DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron Mary Margaret Whipple

2. Bill Number SB 972

House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

3. Committee House Finance

4. Title Retail Sales and Use Tax; Transient Occupancy Tax; Room Rentals

Second House:
__X__ **In Committee**
_____ **Substitute**
_____ **Enrolled**

5. Summary/Purpose:

This bill would expand the application of the Retail Sales and Use Tax regarding hotels, motels, and other accommodations to impose the tax on the total price paid by the ultimate consumer for the use or possession of the room or space occupied, and would outline the procedures for payment of the applicable taxes on these charges. This bill would also amend Virginia's nexus statute to deem an accommodations intermediary that facilitates the sale of an accommodation to be a "dealer," thus requiring that business to register to collect the Retail Sales and Use Tax. The bill would also make similar changes with respect to local transient occupancy taxes. Finally, the bill would require that TAX develop guidelines no later than August 1, 2011 that provide processes and procedures for collecting and remitting retail sales and use and local transient occupancy taxes on the full retail price charged to the customer by the accommodations intermediary.

Under current law, the Retail Sales and Use Tax is imposed on the gross proceeds derived from the charge for transient accommodations made by the entity providing the accommodations. Third parties who facilitate these transactions are not liable to collect the tax on any price mark-up and other charges and fees they may charge in connection with the provision of these services.

The provisions of this bill relating to the imposition of the tax would take effect on January 1, 2012. The provisions of this bill mandating that TAX develop guidelines would take effect on January 1, 2011.

6. Budget amendment necessary: Yes.
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7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

7b. Revenue Impact:

Fiscal Year	*Dollars*	*Fund*
2011-12	$ .63 million	GF
	$ .09 million	TTF
	$1.20 million	Local
	$1.92 million	Total

2012-13	$1.56 million	GF
	$ .23 million	TTF
	$2.97 million	Local
	$4.76 million	Total
2013-14	$1.61 million	GF
	$ .24 million	TTF
	$3.06 million	Local
	$4.91 million	Total
2014-15	$1.66 million	GF
	$ .24 million	TTF
	$3.16 million	Local
	$5.06 million	Total
2015-16	$1.71 million	GF
	$ .25 million	TTF
	$3.26 million	Local
	$5.22 million	Total
2016-17	$1.76 million	GF
	$ .26 million	TTF
	$3.36 million	Local
	$5.38 million	Total

8. Fiscal implications:

Administrative Costs

TAX considers implementation of this bill as "routine" and does not require additional funding.

Revenue Impact

There are approximately 233 online travel companies ("OTC's") doing business in the United States. Sales transacted through OTC's make up approximately 10.3% of all hotel transactions in Virginia. The difference between the price the accommodations providers charge the OTC's and the final price the OTC's charge consumers has been estimated to fall between 25 and 40%. Assuming a retail mark-up of 32.5%, if the amount retained by OTC's were subject to tax effective January 1, 2012, and assuming substantial compliance with this change by accommodation providers, this bill would result in a total state and local estimated revenue gain of $1.92 million in Fiscal Year 2012, $4.76 million in Fiscal Year 2013, $4.91 million in Fiscal Year 2014, $5.06 million in Fiscal Year 2015, $5.22 million in Fiscal Year 2016, and $5.38 million in Fiscal Year 2017. This estimate includes revenues from the state and local Retail Sales and Use Tax and the local transient occupancy taxes. TAX has not factored in any potential revenue loss resulting from OTC's that boycott a state or locality as a result of legislation imposing the tax on the mark-up fees.

9. Specific agency or political subdivisions affected:

TAX
All counties, cities, and towns

10. Technical amendment necessary: No.

11. Other comments:

Retail Sales and Use Tax

Under current law, the Retail Sales and Use Tax applies to the sale or charge for any room or rooms, lodgings, or accommodations furnished to transients by any hotel, motel, inn, tourist cabin, camping grounds, club or other similar place. Any additional charges made in connection with the rental of a room or other lodging or accommodations are deemed to be a part of the charge for the room and are also subject to the tax. This includes additional charges for pay-per view movies, television, and video games, local telephone calls and similar services. Internet Access Services and toll charges for long-distance telephone calls furnished in connection with the accommodation are not subject to the tax; however, any mark-up made by the accommodations provider over the cost of the long-distance phone charge is taxable.

Third party intermediaries often enter into contracts with accommodation providers to allow guests to reserve accommodations online through the intermediary. These intermediaries often have no physical presence in the state of Virginia. Under agreements with the accommodations providers, the third party intermediaries generally collect the total amount that the accommodations provider charges for the use and possession of the room plus any related fees from the customer, as well as a separate service charge for services provided by the intermediary.

In October of 2006, TAX issued a ruling addressing whether the service charges imposed upon the customer by these third party intermediaries, were subject to the Retail Sales and Use Tax. The Tax Commissioner determined that the imposition language in the statute specifically enumerated the entities whose fees and charges would be subject to the Retail Sales and Use Tax. The statute defines “retail sale” to specifically include

> [T]he sale or charges for any room or rooms, lodgings, or accommodations furnished to transients for less than 90 continuous days by any hotel, motel, inn, tourist camp, tourist cabin, camping grounds, club, or any other place in which rooms, lodging, space or accommodations are regularly furnished to transients for a consideration (Emphasis added).

Because the third party intermediaries were not among the list of entities specifically enumerated in the statute whose charges were subject to tax, the Tax Commissioner ruled that the service charges imposed by these intermediaries were exempt of the Retail Sales and Use Tax. Thus, the Retail Sales and Use Tax and the local Transient Occupancy Taxes do not apply to the service charges imposed by third party intermediaries.

Local Transient Occupancy Taxes

Under current law, any county may impose a transient occupancy tax at a maximum rate of two percent, upon the adoption of an ordinance, on hotels, motels, boarding houses, travel campgrounds, and other facilities offering guest rooms. Some counties have received statutory authorization to impose the tax at higher rates. Cities and towns are not limited in the rate of the transient occupancy tax they may impose. The tax, however, does not apply to rooms rented on a continuous basis by the same individual or group for 30 or more continuous days. The tax applies to rooms intended or suitable for dwelling and sleeping. Therefore, the tax does not apply to such rooms used for alternative purposes, such as banquet rooms and meeting rooms.

Constitutional Nexus

Because most online travel companies do not have physical places of business in Virginia, this raises the issue as to whether it is constitutionally permissible for Virginia to require these nonresident entities to collect Virginia's Retail Sales and Use Tax.

The Commerce Clause of the U.S. Constitution reserves to Congress the power to regulate commerce among the states and with foreign nations. The U.S. Supreme Court has established a four-prong test to be used in determining whether a state tax on an out-of-state corporation's activities in interstate commerce violates the Commerce Clause. A state may require an entity engaged in interstate commerce to collect taxes on its behalf provided the tax is 1) applied to an activity with a substantial nexus with the taxing State; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The U.S. Supreme Court has also determined, in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) that the Commerce Clause barred a state from requiring an out-of-state mail-order company to collect use tax on goods sold to customers located within the state when the company had no outlets, sales representatives, or significant property in the state. In this case, the Court determined that only Congress has the authority to require out-of-state vendors, without a physical presence in a state, to register and collect that state's tax.

Virginia law specifically sets out the standards for requiring out-of-state dealers to collect the Virginia Retail Sales and Use Tax on sales into the Commonwealth. The law provides that a dealer is deemed to have sufficient activity within the Commonwealth to require that dealer to register to collect the Virginia Retail Sales and Use Tax if the dealer:

- Maintains an office, warehouse, or place of business in the Commonwealth;
- Solicits business in the Commonwealth, by employees, independent contractors, agents or other representatives;
- Advertises in Commonwealth publications, on billboards or posters located in the Commonwealth, or through materials distributed in the Commonwealth;
- Regularly makes deliveries into the Commonwealth by means other than common carrier;

- Continuously, regularly, seasonally, or systematically solicits business in the Commonwealth through broadcast advertising;
- Solicits business in the Commonwealth by mail, provided the solicitations are continuous, regular, seasonal, or systematic and the dealer benefits from any banking, financing, debt collection, or marketing activities occurring in the Commonwealth;
- Is owned or controlled by the same interests which own or control a business located within this Commonwealth;
- Has a franchisee or licensee operating under the same trade name in the Commonwealth, if the franchisee or licensee is required to obtain a certificate of registration; or
- Owns tangible personal property that is rented or leased to a consumer in the Commonwealth, or offers tangible personal property, on approval, to consumers in the Commonwealth.

Some of the litigation that has arisen, seeking to determine the taxability of mark-up fees imposed by online travel companies has addressed the issue of nexus as it relates to these third party intermediaries. In *City of Charleston v. Hotels.com*, 586 F. Supp. 2d 538 (April, 2008), the United States District Court of South Carolina indicated that "proactively market[ing], book[ing], and leas[ing] hotel rooms and other accommodations" is sufficient to provide both a substantial nexus and a physical presence between the taxing jurisdictions and the out-of-state travel companies. Similarly, in *Expedia Inc. v. City of Columbus*, 285 Ga. 684, 681 S.E. 2d 122 (June, 2009), the Georgia Supreme Court ruled that, because Expedia had voluntarily contracted with accommodations providers in Georgia to collect taxes, it rendered itself accountable to the City's tax authorities for remission of taxes collected. The United States Supreme Court has not ruled on this issue.

Other States

Currently, only two states have enacted legislation providing that the additional amount imposed by the online travel companies is subject to sales or occupancy tax.

North Carolina: In 2010, North Carolina incorporated language into its budget indicating that facilitation and similar types of fees are considered charges necessary to complete the rental of the accommodation, and are included in the sales price. The budget bill further provides that persons authorized to facilitate the rental of an accommodation are included under the definition of a retailer. The budget further requires the third party intermediary to report the sales price to the accommodations provider, who is liable for the tax. If the third party intermediary fails to report the sales price to the provider or understates the sales price reported, the intermediary becomes liable for tax due on the unreported or underreported sales price. North Carolina has anticipated that this change will increase revenues by $1.7 million.

New York: On August 11, 2010, the state of New York's 2010-2011 revenue budget was approved, which contained provisions requiring that room remarketers charge and collect sales tax on the mark-up fees. The budget defines "room remarketer" as a person who reserves, arranges for, conveys, or furnishes occupancy, whether directly or indirectly, to

an occupant for rent in an amount determined by the room remarketer, directly or indirectly, whether pursuant to a written or other agreement. The legislation also amends New York City's locally-administered hotel room occupancy tax so that it conforms to the methodology of the state tax with respect to room remarketers. The legislation took effect on September 1, 2010 and is expected to increase revenues by $20 million.

Bills introduced in Florida, Minnesota, and Missouri during their 2010 legislative sessions to impose tax on these fees ultimately failed.

Study

During the 2010 Virginia legislative session, three bills were introduced that would require online travel companies to compute sales and use taxes and transient occupancy taxes on the total price paid for the use or possession of the accommodation. Senate Bill 452 passed the Senate unanimously, before being carried over by the House Finance Committee until the 2011 legislative session. The Chairman of the House Finance Committee directed TAX to form a working group to study the implications of enacting the legislation.

TAX worked closely with representatives from the hospitality industry, local government, and online travel companies to determine the implications of enacting the bill and the impact the bill would have on accommodations patrons, accommodations providers, and online travel companies. The report, entitled, "Study on the Feasibility of Implementing Senate Bill 452" was completed and issued to the Chairman of the House Finance Committee on December 2, 2010.

Proposal

Generally

This bill would expand the application of the Retail Sales and Use Tax regarding hotels, motels, and other accommodations to authorize the imposition of the tax on the price mark-up and other charges and fees imposed by a third party intermediary. The bill would also outline the procedures for payment of the applicable taxes on these charges. The bill would also specify that, with respect to local transient occupancy taxes, the tax is imposed on the total price paid by the ultimate consumer for the use or possession of the room or space occupied.

Nexus Statute

This bill would amend Virginia's nexus statute to include among those who are deemed dealers, an accommodations intermediary facilitating the sale of an accommodation located in Virginia, and to include among the list of activities that are sufficient to require a dealer to register in Virginia, regularly facilitating the sale of an accommodation located in Virginia. As a result, accommodations intermediaries that facilitate the sale of an accommodation located in Virginia would be deemed dealers under Virginia law and would be required to register to collect the Retail Sales and Use Tax.

Potential Charges and Definitions

Under the terms of this bill, there are two parties that could potentially be required to collect the Retail Sales and Use Tax on the charges associated with the purchase of an accommodation. An "accommodations provider" would be defined as any person that furnishes accommodations to the general public for compensation. An "accommodations intermediary" would be defined as any person other than an accommodations provider that facilitates the sale of an accommodation, acts as the merchant of record, charges a room charge to the customer, and charges an accommodations fee to the consumer, which fee it retains as compensation for facilitating the sale. "Facilitating the sale" would include brokering, coordinating, or in any other way arranging for the purchase of or the right to use accommodations by a customer.

Under the terms of this bill, the total price paid by the purchaser of accommodations would be broken down into several different charges. "Room charge" would be defined as the full retail price charged to the customer by the accommodations intermediary for the use of the accommodations, including any accommodations fee before taxes. The room charge would be determined in accordance with TAX's administrative regulation pertaining to hotels, motels, etc., and related TAX rulings. A "discount room charge" would be defined as the full amount charged by the accommodations provider to the accommodations intermediary (or an affiliate thereof) for furnishing the accommodations. An "accommodations fee" would be defined as the room charge less the discount room charge, if any, provided that the accommodations fee shall not be less than $0.

Procedure for Accommodations Provider

This bill would provide that when a taxable sale of accommodations is made by an accommodations provider to a customer, and no third party intermediary facilitates the transaction, the accommodations provider would be liable for and required to collect the Retail Sales and Use Tax, computed on the total charges for the accommodations, and remit it to TAX.

Under the terms of this bill, if a third party intermediary facilitates the sale, the accommodations provider would be required to collect from the intermediary the sales and use taxes computed on the discount room charge, and would need to remit those taxes to TAX. In addition, the accommodations provider would be liable for retail sales and use taxes on charges made by the accommodations provider that are in addition to the discount room charge, such as room service.

Procedure for Accommodations Intermediary

This bill would provide that whenever an accommodations intermediary facilitates the sale, it would be required to separately state the amount of the tax on the bill, invoice, or similar documentation, and would need to add the tax to the room charge. The bill would also provide that if the accommodations intermediary facilitates the sale, the intermediary would be required to remit the portion of the taxes relating to the accommodations fee directly to TAX, and the portion of the taxes relating to the discount room charge to the accommodations provider. The accommodations intermediary would not be liable for sales and use taxes relating to the discount room charge that it remits to the accommodations provider, but that the accommodations provider fails to remit to TAX.

Each of the procedures relating to the imposition, collection, and remittance of taxes, as set forth above, would also apply to any local transient occupancy taxes imposed, except that the parties would be required to remit such taxes to the local taxing authority, rather than to TAX.

Guidelines and Rules

This bill would also require that TAX develop and make guidelines available by August 1, 2011 which set forth the processes and procedures to implement the provisions of this bill. The guidelines would need to include provisions and procedures under which an accommodations intermediary is required to elect either TAX or the accommodations provider as the entity to which it will remit the retail sales and use taxes and transient occupancy taxes relating to its accommodations fees.

The bill would also require that TAX maintain a current table indicating the rate of the local transient occupancy tax imposed by each county, city and town of Virginia on its website, and would require each locality that imposes a transient occupancy tax to provide written notice to TAX within seven days of making a change to its transient occupancy tax rate.

The provisions of this bill relating to the imposition of the tax would take effect on January 1, 2012. The provisions of this bill mandating that TAX develop guidelines would take effect on January 1, 2011.

Similar Bills

Senate Bill 1431 would treat the retail sale of motor vehicle tires by out-of-state dealers who provide for the installation of such tires within Virginia under an installation agreement with a third party as an activity sufficient to require the dealer to register to collect the Retail Sales and Use Tax, and would impose the tire recycling fee on these dealers.

cc : Secretary of Finance

Date: 2/10/2011 KP
DLAS File Name: SB972FE161.doc