IN THE SUPREME COURT OF THE STATE OF MONTANA
CASE NO.: DA 14-0260

MONTANA DEPARTMENT OF REVENUE,
Plaintiff/Appellant,

-vs-

PRICELINE.COM, INC.; TRAVEL WEB LLC; TRIP NETWORK, INC; ORBITZ LLC; EXPEDIA, INC.; TRAVELOCITY.COM, LP; HOTWIRE, INC.; SITE59.COM, LLC, AND DOES 1-1,000, INCLUSIVE,
Defendants/Appellees.

BRIEF OF MULTISTATE TAX COMMISSION AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFF/APPELLANT MONTANA DEPARTMENT OF REVENUE

On Appeal from the Montana First Judicial District Court,
Lewis and Clark County,
The Hon. Kathy Seeley Presiding

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INTEREST OF THE AMICUS

Amicus Curiae Multistate Tax Commission ("the Commission") submits this brief in support of the Plaintiff-Appellant, the Montana Department of Revenue ("the State"), in seeking a reversal of the holding of the First Judicial District Court of Lewis and Clark County that Montana's sales and use tax laws (§§ 15-68-101 *et seq*, MCA) did not apply to sales of hotel accommodations and leases of rental cars by the Defendants-Appellees, Priceline.com, *et. al.* ("the Defendants," or "the OTC's").

Although the exact basis for the district court's determination is uncertain, it appears the court concluded that Montana's sales and use tax does not apply to sellers where they do not "own" the underlying physical property being sold or leased to customers. If upheld by this Court, the conclusion that sellers could "unbundle" taxable transactions to avoid tax liability on part or all of a transaction would severely undermine Montana's sales and use tax, as it gives an unfair competitive advantage to sellers like the Defendants. Hotel and rental car owners would face competitive pressure to establish similar "independent" retailing/marketing entities in order to reduce their tax burdens, leading to erosion of the tax base and uncertainty in its application.

The Commission's interest in this case stems from its concern that a holding from this state's highest court affirming the district court could negatively affect the application of sales and use tax statutes in similar situations in other states. Montana's sales and use tax system, although limited in application to hotel accommodations and rental vehicles, employs the same structure and terminology as broadly-applicable sales and use tax statutes found in the great majority of states.

Sales and use taxes play such a significant role in the revenue systems of most states that even a single case suggesting uncertainty as to the obligation of retailers in collecting and remitting consumer-based taxes could have a significant national impact.[1] Retail sellers in many fields would be encouraged to make similar efforts to artificially separate consumer transactions into taxable and non-taxable components, increasing uncertainty and administrative costs by favoring some retailing models over others. This would also undermine the currently high degree of "horizontal equity" (similar treatment of similarly-situated parties and transactions) in sales tax systems. That equality of treatment is fundamental to the success of sales taxes in raising substantial tax revenue

[1] *See* Federation of Tax Administrators' publication, *2013 State Tax Collection by Source*, *available at* http://www.taxadmin.org/ftalrate/13taxdis.html. (last visited Sept. 25, 2014).

with minimal "distortion" of economic behavior.[2]

The Commission urges this Court to consider Montana's sales and use tax imposition in the context of established principles of transactional taxation which have evolved in the 45 states and the District of Columbia that impose such taxes. Those principles were not discussed by the lower court in its decision, which appeared to be based on a misapprehension of how transactional taxes function. A holding suggesting that vendors are liable for sales and use taxes only if they are the "owners" of the property or service being sold could undermine the application of transactional taxes to a variety of situations in which the vendor does not "own" the product it sells, including online "fulfillment" houses, auctioneers and direct marketers.

The lower court also determined that Montana's "accommodation charge," §§ 15-65-101 *et seq.*, MCA, imposed no collection and remittance burden on the Defendants by its terms, because they were neither "owners" nor "operators" of lodging facilities. *Decision*, pp. 9-11; § 15-65-101(1), MCA. That tax was enacted by the legislature in 1987, well before the OTC's business model was prevalent.[3] The Commission's brief does not address the question of whether "lodger's taxes" should encompass the activities of OTC's, the subject of dozens

[2] RICHARD D. POMP & OLIVER OLDMAN, STATE AND LOCAL TAXATION, §6-3 (5th Ed. 2005).
[3] Expedia suggests it pioneered the industry in 1996. *See* http://www.expediainc.com/about/history/ (last visited Oct. 11, 2014).

of reported court cases, many of which are explicated in the State's *Opening Brief.* The Commission can add little to that discussion. Further, it is the Commission's understanding that the issue of the Defendants' obligation to remit those taxes is intertwined with state-specific issues of conversion and breach of fiduciary duty based on the collection of amounts implicitly or explicitly designated as taxes, suggesting to consumers that their use tax obligation were satisfied. *See Complaint* at pp. 9, 17-18. Also, most states do not impose such taxes at a statewide level, and the resolution of "lodger's tax" coverage only indirectly implicates generally-applicable sales and use taxes.[4]

The Commission was established as in intergovernmental agency by the Multistate Tax Compact ("Compact"), which became effective in 1967. Sixteen states and the District of Columbia are signatories to the Compact, and another 31 states are associate or sovereignty members of the Commission. Montana was one of the earliest states to join the Compact in 1969 and has remained a member ever since. Laws 1969, Ch. 17, § 1, *codified at* § 15-1-601, MCA.

[4] The one area in which the dispute over the breadth of "lodger's taxes" does implicate the interpretation of sales and use taxes is the question of effectuating legislative intent. It would be illogical for the legislature to impose a fiduciary duty on hotel owners to collect tax from customers on the full value of such rentals, while imposing no such duty on vendors who collect receipts to provide the same property rights to their customers. A statute should be construed if possible to avoid absurd results, *MEA-MFT v. State,* 2014 MT 76, 374 Mont. 296, 323 P.3d 198. The district court's determination in this case would result in economically-indistinguishable transactions and activity receiving vastly different tax treatment, something the Montana legislature surely did not intend.

The Commission is charged with the duty of furthering the purposes of the Compact, which include: "facilit[ating the] proper determination of state and local tax liability for multistate taxpayers" and "promoting uniformity or compatibility with significant components of tax systems," as well as "facilitating taxpayer convenience and compliance" in tax administration. *Compact,* Art. I; § 15-1-601, MCA. The Commission has extensive experience in many facets of state transactional taxation, including conducting multistate sales and use tax audits for 28 states, developing model statutes and regulations with its member states, developing audit manuals, and issuing policy statements and guidelines. The Commission also submits briefs in state and federal courts as *amicus curiae* where, as here, the Commission believes a matter of legal interpretation regarding a common tax system could be of concern to its member states.

ARGUMENT
DEFENDANTS ARE "SELLERS" AND ACCORDINGLY RESPONSIBLE FOR SALES AND USE TAX COLLECTION AND REMITTANCE ON THE FULL RETAIL PRICE PAID BY THEIR CUSTOMERS

1. Introduction.

According to the record as referenced in the *Opening Brief* of the State,[5] the Defendants have acknowledged in various public documents that their

[5] The Commission understands that the cross-motions for summary judgment and much of the evidentiary record in this case have been placed under seal, presumably to protect the trade secrets of the Defendants. The Commission accordingly relies on the description of facts in the State's *Opening Brief* and in published decisions as the factual basis for its contentions.

standard business model consists of securing "options" to purchase the right to license the use of hotel rooms, then advertising those rooms for rent to the general public. *See Opening Brief,* pp. 20-21, and record citations found therein. When the customer agrees to purchase a room, the OTC exercises its option to purchase the room from the hotel, then sells its intangible rights to the room to the customer over its websites, charging the customer's credit card for the full amount of the retail price. *Id.* In a typical transaction, the customer has no further contact with the hotel until check-in, and any refunds or adjustments for cancellations must be undertaken with the OTC, not the hotel. *Id.* This is the so-called "merchant model" which the Commission understands the OTC's use in the majority of sales and is the model addressed in this brief.

The "merchant model" and other types of transactions undertaken by the OTC's are described in detail in a recent decision of the Wyoming Supreme Court involving many of the same parties as the Defendants herein. *See Travelocity.com, L.P. v. Wyoming Department of Revenue*, 329 P.3d 131, 136-8 (Wyo. 2014). The Wyoming court addressed the application of that state's very similar sales and use tax structure to the "merchant model" in a comprehensive decision which held that the OTC's were liable for sales and use taxes on the entire retail amount charged to their customers. The Commission believes the reasoning of the Wyoming court, as further discussed below, should guide this

Court's determination as to the application of Montana's sales and use taxes to sales of hotel accommodations.

The State has also sought to hold the OTC's liable for unremitted taxes on in-state vehicle rentals. According to the State's *Opening Brief,* the OTC's have admitted that they use the "merchant model" for at least some of their transactions, in which the consumer pays the OTC for the rental car at the time the reservation is made. See *Opening Brief*, pp. 21-22.[6] The Commission contends that the Defendants are liable for sales and use taxes for transactions undertaken using the "merchant model," but the Commission lacks sufficient information to address the OTC's potential liability for other types of rental car transactions.

2. *This Court Should Interpret Montana's Sales and Use Tax Statutes in Accordance with Established Principles of Transactional Taxation.*

In this case of first impression applying Montana's 2003 sales and use tax law to sellers of hotel accommodations and car rentals, this Court should be guided by the understanding that the Montana legislature deliberately patterned

[6] The website of one Defendant, Priceline.com, Inc., also suggests that the merchant model is used for that entity's "Name Your Price" sales program where the customer's credit card is charged for the rental amount at the time of booking. http://www.priceline.com/privacypolicy/terms_en.html?jsk=464a200a554a200a201410132157131ae021630939&plf=PCLN&refid=PLMSN&refclickid=D:cBrand10776609040389237406 0&irefid=HPRCMATRIXBID&irefclickid=BIDBOX (last visited Oct. 12, 2014).

its laws on the transactional tax statutes commonly employed in other jurisdictions, thereby taking advantage of those states' long experience in drafting, administering and interpreting their laws. These lessons are reflected in the every one of the provisions of §§ 15-68-101 *et seq.*, MCA.

a. Sales and Use Taxes Are Imposed on the Total Retail Sales Price Paid by the Ultimate Consumer, and Not on Intermediary (Wholesale) Sales to the Retailer.

Transactional taxes have some common "core" characteristics, borne of the states' need to ensure certainty, practicality and efficiency. First among these characteristics is the imposition of the tax rate on the entire retail amount paid by the consumer, with systems of deductions or exemptions for intermediate sales to prevent tax pyramiding. *See generally, Tax Management Multistate Tax Portfolios, Sales and Use Taxes: General Principles*, p. 1300.01.D (BNA 1994); RICHARD D. POMP & OLIVER OLDMAN, STATE AND LOCAL TAXATION, §§ 6-1 through 6-6 (5th Ed. 2005); *See also Central Hardware Co. v. Director of Revenue,* 887 S.W.2d 593 (Mo. 1994) (Sales price included total amount paid by consumer, even though vendor received lesser amount from credit card companies after deduction of "merchant discount fees."). Montana's sales and use tax reflects these characteristics: the legal incidence of the tax is imposed on the consumer, § 15-68-102(2), MCA, but it must be collected and paid over by the

seller. *Id.* The tax is imposed on the total retail price paid by the ultimate consumer. § 15-68-101(14)(a), MCA.

b. *The Collection Burden is on the Seller, not Intermediate Parties.*

A second characteristic of sales and use taxes is that regardless of whether the legal incidence of taxation is imposed on the consumer or in the vendor, the collection burden is imposed on the vendor. The policy reasons behind this requirement are self-evident: the vendor maintains control over all aspects of the transaction and most importantly, the vendor has control over the money and thus the opportunity to collect tax in full. *See, e.g., Fridlund Securities Co. v. Minnesota Commissioner of Revenue,* 430 N.W.2d. 154 (Minn. 1988)(holding that precious metal dealer should be considered a "seller" liable for sales tax because dealer received payments from customers). Montana's sales and use tax laws explicitly follow these rules, placing the tax collection and remittance burden on the "seller", § 15-68-110(1), MCA, requiring the seller to separately state the tax amount on all invoices, §15-68-106, MCA, and providing that the amounts "required to be collected" as well as those amounts actually collected as tax constitute a debt owed to the state. § 15-68-110(4), MCA.

Taxation of intermediary sales would present administrative and enforcement problems for the taxing jurisdiction. It would be unrealistic to impose the primary collection and remittance burden on the intermediary since it

may not know where a product or service is ultimately sold, nor for how much. Wholesale prices may be considered trade secrets, while retail prices are advertised to the public. In the present case, it would be difficult for local hotels and those auditing them to know how much was actually charged for a room sold by the OTC's, and it would be inefficient to collect tax on the retail amount where the customer has already paid the OTC for her room.

c. All Sales by Persons "Engaging in Business" Are Presumed to the Subject to Tax.

The third pillar of sales and use tax systems is the presumption of taxability imposed on all vendors. The purpose of this provision is spelled out in the statute itself:

> (1) In order to prevent evasion of sales tax or use tax and to aid in its administration, it is presumed that (a) all sales by a person engaging in business are subject to the sales tax or use tax.

§ 15-68-103, MCA.

In some states, the presumption applies to the sale of tangible personal property by a retailer and its subsequent taxable use. *See, e.g.,* IDAHO CODE ANN. § 63-3621 (Idaho: presumption that property sold for taxable use); WIS. STAT. ANN. 70.109 (Wisconsin); 61 PA. CODE § 32.3(b) (Pennsylvania); OKLA. ADMIN. CODE 710:65–7–6 (1997) (Oklahoma). Other states, including Montana, have

adopted an even broader presumption of taxability, which attaches to all gross receipts of those engaged in business. § 15-68-103(1), MCA; CAL. REV. & TAX CODE § 6091 (California); MICH. COMP. LAWS ANN. 205.93 (Michigan); N.J. STAT. ANN. 54:32B–12(b) (New Jersey); N.M. STAT. ANN. 1978, § 7-9-5 (New Mexico).

In Montana, "engaging in business" is defined as "...carrying on or causing to be carried on any activity with the purpose of receiving direct or indirect benefit." § 15-68-101(5), MSA. It does not appear that the Defendants contest that they are "engaging in business" in Montana. A similar argument by some OTC's was rejected by the South Carolina Supreme Court in *Travelscape v. Department of Revenue,* 705 S.E.2d 28, 35-36 (S.C. 2011). The OTC's are engaged in profit-making activity by selling property interests in the state, holding themselves out as "sellers" of property interests in hotel rooms and rental cars.

The presumption of taxability not only puts the burden of proof on the seller to show that its sales are not taxable, it also constitutes a statutory basis for the well-recognized legal proposition that exemptions and deductions from tax impositions are to be strictly construed in favor of taxation. As the New Mexico Court of Appeals wrote in construing that state's identical language establishing a presumption that all receipts of anyone engaged in business are taxable, "[t]hus,

taxation is the rule and the claimant must show that his demand is within the letter as well as the spirit of the law." *Security Escrow Corp. v. State ex rel. Taxation & Revenue Dep't,* 760 P.2d 1306, 1309 (N.M. Ct. App. 1988).

Other states have adopted what amounts to a presumption of taxability when a "taxable category" of sales is involved, separate from the statutory presumption as to the taxability of all receipts of those engaged in business. Thus, in *North Cent. Washington Respiratory Care Svcs., Inc. v. State,* 268 P.3d 972, 979 (Wash. Ct. App. 2011), the Court of Appeals wrote:

> We must construe tax law exemptions narrowly: Taxation is the rule and exemption is the exception; and anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it.

In *Catholic Health Initiatives v. City of Pueblo*, 207 P.3d 812, 817-8 (Co. 2009), the Colorado Supreme Court described that state's common-law presumption of taxability as follows:

> As a general rule, "the presumption is against tax exemption and the burden is on the one claiming exemption to establish clearly the right to such relief." [citation omitted] "Every reasonable doubt should be resolved against" the tax exemption. [citation omitted].

Accord, Montana Stockgrowers Ass'n v. State Dep't of Revenue (1989), 238 Mont. 113, 777 P.2d 285, 291 (ambiguous deductions and exemptions construed

narrowly in favor of taxation).

The district court did not acknowledge that the OTC's were "sellers" engaging in business in Montana, and so failed to apply the presumption of taxability. The court's decision also did not consider the policy undergirding the imposition of tax on retail sellers on the full sales price in order to prevent the very sort of "unbundling" seen in this case. Although this is a case of first impression in Montana, this is not the first time these issues have arisen elsewhere.

3. The District Court Failed to Recognize That Sales and Use Taxes Are Imposed on Taxable Transactions, Not Activities.

Montana's sales and use tax is a *transactional* tax—it is imposed on a seller entering into a particular type of transaction. *See* § 15-68-101(14)(a), MCA: "'Sales price' applies to the measure subject to tax." The tax is not imposed on the *activity* of operating a hotel. Therefore, the district court had no basis to create an exception for activities unrelated to hotel services. The nature and the policies of transactional taxation foreclose creation of a judicial exception to Montana's tax imposition for the "services of intermediaries," *Decision,* p. 12, an exception drawn from whole cloth.

The district court apparently based its decision on the conclusion that, because the OTC's were not "owners" of the property interests being sold, the OTC's should be deemed to be engaged in providing a "marketing service" for

the owners of the property, and "sellers of services" (other than "hotel services") are not a taxed under § 15-68-102, MCA. *Id.*

The OTC's are not "intermediaries" between buyers and sellers. They buy property interests in hotel rooms and re-sell them at a mark-up. The district court did not describe how it reached its implicit conclusion that the OTC's, who offer property for sale to others and transfer their property interests in that property for consideration, failed to meet the definition of "sellers" found in § 15-68-101(16), MCA. *Id.* at 12-13. That subsection defines a seller as: "a person that makes sales, leases or rentals of personal property or services." A "sale" is defined in the same statute as "the transfer of property for consideration or the performance of a service for consideration." § 15-68-102(13), MCA.

There is no statutory requirement that a seller must "own" property at the time of sale in order to transfer it for consideration. The activities of the Defendants-Appellees in this case do not differ significantly from that of any retailer offering products from multiple manufacturers or suppliers in its showroom. The states' sales and use tax systems would soon unravel if, for instance, an appliance retailer could avoid tax by arguing that because it did not have a particular appliance in its inventory at the time of sale, it was providing a separate merchandising "service" to the manufacturer by taking orders.

The OTC's may have argued below, as they have in other cases, that the

property rights they sell are somehow different from the property rights a hotel sells to its customers. The Wyoming Supreme Court easily rejected this argument as being a distinction without a difference. *Travelocity.com, L.P. v. Wyoming Department of Revenue*, 329 P.3d 131, 140-144 (Wyo. 2014);[7] *See also Travelscape LLC v. South Carolina Department of Revenue*, 705 S.E.2d 28, 37, fn. 8 (S.C. 2011)(OTC's are "sellers" of hotel rooms within meaning of statute identical to § 15-68-101(16), MCA). It is no different than the retailer in the example above suggesting that it was not truly selling a washing machine, but only the *right* to receive a washing machine from the manufacturer at a future date.[8] It is a legal truism that all property ownership consists of a "bundle of rights." *Kafka v. Mont. Dep't of Fish, Wildlife and Parks*, 2008 MT 460, 348 Mont. 80, 112, 201 P.3d 8, 31. Regardless of whether a customer purchases a hotel accommodation directly from a local hotel or from an OTC, she is receiving no more than a conditional license to the quiet enjoyment and occupancy of a room in that hotel. Montana has chosen to impose an obligation to collect and remit tax upon sellers engaging in transactions creating that limited license.

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[7] The court wrote: "[E]ven though the OTCs do not physically assign rooms and hand out keys, they contract with the hotels that do, and they have authority to rent those rooms at a price they establish. As we have already noted, the Wyoming sales tax statute applies to 'the sales price paid' for lodging services." 329 P.3d at 143.

[8] *Cf., Circuit City Stores, Inc. v. Commissioner of Revenue,* 790 N.E.2d 636, 641 (Ma. 2003)(Vendor liable for sales and use tax where customers ordered and paid for purchases in store but drove to neighboring state to take delivery from affiliated store.).