attorney General to Christopher Elliott, "Whoever wins in tax war, guests will still pay the bill," *Washington Post* (Nov. 13, 2009) ("The taxes are being collected from the consumer, but are not being remitted in full.")

<sup>19</sup> In May 2009, a Washington State trial court found Expedia to have committed breach of contract for not stating that its "service fee" did not cover costs but rather constituted the company's profit. The company was assessed \$184 million in damages, and the case is on appeal. In re Expedia Hotel Taxes and Fees Litigation, No. 05-2-02060-1 SEA (King Co. Sup. Ct. May 28, 2009). Note that the ruling does not assert that online travel companies collect taxes from customers and then refuse to remit them.

<sup>20</sup> William Hays Weissman, "Taxing the Internet, Sort of," 54 *State Tax Notes* 261, 264 (Oct. 26, 2009).

## Failure of States to Follow Sound Tax Principles Has Led to Dispute

A properly structured tax on goods and services should apply to all goods and services once and only once. Goods and services primarily used by non-residents should not be subject to higher, discriminatory taxes, nor would a well-designed, principled tax system attempt to micromanage consumer decisions. It would also minimize tax distortion of investment and production decisions and avoid discriminatory taxation of non-residents that use fewer services than residents and have no democratic recourse.

Unfortunately, states stray from these principles. Whole categories of transactions, primarily services but also politically favored investment and consumer actions, are exempt from sales taxation. Business inputs are often taxed, resulting in multiple taxation. Non-residents are made to bear a disproportionate share of the tax burden, through high taxes on items thought to be used primarily by them: restaurant meals, car rentals, and hotel rooms.

These two unprincipled efforts by states—exempting many goods and services from sales taxation while imposing high taxes on items thought to be used by non-residents—have led directly to the online travel company disputes. States and local governments are loathe to tax services, like the service of booking a hotel room, in the belief that service providers are more likely to leave if taxation becomes excessive. But because officials want to extract more revenue from out-of-state travelers and out-of-state businesses, the result is an effort to tax only services provided by out-of-state and Internet businesses. Rather than correct or contain these misguided ideas, states and cities instead are looking for ways to expand them.

In economics, the idea that individuals should pay taxes in proportion to the government services they use is known as the “benefit principle.” Since visitors use fewer services than residents, and never use the most

expensive service (public schools), they should bear a smaller share of the tax burden. Taxes on restaurants, hotels, and car rentals can thus be considered a proxy for a tax on tourists (although there are tourists who don’t eat out, stay with friends, and don’t rent cars). But the benefit derived from added economic activity from visitors and travelers probably exceed the government services they use during their stay, undermining the basis for excessive hotel taxation.

Such taxes are often described as taxes on “them,” not “us.” But we are all “them” to someone else; the net result is everyone paying high hotel taxes everywhere. These taxes can be considerable: the National Business Travel Association estimates that these taxes alone on travelers can range from \$21.49 to \$40.99 per day.<sup>21</sup> Hotel taxes nationwide average about 14 percent, much higher than sales taxes on other goods and services. The online travel industry sensibly does not argue that hotel taxes are unjustifiably high as a matter of good tax policy, but they are.

There is no principled basis for only taxing those services provided by Internet businesses. If state and local officials believe that online travel companies should pay sales or excise tax based on the services they provide, it should only occur as part of a general taxation of all services. A non-neutral tax system would apply the same tax rate to all services, and the democratic process can settle on a rate that raises needed revenue while minimizing economic harm. By singling out only services provided by Internet-based travel companies, state and local governments are demonstrating that their true motivation is gouging revenue from out-of-staters, not fairness.

## Proposed Multistate Tax Commission Language Would Enshrine Confusion

In May 2009, the Multistate Tax Commission (MTC), which writes model tax laws and regulations to be used in legislation by states,

21 National Business Travel Association, “Lodging, Rental Car, and Meal Taxes on Travelers in the Top 50 U.S. Cities,” (Aug. 2009), at <http://www2.nbta.org/foundation/resourcelibrary/Pages/sept09article2.aspx>.

proposed a “Model Statute on the Tax Collection Responsibilities of Accommodations Intermediaries.” The model statute language would require any “person or entity...that facilitates the sale of an accommodation and charges a room charge to the customer” to pay tax on “the full retail price charged to the customer for the use of the accommodations, including any accommodations fee before taxes.”

The breadth of the model statute is staggering, encompassing anyone who in any way “facilitates” a room rental. Enterprising lawyers will certainly make the arguable cases that paying for an advertisement about a hotel, paying a secretary to make a hotel reservation, and many other things “facilitate” the rental of hotel rooms. Amounts paid by customers to buy newspapers with hotel advertisements or to pay secretaries who handle travel bookings would thus be subject to hotel occupancy taxes (and sales taxes; the model statute simply says “taxes”).

Far from presenting arguments to support the notion that facilitation fees should be subject to hotel occupancy taxes, the model statute simply *assumes* that that is already the case. Eminent Professor Walter Hellerstein of the University of Georgia Law School, who supports the taxation of online travel company services but at the customer’s billing address and at a different rate, nevertheless sees problems with the MTC proposal.

In a December 2009 letter to the MTC, Hellerstein said that the question of whether hotel occupancy taxes encompass facilitation fees “is the very question that has divided courts across the country.”<sup>22</sup> Echoing an earlier memorandum on the topic,<sup>23</sup> Hellerstein criticized the “model” statute for endorsing an approach that would not promote uniformity and instead allow varied tax treatments across the country. He also criticized comments that the MTC proposal would simply collect

existing taxes, writing, “[I]t does not advance rational discourse over this issue to pretend that the MTC proposal would not impose new taxes in many jurisdictions when in fact it would.”<sup>24</sup>

Instead of nudging state and local governments toward good tax policy, the MTC model statute punts, permitting governments to force just about anyone to pay hotel occupancy taxes and allowing each jurisdiction to do it differently. In December 2009, stung by the Hellerstein letter, MTC officials postponed final consideration of its model statute.

### **Proposed Federal Bill Narrowly Bars Discriminatory Taxation and Is in Line with Other Precedents Restraining State Damage to Interstate Commerce**

Circulating on Capitol Hill is proposed language for a federal bill or amendment that would pre-empt occupancy taxes based on travel booking or travel agency services. Supported by the Coalition for Internet Travel Tax Fairness, the bill is designed to narrowly bar discriminatory taxation of online travel company services.

The proposal would neither provide online travel companies with preferential tax treatment by banning taxation of “wholesale” services, nor would it be a blanket tax exemption of online travel companies or their services. Instead, the proposal maintains settled practices in hotel occupancy taxation: hotel occupancy taxes will be calculated by the amounts hotels receive in payment from the hotel occupant. That tax revenue will still be collected, so claims that the bill would endanger the billions of dollars currently collected in hotel taxes by state and local governments are thus misguided. (The bill includes a specific prohibition on hotels’ creating a joint venture or affiliate designed to shelter amounts paid by consumers from hotel occupancy tax.) Further, states retain the option

22 Letter of Walter Hellerstein to MTC Officials, “Re: Hearing Officer’s Report on Proposed Model Statute On the Tax Collection Responsibilities of Travel Accommodations Intermediaries” (Dec. 2, 2009).

23 Letter of Walter Hellerstein to NCSL, “Views of Walter Hellerstein Regarding Proposals for Taxing Services of Travel Intermediaries” (Jul. 16, 2009).

24 *Id.*



of taxing online travel booking services, so long as they tax services generally or at least do not discriminate by only taxing online travel booking services.

The concept behind the federal proposal is in line with other federal actions that prevent parochial state government actions from damaging interstate commerce. The people of the United States adopted the Constitution in large part because their existing national government had no power to stop states from imposing trade barriers with each other, to the detriment of the national economy. As U.S. Supreme Court Justice William Johnson wrote in the seminal case of *Gibbons v. Ogden*, invalidating New York's stifling regulations on interstate water travel:

"[States' power over commerce,] guided by inexperience and jealousy, began to show itself in iniquitous laws and impolitic measures..., destructive to the harmony of the States, and fatal to their commercial interests abroad. This was the immediate cause, that led to the forming of a convention."<sup>24</sup>

Consequently, among the powers granted to Congress by the new Constitution was "[to] regulate Commerce...among the several States," a provision known today as the Commerce Clause.<sup>26</sup> Congress thus has the power to restrain state laws that discriminate against or otherwise burden the flow of interstate commerce.

Congressional actions under the Commerce Clause to remove or prevent state and local burdens on the travel industry are common and have previously been upheld.<sup>27</sup> City

officials claim their motivations are not to burden interstate commerce, but rather to promote fairness and collect owed revenue from the "wholesale" service. In reality, existing tax laws are being contorted to extend to the online travel industry, taxing service transactions with no substantial nexus to the jurisdiction or to hotel occupancy.

The costs imposed in filing and defending these lawsuits are also passed along to taxpayers and travelers. These are magnified in places like California, which requires pre-payment of the disputed (and often enormous) tax amounts before being permitted to challenge the tax in court.<sup>28</sup>

It may be too much to ask that states only tax everything once and only once, and not design taxes to hit only non-residents. The siren call of revenue (sometimes sold as costless and risk-free<sup>29</sup>) is often tempting enough to override principles and sound policy. The Commerce Clause exists precisely for these situations, when states put tax parochialism ahead of the common national good.

It is in the nation's interest and the interest of each state and municipality to have a vibrant and dynamic travel industry. Unpredictable and unaccountable taxes are a hindrance to that, and perhaps only congressional action can move the states toward less harmful tax policy.

## Conclusion

Aggressive and unjustified taxation of online travel companies is a cost, in that each community hopes to burden out-of-state travelers for its own benefit. Such a burden in one

25 *Gibbons v. Ogden*, 22 U.S. 1, 224 (1824) (Johnson, J., concurring).

26 U.S. Const. art. I, sec. 8, cl. 3.

27 See *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241 (1964) (upholding congressional action prohibiting state and local statutes that interfered with use of hotels by interstate travelers); *Katzenbach v. McClung*, 379 U.S. 294 (1964) (same with restaurants used by interstate travelers); the Internet Tax Freedom Act, P.L. No. 105-277 (prohibiting state and local taxation of Internet access); 49 U.S.C. § 40116 (prohibiting state and local taxation of the sale of air transportation); 49 U.S.C. § 14505 (prohibiting state and local taxation of the sale of motor carrier transportation).

28 See *Expedia, Inc. v. City and County of San Francisco*, No. JCCP 4472 (Sup. Ct. Los Angeles Jun. 19, 2009).

29 In several instances, private contingency-fee lawyers have sought to be hired by a city to sue the online travel companies on the city's behalf with no up-front cost, with the agreement that they get a cut of any amounts collected. The city's oversight is often lax, resulting in abuses when private sector individuals are given governmental authority to pursue the collection of disputed taxes. A similar program at the federal level has been cancelled due to rampant abuse. The Tax Foundation filed a friend-of-the-court brief opposing giving tax collection powers to private contingency-fee lawyers in a case currently on appeal to the California Supreme Court. See Joseph Henchman and Justin Burrows, "The Dangers of Privatizing Tax Collection: Priceline.com, Inc. v. City of Anaheim," (Jun. 25, 2009), at <http://www.taxfoundation.org/research/show/25286.html>.

municipality is at best a bother. But when multiplied across the country, it can quickly become death by a thousand cuts.

If a state or local government wishes to tax non-residents or services, that is acceptable. But if non-residents are taxed at a higher rate than residents, or if only services primarily used by non-residents are taxed while everything else is exempt, the real motivation becomes clear: a “meddlesome, money-grabbing plan.”<sup>30</sup> When cities and states act in such a way toward one set of businesses, investment and economic growth can be chilled as other businesses take note.

It is important that our state and local governments collect revenue needed to provide the services demanded by their constituents. But that need does not justify impositions on interstate commerce, burdens on the national economy, or the corruption of sound tax principles.

## Appendix A: Online Travel Company Litigation by State

### Alabama

City of Birmingham, et al. v. Orbitz, Inc., et al. (CV-2009-03607) Circuit Court of Jefferson County, Alabama

### Arkansas

Pine Bluff Advertising and Promotion Commission et al. v. Hotels.com, L.P. (CV 2009946-5) Circuit Court of Jefferson County, Arkansas (dismissed January 22, 2010)

City of Fayetteville v. Hotels.com, L.P., et al. (CV 07-567-01) Circuit Court of Washington County, Arkansas (dismissed on July 25, 2008)

### California

City of Oakland v. Hotels.com, L.P., et al. (07-cv-3432) Northern District of California (dismissed on November 6, 2007)

Transient Occupancy Tax Cases (Judicial Council Coordination Proceeding No. 4474) Superior Court for the State of California, County of Los Angeles

### Florida

Leon County, Florida v. Hotels.com, et al. (1:06-cv-21878-PCH) Southern District of Florida (dismissed on February 22, 2007)

The County of Monroe, Florida v. Priceline.com, et al. (4:09-cv-10044-KMM) Southern District of Florida (dismissed on June 25, 2008)

City of Jacksonville, Florida v. Hotels.com L.P., et al. (2006-CA-005393) Circuit Ct. Duval County, Florida (dismissed August 21, 2007)

Miami Dade County, Florida v. Internetwork Publishing Corp. d/b/a Lodging.com, et al. (6-19187 CA 5) Circuit Ct. Dade County, Florida (voluntarily dismissed January 18, 2007)

Miami-Dade County v. Internetwork Publishing Corp. et al. (9-19187 CA 05) Circuit Court, Eleventh Judicial Circuit in and for Miami-Dade County, Florida (dismissed on January 18, 2007)

County of Monroe v. Priceline.com Inc., et al. (09-cv-21002) Southern District of Florida (dismissed on May 13, 2009)

Brevard County, FL v. priceline.com Incorporated, et al. (6:09-cv-1695) Middle District of Florida

Orange County, Florida v. Expedia, Inc., et al. (2006-CA-0021 04) Ninth Judicial Circuit, Orange County, Florida

The City of Jacksonville v. Hotels.com, L.P. (2006-CA-005393) Fourth Judicial Circuit, Duval County, Florida

Leon County, et al., v. Expedia, Inc., et al. (2009-CA-4319) Second Judicial Circuit, Leon County, Florida

Gannon v. Hotels.com, L.P. et al. (502009CA025919) Fifteenth Judicial Circuit, Palm Beach County, Florida

Orbitz, LLC, et al. v. Broward County, Florida, et al. (37 2009 CA 000126) Second Judicial Circuit, Leon County, Florida

Leon County v. Expedia, Inc., et al. (2009CA4002) Second Judicial Circuit, Leon County, Florida

Expedia, Inc. v. Miami-Dade County, Florida, et al. Second Judicial Circuit, Leon County, Florida

Hotels.com, L.P. v. Miami-Dade County, Florida, et al. Second Judicial Circuit, Leon County, Florida

30 “Suing travel sites over taxes a terrible idea,” Editorial, *Las Vegas Review-Journal* (Nov. 10, 2009).

Hotwire, Inc. v. Miami-Dade County, Florida, et al.  
Second Judicial Circuit, Leon County, Florida

### Georgia

City of Rome, Georgia v. Hotels.com, et al.  
(4:05-cv-00249-HLM) Northern District of  
Georgia

City of Atlanta v. Hotels.com, L.P., et al. (06-cv-  
114732) Superior Court of Fulton County, State of  
Georgia, Court of Appeals of the State of Georgia;  
(S08G0568) Supreme Court of Georgia

Columbus, Georgia v. Hotels.com, L.P. (06-cv-  
1893-8) Superior Court of Muscogee County,  
Georgia

Columbus, Georgia v. Expedia, Inc. (SU06-  
CV-1794-7) Superior Court of Muscogee County,  
Georgia

### Illinois

Village of Rosemont, Illinois v. Priceline.com, et al.  
(1:09-cv-04438) Northern District of Illinois

City of Fairview Heights v. Orbitz, Inc., et al. (05-  
cv-0840) Southern District of Illinois (voluntarily  
dismissed on March 30, 2009)

City of Chicago v. Hotels.com, L.P., et al. (05 L  
051003) Circuit Court of Cook County, Illinois  
County Dept., Law Division

### Indiana

Lake County Convention and Visitors Bureau v.  
Hotels.com, et al. (2:06-cv-00207-JVBAPR) North-  
ern District of Indiana

Marshall County v. Hotels.com, L.P., et al. (06-cv-  
0357) Northern District of Indiana (dismissed on  
June 20, 2006)

Travelscape, LLC v. Indiana Dep't of State Revenue  
(49T10-0903-TA-11) Indiana Tax Court

Hotels.com, L.P. v. Indiana Dep't of State Revenue  
(49T10-0903-TA-13) Indiana Tax Court

Hotwire, Inc. v. Indiana Dep't of State Revenue  
(49T10-0903-TA-12) Indiana Tax Court

### Kentucky

Louisville/Jefferson County v. Hotels.com, et al.  
(06-CY-480) Western District of Kentucky (dis-  
missed by the district court; dismissal affirmed by  
Court of Appeals for the Sixth Circuit)

City of Bowling Green, KY v. Hotels.com, L.P. et al.  
(No. 09-CI-409) Warren Circuit Court, Common-  
wealth of Kentucky

### Maryland

County Commissioners of Worcester County, Mary-  
land v. Priceline.com et al. (1 :09-cv00013-MJG)  
District of Maryland

Mayor & City Council of Baltimore v. Priceline.  
com, et al. (1 :08-cv-03319-MJG) District of  
Maryland

### Michigan

County of Genesee, MI v. Hotels.com, L.P. et al.  
(09-265-CZ) Circuit Court for the County of  
Ingham, Michigan

### Missouri

City of Branson v. Hotels.com, L.P., et al.  
(106CC5164) Circuit Court of Greene County,  
Missouri

City of Jefferson v. Hotels.com, L.P., et al. (07  
AC-CC00551) Circuit Court of Cole County, Mis-  
souri (dismissed on December 29, 2009)

St. Louis County, MO v. Prestige Travel, Inc. et al.  
(09SL-CC02912) Circuit Court for the County of  
St. Louis, Missouri

### New Jersey

Township of Lyndhurst v. Priceline.com Inc., et  
al. District of New Jersey (dismissed on March 18,  
2009)

### New Mexico

City of Gallup, New Mexico v. Hotels.com, et al.  
(2:07-cv-00644- JEC-RLP) District of New Mexico

### New York

County of Nassau, New York v. Hotels.com, et al.  
(2:06-cv-05724-ADS-WDW) Eastern District of  
New York

Expedia, Inc., et al. v. City of New York Dep't of  
Finance, et al. State of New York Supreme Court

### North Carolina

Pitt County v. Hotels.com, L.P., et al. (06-cv-  
30-BO) Eastern District of North Carolina  
(07-1900) (dismissed)

Wake County v. Hotels.com, L.P., et al. (06 CV 016256) Wake County General Court of Justice, Superior Court Division, North Carolina

Dare County v. Hotels.com, L.P., et al. (07 CV S56) Dare County Superior Court, North Carolina

Buncombe County v. Hotels.com, L.P., et al. (7 CV 00585) Buncombe Superior Court, North Carolina

Mecklenburg County v. Hotels.com, L.P., et al. General Court of Justice Superior Court Division, North Carolina

## Ohio

City of Columbus, et al v. Hotels.com, et al. (3:07-cv-02117-DAK) Northern District of Ohio

City of Findlay v. Hotels.com, et al. (3:05-cv-07443-DAK) Northern District of Ohio

## Pennsylvania

County of Lawrence, Pennsylvania v. Hotels.com, et al. (2:09-cvOI219-GLL) Western District of Pennsylvania (voluntarily dismissed)

City of Philadelphia v. Hotels.com, et al. (000860) Commonwealth of Pennsylvania Court of Common Pleas, Philadelphia County (dismissed on May 25, 2006)

Cumberland County v. Hotels.com, L.P., et al. (06 CV 10630) Cumberland County General Court of Justice, Pennsylvania (dismissed on November 19, 2007)

## South Carolina

City of Myrtle Beach, South Carolina v. Hotels.com, et al. (4:06-cv-03063-RBH) District of South Carolina

City of Charleston, South Carolina v. Hotels.com, et al. (2:06-cv-01646-PMD) District of South Carolina

City of North Myrtle Beach v. Hotels.com, L.P., et al. (06-cv-03063) District of South Carolina

Town of Mount Pleasant, South Carolina v. Hotels.com, et al. (2:06-cv-02087-PMD) District of South Carolina

Horry County v. Hotels.com, L.P., et al. (CP 26 737) South Carolina Court of Common Pleas

Travelscape, LLC v. S. Carolina Dep't of Revenue (08-ALJ-17-0076-CC) State of South Carolina, Court of Appeals

## Tennessee

City of Goodlettsville, Tennessee v. Priceline.com, et al. (3 :08-cv-00561) Middle District of Tennessee

## Texas

City of San Antonio, Texas v. Hotels.com, et al. (5:06-cv-00381-OLG) Western District of Texas

City of Orange, Texas v. Hotels.com, LP, et al. (06-cv-21878) Eastern District of Texas (dismissed on September 21, 2007)

City of Houston v. Hotels.com, L.P., et al. (2007-13227) District Court of Harris County, Texas

## Washington

City of Bellingham v. Hotels.com, L.P., et al. (05-cv-01822) Western District of Washington, (voluntarily dismissed on 2/17/06)

## Wisconsin

City of Madison v. Expedia, Inc. et al. (2007-cv-004488) Dane County Circuit Court, Wisconsin (dismissed on July 24, 2008)



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