

# DEPARTMENT OF TAXATION

## 2015 Fiscal Impact Statement

1. **Patron** Adam P. Ebbin

3. **Committee** Senate Finance

4. **Title** Retail Sales and Use Tax and Transient  
Occupancy Tax; Rooms Rented Through  
Third Parties

2. **Bill Number** SB 1210

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would expand the application of the Retail Sales and Use Tax and local occupancy taxes when hotels, motels, and other accommodations are rented through third party intermediaries. The bill would 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 make similar changes with respect to local transient occupancy taxes. The bill would also require that the Department develop guidelines 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. Finally, the bill would mandate that the Department maintain a current table on its website that indicates the rate of the local transient occupancy tax imposed by each locality in Virginia. Localities that change the rate of their local transient occupancy tax would be required to provide written notice to the Tax Commissioner of the adjusted rate within seven days.

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 that facilitate these transactions are not liable to collect the tax on any price mark-up or fees they may charge in connection with the provision of these services.

The effective date of this bill is not specified.

**This is a Secretary of Finance Bill.**

6. **Budget amendment necessary:** Yes

Page 1, Revenue Estimates

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

## 8. Fiscal implications:

### Administrative Costs

The Department 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 12.1% 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 July 1, 2015, and assuming substantial compliance with this change by accommodation providers, this bill would result in a total state and local estimated revenue gain of \$5.98 million in Fiscal Year 2016, \$6.74 million in Fiscal Year 2017, \$6.97 million in Fiscal Year 2018, \$7.20 million in Fiscal Year 2019, \$7.41 million in Fiscal Year 2020 and \$7.63 million in Fiscal Year 2021. This revenue estimate includes revenues from the state and local Retail Sales and Use Tax and local transient occupancy taxes.

The Introduced Executive Budget assumes the General Fund increase of Retail Sales and Use Tax revenues of approximately \$1.72 million beginning in Fiscal Year 2016. As the Introduced Executive Budget assumes the fiscal impact of this bill, a budget amendment would be necessary if the bill is not enacted.

### State and Local Revenue Impact

	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Aggregate	\$5.98	\$6.74	\$6.97	\$7.20	\$7.41	\$7.63
Local Transient Occupancy	\$3.06	\$3.45	\$3.57	\$3.69	\$3.80	\$3.91
<i>Sales and Use Tax</i>	\$2.93	\$3.30	\$3.41	\$3.53	\$3.63	\$3.73
<b>Total Sales and Use Tax</b>	<b>\$2.92</b>	<b>\$3.29</b>	<b>\$3.40</b>	<b>\$3.52</b>	<b>\$3.62</b>	<b>\$3.72</b>
<i>General Fund-Unrestricted</i>	\$1.15	\$1.28	\$1.32	\$1.36	\$1.40	\$1.44
<i>General Fund-Restricted</i>	\$0.58	\$0.65	\$0.67	\$0.69	\$0.71	\$0.73
<i>Transportation Trust Fund</i>	\$0.26	\$0.29	\$0.30	\$0.31	\$0.32	\$0.33
<i>Local Option</i>	\$0.52	\$0.58	\$0.60	\$0.62	\$0.64	\$0.66
<i>Dealer Discount</i>	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
<i>HMOF GF Transfer</i>	\$0.08	\$0.10	\$0.11	\$0.11	\$0.11	\$0.12
<i>HMOF</i>	\$0.09	\$0.10	\$0.11	\$0.11	\$0.11	\$0.12
<i>IPROCF</i>	\$0.03	\$0.03	\$0.03	\$0.03	\$0.03	\$0.03
<i>Mass Transit Fund</i>	\$0.04	\$0.04	\$0.05	\$0.05	\$0.05	\$0.05
<i>HRTPO and NVTAFund</i>	\$0.19	\$0.22	\$0.22	\$0.23	\$0.24	\$0.24
	<b>FY 2016</b>	<b>FY 2017</b>	<b>FY 2018</b>	<b>FY 2019</b>	<b>FY 2020</b>	<b>FY 2021</b>
State Impact	\$2.40	\$2.71	\$2.80	\$2.89	\$2.98	\$3.06
Local Impact (Transient Occupancy + Local Option)	\$3.58	\$4.03	\$4.17	\$4.31	\$4.44	\$4.57
<b>Aggregate</b>	<b>\$5.98</b>	<b>\$6.74</b>	<b>\$6.97</b>	<b>\$7.20</b>	<b>\$7.41</b>	<b>\$7.63</b>
<b>Total General Fund</b>	<b>\$1.72</b>	<b>\$1.92</b>	<b>\$1.99</b>	<b>\$2.06</b>	<b>\$2.12</b>	<b>\$2.18</b>

**9. Specific agency or political subdivisions affected:**

Department of Taxation  
All localities

**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, lodging, 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.

OTC's often enter into contracts with accommodation providers to allow guests to reserve accommodations using their online websites. These companies often have no offices, warehouses or other physical locations in the state of Virginia. Under agreements with the accommodations providers, OTC's 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 the services they provide.

In October of 2006, the Department issued a ruling addressing whether a third-party intermediary's mark-up charges 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 bundled into the total charge paid by the taxpayer.

## 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 OTC's do not have physical offices or headquarters 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: 1) is 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 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 broadcasting 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.

Various courts have addressed the issue of nexus as it relates to OTC's. For example, in *City of Charleston v. Hotels.com*, 586 F. Supp. 2d 538 (April 2008), the United States District Court of South Carolina opined that "proactively market[ing], book[ing], and lease[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 Court Cases

State and local governments across the country have been involved in litigation with OTC's to determine how these transactions should be taxed. In most cases, the courts have ruled in favor of the OTC's, based upon the imposition language in the statute or ordinance. Courts in Illinois, New York, South Carolina, Wyoming and D.C., however, have held that OTC's must collect the tax on the full retail rate charged the customer.

Two notable cases are pending in Hawaii and California. In *Travelocity.com, LP v. Director of Taxation*, the Tax Appeal Court granted summary judgment to the state finding the companies failed to pay Hawaii's general excise tax between 2000 and 2011, and imposing a \$247 million award for unpaid taxes, penalties and interest. Both parties are appealing in the Hawaii Supreme Court. *In re Transient Occupancy Tax Cases* is in the California Supreme Court and will address the City of San Diego's appeal of the appellate court's ruling that OTC's were not liable for unpaid hotel occupancy taxes due to the language of the ordinance in question. Since several California jurisdictions use the same language, this decision will have a large impact on the state.

### Statutes in Other States/Jurisdictions

**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. Under the budget provisions, the third party intermediary must 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 estimated that this change would 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.

**District of Columbia:** The District of Columbia's ordinance provides that when the occupancy of a room or rooms, lodgings, or accommodations is reserved, booked, or otherwise arranged for by a room remarketer, the tax applies to both the net charges and additional charges received by the room remarketer.

**Oregon:** Legislation that took effect in October, 2013, requires transient lodging providers and facilitating intermediaries to collect and remit transient lodging taxes computed on total retail prices, including all charges other than taxes. Oregon does not impose a sales and use tax.

**Minnesota:** In 2012, Minnesota enacted legislation imposing the sales tax on accommodations intermediary services provided in connection with lodging and requiring accommodations intermediaries to collect sales tax and remit it to the Commissioner of Revenue for services provided in connection with or for lodging located in Minnesota.

**Missouri:** In 2010, Missouri enacted legislation prohibiting the imposition of taxes upon charges or fees that are not received by a hotel or similar entity's "operator." The 2010 legislation specifically excludes travel agents and intermediaries from this classification.

## Proposal

### ***Generally***

This bill would expand the application of the retail sales and use tax and local transient occupancy taxes 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 an OTC. The bill would also outline the procedures for payment of the applicable taxes on these charges.

## ***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 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 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. This definition would apply to the hotels, motels, and similar facilities. 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 the Department's administrative regulation pertaining to hotels, motels, etc., and related Departmental 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***

Under the terms of this bill, if a third party intermediary facilitates the taxable sale or rental of an accommodations, 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 the Department. 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***

The 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. In addition, the bill would require the accommodations intermediary that facilitates the sale to remit the portion of the taxes relating to the accommodations fee directly to the Department, 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 the Department.

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 the Department.

### ***Guidelines and Rules***

This bill would also require that the Department develop and make guidelines available which set forth the processes and procedures to implement the provisions of this bill.

The bill would also require that the Department 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 the Department within seven days of making a change to its transient occupancy tax rate.

The effective date of this bill is not specified.

cc : Secretary of Finance

Date: 1/25/2015 KP  
DLAS File Name:SB1210F161