



JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2011 Session

Bill Number: SB 972
Review Requested By: Senator Colgan

JLARC Staff Fiscal Estimates

JLARC staff concur with the Department of Taxation's estimate that SB 972 may generate at least \$4.22 million in new State and local revenue in FY 2012. The State General Fund would receive at least \$1.38 million of this amount.

The two key questions behind the estimate are the percentage of hotel bookings made through Online Travel Companies (OTCs) and the markup charged by the OTCs. JLARC staff identified several estimates of hotel bookings attributable to OTCs ranging from 11.1 percent of all hotel bookings (based on the findings from a market research firm) to 21 percent (based on hotel industry literature). Predicting OTCs' share of hotel bookings has a great deal of uncertainty. In past years, online bookings and OTCs have revolutionized the travel industry, and in recent years the OTCs' share of hotel bookings appears to have increased substantially, although there is also some discussion in the industry that OTC bookings may decline as hotel websites become more popular, allowing customers to book directly with hotels. Thus, the rate at which OTC bookings will continue to increase is subject to speculation.

The bill would apply the State sales tax and local transient occupancy taxes to the markup used by OTCs. Estimates of this markup range from 20 to 40 percent, although there is also speculation about this.

While JLARC staff's estimate of State and local revenues ranges from \$7.25 million to \$10.56 million, it may be prudent to use a more conservative estimate, such as that from the Department of Taxation given the uncertainties associated with current hotel bookings estimates. Revenue estimates by JLARC staff and the Department of Taxation are both below the Arlington County Treasurer's Office estimate of \$28.17 million in total revenue, which was prepared using higher assumptions about OTCs' share of hotel bookings.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:



Glen S. Tittermary
Director

Bill Summary

Online Travel Companies (OTCs) buy hotel rooms at a discounted (wholesale) rate from the hotels, remit State sales tax and local transient occupancy tax on the wholesale price to the hotel (which gets passed on to State and local governments), mark up the price of the hotel rooms to the final customers, and currently do not pay any taxes on the markup. SB 972 would mandate that OTCs separately state and collect Retail Sales and Use tax and local occupancy taxes on this wholesale-to-retail differential that is charged to final customers.

Discussion of Fiscal Implications

JLARC staff estimated the additional tax revenues that could be generated by SB 972 in the four steps outlined below. Results were then compared to the Tax Department's estimates and to an estimate produced by staff in the Arlington County Treasurer's Office.

Step1: Determine hotel room rental gross receipts that are attributable to the hotels themselves and to OTCs (nationally).

According to the market research firm PhoCusWright, Inc.'s annual report "U.S. Online Travel Overview," U.S. hotels in 2007 directly received \$94.8 billion in room bookings nationally. OTCs received \$11.8 billion from hotel bookings, including both recovery of the wholesale room costs and the OTCs' markups. These numbers result in an assumption that 11.1 percent of hotel sales go through OTCs.

Step2: Estimate Virginia's share of the gross receipts.

The gross receipts were assigned to Virginia in proportion to Virginia's share of sales receipts reported for hotels and motels in the U.S. Census Bureau's Economic Census from the year 2007. The reported sales derive from North American Industry Classification System (NAICS) codes 72111 (hotels and motels except casino hotels) 72112 (casino hotels). But the sales figures from these two types of hotels include receipts associated with restaurants, banquet room rental, and other services, not just sleeping room rentals to which the relevant hotel taxes apply. However, a different 2007 Economic Census publication for NAICS Code 72 provide data on a national level on the share of hotel revenues attributable to sleeping rooms alone. These shares were estimated separately for regular hotels (74.9 percent) and casino hotels (11.3 percent), and were assumed to apply to all states including Virginia.

Virginia's share was calculated from the 2007 Economic Census data (in \$ millions) as:

$$\frac{\text{Estimated sleeping room sales in Virginia}}{\text{Estimated sleeping room sales in U.S.}} = \frac{(3,687 \times .749) + (0 \times .113)}{(122,141 \times .749) + (51,785 \times 0.113)} = 0.0284$$

As a result, in 2007 hotel bookings in Virginia directly by hotels was estimated to be \$2,692.32 million, and by OTCs to be \$335.12 million under the assumption that 11.1 percent of hotel bookings are through OTCs.

Step 3: Estimate the amount of markup the OTCs charge.

According to Beth Anne Stanford in "State and Local Efforts to Collect Additional Tax on Hotel Rooms Booked Online" in the January 31, 2005 issue of *State Tax Notes*: "In the last several years, the final selling price of merchant model rooms [i.e., rooms booked through OTCs] has averaged approximately 25 percent to 40 percent above the net rate amount paid to hotel operators." Therefore, about 20 to 28.6 percent of OTCs' receipts are attributable to markup. Under the 11.1 percent assumption, these percentages would mean OTCs' markups would be \$67.02 to \$95.75 million in Virginia.

Step 4: Apply the sales tax rate and the effective local occupancy tax rate to the estimated OTC markup.

Assuming OTC share is 11.1 percent

Sales tax of 5 percent applied to markup: **\$3.35 to 4.79 million.**

Breakdown of sales tax revenues:

General Fund:	\$1.51 to 2.15 million
K-12 Education:	0.84 to 1.20 million
Transportation Trust Fund	0.34 to 0.48 million
Local Option	0.67 to 0.96 million

Effective local occupancy tax (of 5.82 percent) applied to markup: **\$3.90 to \$5.57 million.**

The effective local occupancy tax rate was calculated by (dollar amounts in \$ millions):

$$\begin{aligned} \text{Statewide local hotel and motel room tax revenues} &= \underline{\$176.308^*} \\ \text{Hotel \& OTC gross receipts from hotel bookings} &= \$2,692.32 + \$335.12 \text{ (or } \$2,121.61 + \$905.83) \\ &= .0582 \end{aligned}$$

*from Auditor of Public Accounts, *2007 Comparative Report of Local Government*, Exhibit B2.

Comparison of JLARC Staff Estimates to Others' Estimates

The estimated revenue impact of SB 972 depends heavily on what proportion of hotel bookings are assumed to be made through OTCs. There is some evidence that OTC bookings are increasing, although there is also some discussion in the industry that, as hotel websites gain in popularity, the share of OTC bookings may decline in the future.

Given these uncertainties, JLARC staff suggest using lower, more conservative estimates. Under the 11.1 percent assumption, the JLARC staff estimated total State and local revenue in the range of \$7.25 million to \$10.36 million (see table, next page). The Department of Taxation staff's estimate, based on a 10.3 percent assumption, was \$4.22 million in total revenue. Although the JLARC staff estimate is somewhat more than the Department of Taxation's estimate, both estimates are below the estimate prepared by the Arlington County Treasurer's Office. Based on industry estimates, the county staff used an assumption that 30 percent of hotel bookings are through OTCs. This assumption led to an estimate that the bill could generate \$28.17 million in combined State and local revenue. While JLARC staff's estimate of State and local revenues ranges from \$7.25 million to \$10.56 million, it may be prudent to use a more conservative estimate given the uncertainties associated with current hotel bookings estimates.

Budget Amendment Necessary: No

Agencies Affected: Department of Taxation

Date Released, Prepared By: 01/27/2011; Greg Rest, Walt Smiley.

Estimates of Impacts of Taxing Markup of OTCs' Hotel Room Sales, FY 2012
(\$ in millions)

	JLARC Staff (from 2007 data) Assuming 11.1 Percent OTC Bookings	Dept. of Taxation
Sales and Use Tax Revenues on Markup	\$3.35 to \$4.79	\$1.99
General Fund	1.51 to 2.15	1.38
K-12 Education	0.84 to 1.20	
Transportation Trust Fund	0.34 to 0.48	0.20
Local Option	0.67 to 0.96	0.40
Local Occupancy Tax Revenues on Markup	3.90 to 5.57	2.23
Total State and Local Tax Revenue from Markup	\$7.25 to \$10.36	\$4.22