The University of Georgia

School of Law

December 2, 2009

BY FEDERAL EXPRESS

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Mr. Ramon J. Hirsig, Member, Executive Committee
Ms. Roxy Huber, Member, Executive Committee
Multistate Tax Commission
444 North Capitol Street, N.W.
Suite 425
Washington, DC 20001-1538

Re: Hearing Officer's Report on Proposed Model Statute On the Tax Collection Responsibilities of Travel Accommodations Intermediaries

Dear Executive Committee Members:

In my submission of August 20, 2009 (copy attached), I provided the Multistate Tax Commission with a memorandum of my views on two alternative proposals for taxing the services of travel intermediaries in connection with the Multistate Tax Commission's hearing and invitation for comments on a Proposed Model Statute on the Collection Responsibilities of Accommodations Intermediaries. At the request of John Allan, of Jones Day, I have now reviewed the Hearing Officer's Report on the proposed model statute and offer the following comments. Like the views expressed in my memorandum, the views expressed in this letter are entirely my own based on my best professional judgment and do not necessarily represent those of Jones Day or of its travel intermediary clients.

My memorandum was addressed to two alternative legislative proposals for taxing the receipts of travel intermediaries (the "MTC proposal" and the "industry proposal"). It evaluated the relative merits of these proposals based on tax policy considerations and without regard to their current treatment under existing law. Indeed, I specifically noted that "[w]hether that margin is in fact taxable under existing sales and

accommodations taxes has been and continues to be the subject of nationwide litigation," citing 2 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 19.03[6][b] (3d ed. 2008 & Cum. Supp. 2009).

In support of its recommendation of the MTC proposal, the Hearing Officer's Report asserts that the proposal "does not impose new lodging taxes on the intermediaries' margin" because "the model assumes that the state or locality has already taken the position that the margin is subject to lodging taxes." But this assumption, which is embodied in the model's definition of a "room charge," is the very question that has divided courts across the country. If the model were adopted in Pitt County, North Carolina or in Louisville/Jefferson County, Kentucky, it would indeed impose new lodging taxes on the intermediaries' margins. See *Pitt County v. Hotels.com*, 553 F.3d 308 (4th Cir. 2009) and *Louisville/Jefferson County Metro Government v. Hotels.com, LP*, No. 3:06-CV-480-R, 2008 WL 4500050 (W.D. Ky. Sept. 30, 2008) (both of which are cited and discussed in Hellerstein & Hellerstein, *supra*, at ¶ 19.03[6][b]). Whatever may be the case for favoring the MTC proposal over the industry proposal, it 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.

In my memorandum supporting the industry proposal over the MTC proposal, I also noted that the industry proposal was consistent with the sourcing principles of the Streamlined Sales and Use Tax Agreement (SSUTA) whereas the MTC proposal was inconsistent with those principles. The Hearing Officer's Report disagrees, but *not* because it questions my conclusion that the MTC proposal will source receipts in a manner that is inconsistent with SSUTA. Rather, the Hearing Officer's Report takes comfort in its view that the MTC proposal involves "lodging taxes" not "sales taxes."

But this response only underscores the fundamental problems with the Hearing Officer's Report's recommendation. First, it ignores the fact that many of the cases being litigated across the country over the taxability of the travel intermediaries' margin in fact involve traditional sales and use taxes rather than "lodging taxes." See Hellerstein & Hellerstein, *supra*, at ¶ 19.03[6][b]). Second, there is certainly nothing in the MTC proposal that would limit it to "lodging taxes," since one could as easily refer to a sales tax as to lodging tax in the proposed model statute's language that makes "[a]n accommodations intermediary ... responsible for the collection of tax imposed by [cite to applicable code sections(s)] on the room charge ...." MTC Proposed Model § 2(a). Third, even if the proposal were in fact limited to "lodging taxes" (however they might be distinguished from "sales taxes" – another subject for extended litigation), it would create an administrative nightmare, because many retail sales taxes apply to hotel rentals (thus raising the issue of the taxability of the travel intermediaries' margins), and there would be different sourcing rules for these margins depending on whether they were subject to sales tax or "lodging" tax. See All States Tax Guide (RIA) ¶ 253 (Sales-Use Taxes – Taxability of Specific Transactions) (chart) at note 43 ("Practically every state taxes

transient hotel, etc., rentals; also many localities in some states."), available at www.checkpoint.riag.com (visited on Dec. 2, 2009). Finally, if the proposal were in fact limited to "lodging taxes," one may reasonably ask why the Multistate Tax Commission, an organization whose purpose is to promote "uniformity ... in significant components of tax systems," Multistate Tax Compact Art. I(2), would promote a model statute that would do just the opposite.

Hence, in my view, the Hearing Officer's Report's dismissal of the sourcing point reinforces the case for the industry proposal as the appropriate means of taxing the intermediaries' margin on the assumption (on which my memorandum was based) that the intermediaries' margin would be taxed by one of the two proposed alternatives.

If you have any questions about these comments, I will be happy to respond to them.

Sincerely,

Walter Hellerstein

Walter Hellerstein
Shackelford Professor of Taxation

Enc.

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August 20, 2009

BY FEDERAL EXPRESS

Roxanne Bland, Esq.
Multistate Tax Commission
444 North Capitol Street, N.W.
Suite 425
Washington, DC 20001-1538

Dear Roxanne:

Re: Taxation of Travel Intermediary Services

In connection with the Multistate Tax Commission's hearing and invitation for comments on a Proposed Model Statute on the Collection Responsibilities of Accommodations Intermediaries, I am attaching a memorandum (along with an executive summary) of my views on two alternative proposals for taxing the services of travel intermediaries. These documents were originally prepared for the National Conference of State Legislatures' discussion of the issue at their annual conference in July. I would be happy to respond to any questions you may have regarding these views.

Sincerely,

Walter Hellerstein
Shackelford Professor of Taxation

Encs.

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Executive Summary

Views of Walter Hellerstein
Regarding Proposals for Taxing Services of Travel Intermediaries

Two proposals have been advanced for imposing sales tax and sales tax collection obligations on the receipts that travel intermediaries derive from their services of facilitating the sale of hotel accommodations. The essential distinction between the two proposals is whether the travel intermediaries' receipts are taxed as an integral part of the provision of hotel accommodations, at the location and rate where the hotel accommodations are consumed, or as a service distinguishable from the provision of hotel accommodations, taxable at the location and rate where the customer resides. For the following reasons, I believe that the latter proposal is preferable to the former as matter of sound tax policy and as a matter of administrative convenience.

1. **Travel intermediaries generally do not provide hotel accommodations.** Travel intermediaries neither own nor operate hotels, and their function of facilitating consumers' booking of hotel accommodations is distinct from the provision of the hotel lodging itself. Because tax laws should reflect the common understanding of transactions in which taxpayers engage, travel intermediary services should not be taxed as the provision of hotel accommodations.

2. **Both proposals recognize that travel intermediaries generally do not provide hotel accommodations.** Point 1 is reinforced by the fact that both proposals explicitly differentiate the travel intermediaries' services (and the receipts associated with them) from the provision of hotel accommodations (and the receipts associated with them).

3. **Consumption should be taxed where it occurs, and there is at least as strong a case for taxing travel intermediaries' services at the customer's location as taxing them at the location of the hotel.** While the consumer surely enjoys some portion of the travel intermediaries' services at the location where he or she actually occupies the hotel room that was booked through the travel intermediary, the consumer enjoys some (if not more) of those services at his or her principal location where the travel intermediary has saved him or her the time of searching for and booking the appropriate hotel accommodation at the best possible rate.

4. **Legislatures should determine the rates at which consumers pay sales taxes based on their judgment as to the appropriate rate for the transaction that is being taxed.** If legislatures choose to extend their sales tax to services provided by travel

intermediaries, they then need to decide whether the rate of such tax should be that applicable to most other sales of goods and services in the jurisdiction or to those subject to unusually high rates, e.g., hotel accommodations and massage parlors. The proposal for taxing intermediaries' services as an integral part of hotel accommodations services obscures this important tax rate issue.

5. **Taxing travel intermediary services at the customer's location reflects the rules of the Streamlined Sales and Use Tax Agreement.** The so-called "sourcing rules" of the Streamlined Sales and Use Tax Agreement (SSUTA) reinforce the case for taxing intermediary services at the customer's location, because the SSUTA sourcing rules will source the receipts to the customer's location not the location of the hotel accommodations.

6. **Administrative considerations strongly support the case for taxing travel intermediary services at the customer's location.** For a travel intermediary, whose taxable receipts under both proposals constitute only the difference between what the consumer pays to the travel intermediary and what the travel intermediary remits to the hotel operator, a rule that limits the travel intermediary's tax collection and reporting responsibilities to such receipts at the customer's billing address is considerably less cumbersome than requiring it to undertake, in addition, the obligation (normally imposed on the hotel) to collect tax on the charge for the accommodations themselves.

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MEMORANDUM

To: National Conference of State Legislatures
From: Walter Hellerstein
Re: Travel Intermediaries
Date: July 16, 2009

Per the request of John Allan, of Jones Day, I have briefly set forth my views regarding the relative merits of two legislative proposals (the "MTC proposal" and the "industry proposal" attached hereto as Exhibits A and B) for imposing sales tax and sales tax collection obligations on the receipts that travel intermediaries derive from their services of facilitating the sale of hotel accommodations. The views expressed in this memorandum are entirely my own based on my best professional judgment and do not necessarily represent those of Jones Day or of its travel intermediary clients.

The Issue

To evaluate the relative merits of the two alternative legislative proposals for taxing the receipts of travel intermediaries, it is appropriate first to identify the issue at which they are directed. Prior to the advent of the Internet and online travel intermediaries, the taxation of receipts that traditional travel agents derived from their services in facilitating the sale of hotel accommodations to consumers was not a contentious one. Because states and localities did not (and still do not) generally tax services, the travel agents' receipts were not subject to sales tax. At the same time, however, the full amount paid by the consumer for taxable hotel accommodations booked through a travel agent was subject to sales or accommodations tax,[1] and it was not reduced by the commission generally remitted by the hotel operator to the travel agent.

With the advent of the Internet and online travel intermediaries, however, and the business model associated with such intermediaries,[2] the payment flows changed. The consumer now remits his or her payment to the travel intermediary, who remits only the amount that it has negotiated with the hotel operator as payment for the hotel accommodations, retaining for itself the difference ("the margin") between the consumer's payment and the amount paid the hotel. Whether that margin is in fact

[1] For ease of exposition, unless otherwise indicated, the term "sales tax" as hereafter used in the memorandum shall include accommodations tax.

[2] See 2 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 19.03[6][a] (3d ed. 2008) (describing Internet travel company business model).

taxable under existing sales and accommodations taxes has been and continues to be the subject of nationwide litigation, and resolution of those issues has little bearing on the present inquiry.[3] I say that because the present inquiry starts from the common view that these intermediary services *will be taxed.* The fundamental question raised by the alternative legislative proposals is simply how such services should be taxed, not whether they are taxable under existing law.

Evaluation of Alternative Legislative Proposals for Addressing the Issue

The essential distinction between the two proposals is whether the travel intermediaries' margin should be taxed as an integral part of the provision of hotel accommodations, at the location and rate where the hotel accommodations are consumed, or as a service distinguishable from hotel accommodations, taxable at the location and rate where the customer resides. For the following reasons, I believe that the latter proposal is preferable to the former as matter of sound tax policy and, equally important, as a matter of administrative convenience.

1. **Travel intermediaries generally do not provide hotel accommodations.** While the facts of particular arrangements between travel intermediaries and hotel operators may vary, it is plain as a matter of common understanding that travel intermediaries generally do not provide hotel accommodations. They neither own nor operate hotels, and their function, to wit, facilitating consumers' booking of hotel accommodations, is distinct from the provision of the hotel lodging itself. Because sales taxation should reflect taxpayers' "common understanding" of the transactions in which they engage,[4] sales tax policy supports the view that the travel intermediaries' margin should be taxed as a service discrete from the provision of hotel accommodations.

2. **Both proposals recognize that travel intermediaries generally do not provide hotel accommodations.** Point 1 is reinforced by the fact that both proposals explicitly differentiate the travel intermediaries' services (and the margin associated with them) from the provision of hotel accommodations (and the receipts associated with them). If these services were truly part of an inextricable component of the provision of "hotel accommodations," there would be little reason to recognize these services (and the receipts associated with them) as separate items.

3. **Consumption should be taxed where it occurs, and there is at least as strong a case for taxing travel intermediaries' services at the customer's location as taxing them at the location of the hotel.** As a matter of consumption tax policy, it is

[3] My analysis of those issues is set forth in *id.* ¶ 19.03[6][b] (3d ed. 2008 & Cum. Supp. 2009).

[4] See Hellerstein & Hellerstein, *supra* note 2, at ¶ 12.08[2] (3d ed. 1999 & Cum. Supp. 2009) (advocating "common understanding" test for distinguishing between sales of tangible personal property and sales of services for sales tax purposes). I believe the same analysis applies to distinguishing between sales of hotel accommodations and sales of arranging for hotel accommodations.

generally recognized that consumption should be taxed where consumption occurs.[5] There is at least as strong a case for saying that a consumer enjoys the benefit of travel intermediaries' services at his or her location from which the hotel booking is made (or deemed to be made) as there is for saying he or she enjoys such services at the location of the hotel where he or she stays. While the consumer surely enjoys some portion of the travel intermediary's services at the location where he or she actually occupies the hotel room that was booked through the travel intermediary, the consumer enjoys some (if not more) of those services at his or her principal location where the travel intermediary has saved him or her the time of searching for and booking the appropriate hotel accommodation at the best possible rate.

4. **Legislatures should determine the rates at which consumers pay sales taxes based on their judgment as to the appropriate rate for the transaction that is being taxed.** It is no secret that states and localities often impose sales and accommodations taxes on hotel rooms at rates that are higher than those attributable to most other sales that are taxable under state and local sales taxes. This memorandum does not address the question whether the effort of states and localities to tax consumption of those who are only temporarily within their borders represents sound tax policy. It does, however, strongly recommend that legislatures determine the rate at which they impose taxes on services provided by travel intermediaries independently of their determination of the rates imposed on hotel accommodations. If legislatures choose to extend their sales tax to services provided by travel intermediaries, they then need to decide whether the rate of such tax should be that applicable to most other sales of goods and services in the jurisdiction or to those subject to unusually high rates, e.g., hotel accommodations and massage parlors. The MTC proposal for taxing travel intermediaries' services as an integral part of the charge for hotel accommodations obscures this important tax rate issue, which legislatures should address in a transparent and independent fashion.

5. **The industry proposal reflects the rules of the Streamlined Sales and Use Tax Agreement.** The so-called "sourcing rules" of the Streamlined Sales and Use Tax Agreement (SSUTA)[6] reinforce the case for the industry proposal. Under SSUTA's sourcing rules, which apply to all "products" (which include both goods and services), the sale is generally sourced to the purchaser's address, unless the purchaser "receives" the "product" at some other identifiable location.[7] Although the concept of a receipt of a service – "making first use of services"[8] – is not a model of clarity, a strong argument can

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[5] Organisation for Economic Cooperation and Development, *Taxation and Electronic Commerce: Implementing the Ottawa Framework Conditions* 18 (2001). Although American retail sales and accommodations taxes are not ideal consumption taxes, it is reasonable, at least as applied to business-to-consumer transactions that constitute the lion's share of travel intermediaries' services, to characterize and analyze such taxes as consumption taxes.

[6] See generally Walter Hellerstein & John Swain, *Streamlined Sales and Use Tax* ch. 6 (2008/2009 ed.); Hellerstein & Hellerstein, *supra* note 2, at ¶ 19A.06 (3d ed. 2008 & Cum. Supp. 2009).

[7] SSUTA § 310.

[8] SSUTA § 311(B).

be made that a consumer makes the "first use" of a travel intermediary's service when he or she enjoys the value of the time saved by the travel intermediary's facilitation of his or her hotel booking. This "first use" would normally be at the customer's location rather than at the location of the hotel. Moreover, if the place of first use cannot be determined, as arguably it cannot be in a typical travel intermediary transaction, the SSUTA sourcing rule indisputably attributes the sale to the purchaser's address.[9]

6. **Administrative considerations strongly support the case for the industry proposal.** Perhaps more important than any of the preceding points is that administrative considerations strongly support the case for the industry proposal. Taxation, after all, is essentially a practical exercise, and administrability is one of the signal characteristics of a good tax.[10] Although an ideal consumption tax would tax consumption wherever it occurs, in the real world of tax administration we need serviceable proxies for consumption to determine the appropriate location of taxation. Assuming that "actual" consumption of a travel intermediary's services in facilitating hotel accommodations occurs in part at the customer's location and in part at the hotel (as suggested in paragraph 3 above), administrative concerns should inform the choice between them. For a travel intermediary, whose taxable receipts under both proposals constitute only the margin, a rule that limits its tax collection and reporting responsibilities to that item at the customer's billing address seems considerably less cumbersome than requiring it to undertake, in addition, the obligation (normally imposed on the hotel operator) to collect tax on the charge for the accommodations itself. Moreover, this burden is exacerbated by forcing the travel intermediary to become familiar with literally thousands of local ordinances imposing hotel accommodations taxes. Under the industry proposal, this issue does not arise because the obligation for complying with local hotel accommodations is imposed on the hotel operator, which is presumably familiar with such local taxes.[11]

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[9] SSUTA §§ 310(A)(3), 310(A)(4).

[10] See, e.g., OECD, *supra* note 5, at 10.

[11] In my treatise, in offering a "normative" approach to the issue addressed in this memorandum, see Hellerstein & Hellerstein, *supra* note 2, at ¶ 19.03[6][d] (3d ed. 2008), I suggested a "practical approach" (*id.*) to taxing the travel intermediaries' margin that neither the MTC nor the industry proposal has embraced, namely, requiring the hotel operator to add a presumed markup to the travel intermediary's price, and collect tax on the marked-up price, subject to the hotel's establishment of an actual markup that is different. This would remove the travel intermediary from the tax collection process altogether and was addressed to the concern that there might otherwise be constitutional problems with asserting tax collection nexus over out-of-state travel intermediaries. See *id.* ¶ 19.03[6][c] (3d ed. 2008). However, for reasons suggested above, my "practical" proposal is less defensible as a matter of tax policy (as distinguished from administrative concerns). Indeed, I specifically noted, that "tax equity does not support the relatively high hotel rates that are often charged as a means to export taxes to nonresident travelers." *Id.* 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.

EXHIBIT A

MODEL STATUTE ON THE TAX COLLECTION RESPONSIBILITIES OF ACCOMMODATIONS INTERMEDIARIES

DRAFT 5/7/09—Referred to Public Hearing

MTC Executive Committee

1. Definitions.—

(a) "Accommodations" means one or more individual sleeping rooms or suites for transient overnight lodging.

(b) "Accommodations provider" means any person or entity that furnishes accommodations for periods of [less than thirty days ***alternative language*** thirty days or less] to the general public for compensation. The term "furnishes" includes the sale of use or possession, or the sale of the right to use or possess.

(c) "Accommodations intermediary" means any person or entity, other than an accommodations provider, that facilitates the sale of an accommodation and charges a room charge to the customer. For purposes of this definition, the term "facilitates the sale" includes brokering, coordinating, or in any other way arranging for the purchase of, or the right to use accommodations by a customer.

(d) "Accommodations fee" means the room charge less the discount room charge, if any, provided that for purposes of this Act the accommodations fee shall not be less than zero.

(e) "Room charge" means the full retail price charged to the customer for the use of the accommodations, including any accommodations fee before taxes.

(f) "Discount room charge" means the amount charged by the accommodations provider to the accommodations intermediary for furnishing accommodation.

(g) "Unrelated accommodations intermediary" means an accommodations intermediary that is not part of a controlled group of corporations, as defined in I.R.C. Section 1563(a), that includes the accommodations provider.

2. Collection and Remittance.—

(a) An accommodations intermediary shall be responsible for the collection of tax imposed by [cite to applicable code section(s)] on the room charge

but shall not be required to separately state on the invoice the specific amount of taxes collected.

(b) An accommodations intermediary shall remit to the accommodations provider the tax collected on the discount room charge.

(c) An accommodations intermediary shall remit to the [state or local tax agency] the tax(es) collected on the accommodations fee.

(d) An accommodations provider shall collect and remit to the [state or local tax agency] the tax(es) imposed on the discount room charge.

3. Safe Harbor.—

(a) No assessment shall be made against an accommodations intermediary on the basis of an incorrect remittance of tax on the room charge if the tax rate applied to the room charge by an accommodations intermediary in collecting and remitting such tax is identical to the rate applied to the discount room charge by the accommodations provider.

(b) No assessment shall be made against an accommodations provider on the basis of an incorrect remittance of tax on the accommodations fee by an unrelated accommodations intermediary.

Optional:

Example:

Accommodations Provider (Provider) furnishes a one night accommodation to a guest who booked the accommodations through Accommodations Intermediary (Intermediary). The Provider bills the Intermediary for a discount room charge of $80.00. The price at which the Intermediary facilitates the sale of a one-night accommodations to the customer is $100.00, which includes a $20.00 accommodations fee. The 5% tax applied to the discount room charge is $4.00 and applied to the accommodation fee is $1.00. The total price charged to the customer, including tax, is $105.00, which is the sum of the discount room charge, the accommodations fee and the $5.00 tax ($100 room charge + [5% tax rate x $100.00 room charge] = $105.00 price to customer).

Intermediary remits $4.00 tax (5% tax rate x $80.00 discount room charge) to the Provider and a $1.00 tax (5% tax rate x $20.00 accommodations fee) to [the state or local tax agency]. Provider remits the $4.00 tax to the [state or local tax agency].

$80.00		Discount room charge
$20.00		Accommodations fee
	$100.00	Room charge
$4.00		Tax on discount room charge remitted by intermediary to provider, and by provider to [state or local government] = (5% x $80.00)
$1.00		Tax on accommodations fee remitted by intermediary to [state or local government] = (5% x $20.00)
	$5.00	Total tax on room charge
$105.00		Price to customer including tax charged by Provider and Intermediary

EXHIBIT B

Model State Statute for Tax on Travel Intermediaries Facilitation Fees

DRAFT—FOR DISCUSSION PURPOSES ONLY

1. Definitions.—

(a) A "travel intermediary" is defined as an entity that acts independently of hotel operators, and who facilitates the reservation of hotel rooms without acquiring ownership or possessory interest in the hotel rooms.

(b) A "hotel operator" is defined as a person or entity that operates a hotel, motel, inn, bed and breakfast, tourist camp, or other similar facility housing transients by:

(i) Owning a hotel or managing the day-to-day operations of the hotel, and

(ii) Physically furnishing hotel accommodations to the general public.

(c) A "facilitation fee" is defined as the charge for the service of facilitating hotel room reservations by a travel intermediary for any room, lodging, or accommodation furnished to transients by any hotel, inn, tourist court, tourist camp, tourist cabin, motel, or any similar facility in which rooms, lodgings or accommodations are furnished to transients. A facilitation fee shall not include any amount required to be paid by the travel intermediary to the hotel operator in furnishing accommodations.

2. Imposition of Tax.—

(a) For purposes of this Act, a facilitation fee charged by a travel intermediary for the facilitation of reservations shall be sourced to the location indicated by an address for the purchaser of the services that is available from the business records of the travel intermediary.

(b) The gross receipts from the facilitation fees subject to tax shall be that portion of the total charge to any customer of the travel intermediary that is retained by the travel intermediary.

(c) The rate of tax shall be __% of the gross receipts from the facilitation fees.

(d) The travel intermediary shall not be required to separately state or otherwise disclose the facilitation fee, or the amount of tax imposed on the facilitation fee, on any customer invoice or customer receipt so long as it can provide such information from its books and records to the [state taxing authority].

(e) The travel intermediary shall not be required to disclose to its customer the amount paid by the travel intermediary to the hotel operator, including any taxes charged by the hotel operator. The travel intermediary shall represent to its customer that the charge by the travel intermediary includes taxes charged by the hotel operator.

(f) A local jurisdiction may impose a gross receipts tax at a rate of up to ___% of the facilitation fee, but may not impose any other taxes on the facilitation fee. Except as to rate, any local tax existing as of the date of adoption of this section, or enacted after the date of adoption of this section, shall correspond to the provisions of this section.

11/13/06