

CITY OF MADISON
OFFICE OF THE CITY ATTORNEY
Room 401, CCB
266-4511

DATE: February 27, 2006

OPINION #06-001

TO: **Ald. Zach Brandon, District 7**

FROM: Michael P. May, City Attorney
 Andrew Jones, Assistant City Attorney

SUBJECT: **Madison's Room Tax as Applied to Internet Room Providers**

You have asked my opinion as to whether the City of Madison's room tax, set forth in sec. 4.21, Madison General Ordinances (MGO), could be applied to internet hotel room providers. Your question came up due to recent lawsuits by cities such as Los Angeles, Philadelphia and Fairview Heights, Illinois, against certain members of the Interactive Travel Services Association (ITSA) for unpaid tax liability. These lawsuits contend that additional room tax is due to municipalities for the fees charged by members of ITSA such as Travelocity, Expedia, Orbitz and Priceline.

As is set forth in more detail below, it is my opinion that the City has a strong argument that additional room taxes are due on the rooms furnished by these providers.

Issue Presented

Is the City of Madison entitled to additional room tax revenues because of the fees charged by internet travel service companies?

Short Answer

While there is no precedent directly on point, it is our opinion that the City has a relatively strong argument that such fees should be included in calculating the room tax. Therefore, additional tax revenues are due the City. The internet travel companies will resist payment of the tax, and have countervailing arguments to support their position. The outcome of a lawsuit is difficult to predict in this legal environment. The City should examine carefully the pursuit of these additional revenues through a lawsuit.

Relevant Statute and Ordinance

Sec. 66.0615(1m)(a), Wis. Stats., provides in part:

The governing body of a municipality may enact an ordinance ... imposing a tax on the privilege of furnishing, at retail, except sales for resale, rooms or lodging to transients by hotelkeepers, motel operators and other persons furnishing accommodations that are available to the public

Sec. 4.21(2), Madison General Ordinances, provides in part:

Pursuant to Wisconsin Statutes, sec. 66.0615, a tax is hereby imposed tax on the privilege and service of furnishing, at retail, except sales for resale, rooms or lodging to transients by hotelkeepers, motel operators and other persons furnishing accommodations that are available to the public Beginning January 1, 1996, such tax shall be at the rate of eight percent (8%) of the gross receipts from such retail furnishing or rooms or lodgings.

Discussion

A. Background: Transaction Mechanism for Internet Travel Companies

Internet travel companies such as Priceline, Travelocity, Expedia, and other members of the ITSA characterize their business as intermediaries between hotel and guest. Their standard business practice involves entering into an agreement with a hotel owner in which the hotel agrees to provide a room at a certain price, the “negotiated rate”¹ or “net-rate”. The internet company then advertises the room online at a rate higher than the negotiated rate (“full rate”), to include the fees to be collected by the internet travel company (ITC), and related taxes. Once a customer purchases the room through the ITC, the customer makes payment to the ITC, which in turn remits payment to the hotel less the company’s fee for the transaction.

The ITCs maintain that “the vast majority” of online travel companies do not purchase the rooms from the hotel. They are not responsible for purchasing the rooms at a set price if the ITC is unable to find a buyer. The ITCs maintain that they simply market the room at the full rate, find a buyer for the room, and submit payment to the hotelier for the net-rate, along with applicable state and local taxes on the net-rate. The ITC does not provide an itemized breakdown of the taxes and fees, stating only that room tax is included in this amount passed on to the hotel. The dispute arises because the room tax is calculated using the net-rate that the Internet company pays to the hotel, rather than the full rate received by the ITC.

¹ From the Interactive Travel Service Association’s website
http://www.interactivetravel.org/attachments/How_Online_Travel_Companies_do_Business.pdf

A sample hypothetical calculation would be as follows: Hotel A normally retails a room to a customer for \$150, calculating the room tax due under sec. 4.21(2), MGO, of 8% and passing this \$12 room tax onto the consumer as a portion of the cost. The ITC contracts with Hotel A for the right to sell the room at a discounted rate of \$80 (the net-rate). The ITC then advertises the room for \$80 plus unidentified “taxes and fees” of (in this example) \$30.40, and finds a customer willing to purchase the room for \$110.40 (the full rate). The non-itemized “taxes and fees” include state sales tax (assume 5% in this example), room tax (assume 8% in this example), and the fee collected by the ITC for facilitating the transaction (assume \$20 in this example). The customer tenders payment to the online company of \$110.40, which in turn sends Hotel A the net-rate (\$80), along with the taxes for the transaction, based on the \$80 net-rate (\$6.40 in room tax and \$4.00 in sales tax).

The ITC’s position that it does not sell or supply the room is critical in determining the applicability of the room tax to their profit margin. The company’s fee for their service is added onto the discounted rate. We have assumed that the company assesses a \$20 transaction fee on the sample room, bringing the total non-tax amount paid by the consumer \$100, with the hotel receiving \$80 and the ITC receiving \$20.

The ITSA companies argue that because they are not hotel owners/operators and do not sell the room, only the \$80 should be utilized and the applicable taxes are 5% sales tax (\$4.00) and 8% room tax (\$6.40). The view taken by municipalities that have filed suit is that the applicable room tax should be \$8, calculated from the \$100 total gross payment to the ITC company for the room. The City of Fairview Heights in Illinois has filed suit against the internet travel providers based upon this example, alleging a deficit of \$1.60 in unpaid room tax in the example transaction.² Similar lawsuits have been filed by the City of Los Angeles and the City of Philadelphia. The Illinois suit was brought as a class action on behalf of similarly situated Illinois municipalities.

As will be discussed further below, the position taken by the ITCs impacts not only the municipal room tax, but the state sales tax. The Wisconsin Department of Revenue (DOR) takes the position that the ITCs should pay sales tax on the full rate.

B. Legal Standard

The Wisconsin Statutes provide the City of Madison the authority to enact an ordinance establishing a room tax on receipts taken in by hotelkeepers, motel operators, and “other persons furnishing accommodations made available to the public.” Sec. 66.0615(1m)(a), Wis. Stats. Pursuant to this authority, Sec. 4.21, MGO, provides that the tax is imposed on “the privilege and service of furnishing, at retail, except sales for resale, rooms or lodging to transients by hotelkeepers, motel operators and other persons furnishing accommodations that are available to public...such tax shall be at the rate of 8% of the gross receipts from such retail furnishing of rooms or lodgings.” Sec. 4.21(2), MGO.

² A copy of the complaint for City of Fairview Heights v. Orbitz, Inc. *et al* is available if you want to review it. We did not obtain copies of the Philadelphia or Los Angeles suits.

In a taxation case, any ambiguity within a taxation statute is to be resolved in the favor of a taxpayer. G&G Trucking, Inc. v. Wisconsin Department of Revenue, 267 Wis.2d 847, 855, 672 N.W.2d 80, 85 (Ct. App 2003), citing DOR v. Horne Directory, Inc., 105 Wis.2d 52, 57, 312 N.W.2d 820 (1981). The Wisconsin Supreme Court has held that a municipality may utilize gross receipts to calculate the applicable tax to be assessed for the sale of the room. Blue Top Motel, Inc. v. City of Stevens Point, 107 Wis.2d 392, 395, 320 N.W.2d 172, 174 (1982). “Gross receipts” are defined statutorily as “the total amount of the sale, lease, or rental price, as the case may be, from sales at retail of tangible personal property, or taxable services.” Wis. Stat. §77.51(4)(a). Blue Top noted the similarities between the state sales tax statute and the hotel tax statute in that they both were taxes “upon the privilege of furnishing at retail”, and the most equitable method for calculating the tax amount would be based upon the gross receipts for the transaction. Blue Top, 107 Wis.2d at 395-396, 320 N.W.2d at 173-174.

Sec. 4.21, MGO, places the tax upon the gross receipts taken in for the furnishing at retail of the hotel room. The ITCs surely are making sales at retail, rather than “sales for resale” in the language of the state statute and the Madison ordinance. The ITCs have taken steps to hold themselves out as independent brokers that are not in the business of reselling hotel rooms. Based on the ITSA’s characterization of its member companies, the exception for sales at resale are not applicable to the ITSA’s transaction. They are selling their service at retail; thus the issue becomes whether the ITCs qualify as “hotelkeepers, motel operators [or] other persons furnishing accommodations that are available to the public” within the meaning of MGO 4.21(2).

C. Are the ITCs “other persons furnishing accommodations” under Sec. 4.21, MGO, and Sec. 66.0615, Wis. Stats. ?

1. Cases and Arguments Supporting Imposition of the Tax.

Courts have not provided a definition of “other persons furnishing accommodations” in the context of room tax assessment. The Court of Appeals considered the issue with respect to the state sales tax as applied to individuals furnishing time-share properties in the future pursuant to Sec. 77.52(2)(a)(1), Wis. Stats. Telemark Development, Inc. v. Department of Revenue, 218 Wis.2d 809, 815, 581 N.W.2d 585, 587 (Ct. App. 1998). The court held “persons furnishing accommodations” to include a developer providing condominium properties, pointing out that the furnishing of lodging is the sale of a service akin to admission to entertainment or recreational events. Telemark, 218 Wis.2d at 822, 581 N.W.2d at 590.

In reaching this decision, the court pointed towards the language of Sec. 77.52(2)(a)(1), Wis. Stats., which at the time included language that specifically addressed time-share properties. Id. at 815-816, 587. Though the statutory language in Telemark specifically mentioned the class of defendants, the court still noted in a footnote that “furnish” was not so restrictive as to exclude a certain type of sale, stating:

“Citing a law-dictionary definition of the phrase “to furnish” as “[t]o supply or provide in any way other than by sale,” Telemark next argues that, as a result, the “furnishing” of lodging cannot include a sale. We are not persuaded. We note that

other "services" taxed by § 77.52(2)(a), Stats., include "[t]he sale of admissions to . . . entertainment or recreational events," as well as "[t]he sale of "telecommunications, cable television and landscaping services. Section 77.52(2)(a)2, 5, 12 and 20 (emphasis added)." *Id.* at 822-823, 590.

This language from Telemark arguably suggests "other persons furnishing accommodations" is to be read expansively, rather than as restricting the scope of the statute to specifically enumerated groups such as hotelkeepers. Further, it demonstrates that the provision of a service regarding accommodation is still a sale for purposes of taxation. The Telemark case is the sole Wisconsin case that addresses the definition of "persons furnishing accommodations" and it does not consider the definition within the scope of a local room tax or a third party marketer/facilitator such as an internet travel company. However, reading Telemark and Blue Top together shows that the courts will look to the nearly identical language in the state sales tax when interpreting the local room tax provisions. Wisconsin courts have long held that similar provisions in taxing statutes are *in pari materia*, and thus are to be given similar meanings. Pulsfus Poultry Farms, Inc. v. Town of Leeds, 149 Wis. 2d 797, 804, 440 N.W. 2d 329 (1989); Miller v. Wisconsin Department of Revenue, 238 Wis. 287, 290, 299 N.W. 28, appeal dismissed, 314 U.S. 581 (1941).

There are no Wisconsin cases or statutes that provide a specific definition of "persons furnishing accommodations". Webster's Collegiate Dictionary-10th Edition dictionary defines furnish as "1. To provide with what is needed; 2. Supply, Give." A suit against Orbitz, *et. al.* would turn upon the interpretation of "furnish" and whether the internet company's role in the transaction amounts to supplying the hotel room to the consumer.

"Other persons furnishing accommodations" arguably includes the action by the ITCs in soliciting customers on behalf of the hotel, securing a purchaser for a room at a given hotel, collecting money from the consumer, and then remitting payment to the hotel operator less the ITC's service fee. The transaction would not have taken place but for the ITC's active participation in bringing the customer to the hotel operator. The ITC is therefore a necessary actor in the transaction and has provided the access to the room for the consumer.

At the moment the consumer purchases the room online, the ITC is the only entity controlling the transaction. The company is binding the hotel to provide a contingent right of lodging to the consumer, and thus is furnishing the room for the net rate plus the service fee. As such, that amount received by the internet company is the amount that should be considered gross receipts for purposes of calculating the room tax. Blue Top clearly reiterates that the gross receipts to be used in calculating the applicable room tax, and sec. 77.52(4)(a)(1), Wis. Stats., provides gross receipts to be "the total amount of the sale, lease, or rental price". When the consumer purchases the room through Orbitz or another online company, they do so for the net rate plus the service fee. This should be the total amount of the sale for calculating the room tax. The agreement between hotel and the online company creates the authority for the company to actively furnish the room to the consumer, and the consumer's out of pocket cost for the entire service should be the amount for calculating the room tax.

The Telemark case arguably suggests that "furnish" should be interpreted broadly to

encompass the ITSA members. The action by the online companies is a service akin to the Telemark service and thus they would fall within the “persons furnishing accommodations”. Just as a time-share provider’s business constitutes a sale at retail, an online travel company’s service in providing access to a discounted hotel room may constitute “furnishing” of the accommodation.

The consumer is paying the ITC for a contingent right of occupancy of a hotel room. The consumer is not expected to make separate payments to the hotel for the room and the internet company for their service. From the perspective of the consumer, the amount tendered to the ITC is for the right to use a room on a given night plus applicable taxes and fees. There is no distinction between the payment to the hotel and the ITC to the consumer. The consumer pays the ITC and is provided a room with no interaction with the hotelkeeper or operator. The nature of the transaction between Orbitz and an online consumer suggests that the internet company is the supplier of the room.

The privilege of furnishing the room is central to analysis the business model of the internet companies. As an example, a hotelkeeper that charges a fee to a customer for a late cancellation would still be required to pay the room tax upon the amount received, as the tax is assessed upon the privilege and service of furnishing the room. The fact that the customer does not physically use the room is immaterial; the tax is upon the service of providing the room for retail. Similarly, an internet travel company is receiving funds for the service of providing the consumer a contingent right to the room. The fact that the ITC does not physically provide or control the room should be of no consequence. It is the working arrangement between the hotel, online company, and consumer that demonstrates the service provided by the online company is supplying a hotel room to a transient guest. The online company’s role in the transaction is so integral as to make the internet company a “person furnishing” the room and thus subject to sec. 4.21, MGO.

By shifting the order of payment to the hotel, the ITSA companies are arguably incorrectly assessing gross receipts requirements in Blue Top. If the transaction were such that the transient guest paid the entire amount to the hotel operator and the hotel operator then remitted the service fee to the online company, sec. 4.21(2), MGO, would mandate the room tax be calculated on the lump sum paid by the transient to the hotel company pursuant to the statute and Blue Top, 107 Wis.2d at 395-396, 320 N.W.2d at 173-174. The shift in payment order by the online companies does not change the fundamental nature of the transaction; the customer is still paying \$100 for the privilege of using the room at a future date. The amount received by the ITSA and the hotel itself should be calculated at the total non-tax amount paid by the consumer and received by the companies involved in providing the room. The shifted order in payment is inconsequential. Gross receipts should be calculated using the total amount received by the selling parties in the hypothetical transaction.

2. *Cases and Arguments to be Made by the ITCs.*

ITSA will maintain that as an intermediary they are not the direct provider or supplier of the room and thus are not subject to the tax. They will characterize themselves as akin to a conventional travel agent. A travel agent books accommodations for travelers and receives a commission for this service from the hotels, but is not expected by state and local authorities to pay a room tax for their customer's stay. The online travel companies will argue that the order of the transaction is structured similarly to that of a conventional travel agent and thus their service fee is exempt from the room tax.

Because they do not purchase the room and do not exercise any authority over the room assignment or control of the actual hotel property, the online companies will argue they do not furnish any accommodations. The online travel operators will argue they fit neither within the category of hotelkeeper nor motel operator, and that there is no language in the ordinance or state statute that suggests they are "persons furnishing accommodations." Further, the Telemark case is distinguishable on the grounds that the case deals with the assessment of sales tax and that the time-share sellers were specifically included in the taxation statute.

A court case out of Arkansas regarding a similar room tax is illustrative of the uncertainty on the subject of third party intermediaries and room tax liability. Leathers v. Active Realty, Inc., 876 S.W.2d 583 (1994). Active Realty's business was management of rental properties, including properties rented for nightly or weekly stays. Active Realty, 876 S.W.2d at 583-584. The company did not own any of the rental properties, but did receive a fee for management of the properties and weekly linen and cleaning services. Id. The Arkansas room tax statute at the time did provide a tax on gross receipts for "the service of furnishing guest rooms by hotels, motels, lodging houses, and tourist camps or courts to transient guests". Id. at 583.

The majority held that because the business type of Active Realty did not qualify as a taxable service under the room tax statute, stating "Had the legislature intended to impose a tax on entities such as appellee, it could have easily done so..." Id. at 584. The court made this decision based upon the lack of specific statutory language delineating a business model such as Active Realty to be subject to room tax. Id. A dissenting opinion looked at the matter as a tax imposed upon the service provided rather than the characterization of the business as a hotel, motel, or lodging house operation. Id. at 585. The dissent points out that Active Realty provides accommodations to transient guests who are "...the precise object at which this tax is aimed." Id.

The Arkansas case presents the same core issues as does the online travel companies business in Madison. The Active Realty decision demonstrates two plausible viewpoints to the issue. The focus may be upon the precise characterization of the business in question or may be upon the nature of the service provided. Arguably sec. 4.21, MGO, and sec. 66.0615, Wis. Stats., are better vehicles than the Arkansas room tax statute due to the "other persons furnishing accommodations" language. This language could be read to expand the businesses to which the room tax applies.

3. *Conclusion.*

There are significant problems with the arguments made by the ITCs. First, the core of the argument is that they are not hotelkeepers or motel operators. However, the tax is imposed on hotelkeepers, motel operators, and “other persons furnishing accommodations” The reading of the statute and ordinance by the ITCs would essentially read this last clause out of the law. A primary rule of construction is to give effect to each part of the statute, so that none of it is rendered surplusage. Blazekovic v. City of Milwaukee, 2000 WI 41, ¶ 30, 234 Wis. 2d 587, 610 N.W. 2d 467 (2000). Second, there is a key distinction between a travel agent who is paid a commission on a sale, and a fee charged up front as part of the hotel transaction. The person renting the room pays room tax on the entire amount of the hotel charge to the hotel in the prior circumstance. That the hotel may pay a fee back to the travel agent does not increase the cost to the consumer. That is not the case in payment of an upfront fee. And, as will be noted in the next section, the Wisconsin Department of Revenue thinks an agent charging a fee as part of a total transaction must pay the sales tax on the hotel portion of the charge.

I conclude that it is likely that the ITCs will be found to be “other persons furnishing accommodations” under the Madison room tax.

D. Position of the Wisconsin DOR on the Sales Tax

As was noted in the Blue Top and Telemark cases, the language in the Wisconsin sales tax statute (sec. 77.52(2)(a)1., Wis. Stats.) is nearly verbatim of the room tax statute (sec. 66.0615(1m)(a), Wis. Stats.). The sales tax statute imposes the 5% tax on “[t]he furnishing or rooms or lodging to transients by hotel-keepers, motel operators and other persons furnishing accommodations that are available to the public” (Emphasis added). In a recent article in the Wisconsin Tax Bulletin, the DOR stakes out its position that any agents charging for hotel rooms are to include the full rate charged, even if they have a lower net-rate agreement with the hotels.

In the February, 2006, Tax Bulletin, the DOR uses the example of a travel agent selling a “package deal” to a Packer football game for \$400. Although the agent only pays the hotel \$50 for the room, the agent must allocate a portion of its fee to the room and pay tax on that portion of its fee. See page 13 of the February Wisconsin Tax Bulletin, copy attached.

We understand that this is also the position of the Wisconsin DOR with respect to intermediaries such as internet travel sales companies. The DOR appears to adopt a logical and common sense approach to the issue by measuring the transaction from the consumer’s point of view. Whatever amount the consumer pays to obtain a hotel room, that same amount is a taxable receipt by some entity -- either the hotel or some “other person” has received that amount to furnish the room. The fact that the State agency charged with enforcing the similarly-worded state statute believes these companies must pay the sales tax is a strong suggestion that Madison should attempt to enforce its ordinance in the same way.

Conclusion

The law regarding room tax as applied to third party intermediaries suggests that these entities should be paying a tax on the full amount charged for providing a room. Nonetheless, the applicability of a room tax to online travel companies must overcome the legal presumption in favor of the potential taxpayer. Horne Directory, Inc., supra, 105 Wis.2d at 57, 312 N.W.2d 820 (1981). Although the language regarding “other persons furnishing accommodations” certainly appears to include the online companies, the lack of established law on the subject makes the outcome of a lawsuit uncertain. It is noteworthy that the Wisconsin DOR, in applying similar language in the state sales tax, takes the position that the ITCs should be taxed on the full amount charged for obtaining a hotel room.

If you have further questions, feel free to contact me.

Michael P. May
City Attorney

SYNOPSIS: Madison’s Room Tax ordinance, sec. 4.21, MGO, likely can be enforced against internet travel service companies who charge consumers an additional fee for purchasing hotel rooms in Madison. These companies likely will be found to be “other persons furnishing accommodations” within the ordinance.

cc: Mayor Dave Cieslewicz
All Alders

Travel Agents May Have Taxable Sales

Travel agents are liable for the reporting and payment of sales tax if they make sales of taxable property or services in Wisconsin. If a travel agent sells a package including both taxable and nontaxable items, the travel agent may make a reasonable allocation of its selling price to determine the tax due.

Example: Sale of a “Package Deal” Which Includes Ticket to Event, Meals, Lodging, and Transportation

- Individual A wants to attend a football game in Green Bay, Wisconsin.
- Individual A contacts Travel Agent B, located in Wisconsin, who is offering a “game day package” for \$400.
- The “game day package” includes one ticket to the game, meals at a restaurant, one night of lodging at a hotel, and transportation from the hotel to the game.
- Travel Agent B purchases the ticket to the game from Football Team C for \$75, the meals from Restaurant D for \$50, the lodging from Hotel E for

\$50, and the transportation to the game from Transporter F for \$25.

- Travel Agent B provides Football Team C, Restaurant D, and Hotel E with a properly completed exemption certificate claiming the resale exemption.

Allocation of Selling Price Among Items Included in Package

The \$400 selling price of the complete package should be allocated among the four items being sold as part of the package (i.e., the ticket to the game, meals, lodging, and transportation to the game).

One method of allocating the \$400 selling price is to determine the percentage cost of each of the components offered in the package to the total cost of all the components offered in the package and multiply that percentage times the \$400 package selling price.

Based on the facts in the above example, the percentage cost of each of the components in the package and the amount allocated to the selling price of the package would be as follows:

Item in Package	Cost of Item (A)	Total Cost of All Items in Package (B)	Percentage of Total Cost (A)/(B)	Amount of Selling Price of Package (\$400) Allocated to This Item
Ticket	\$75	\$200	37.5%	\$150
Meals	\$50	\$200	25%	\$100
Lodging	\$50	\$200	25%	\$100
Transportation	\$25	\$200	12.5%	\$50

That portion of the \$400 selling price of the package to Individual A which is allocated to the meals (\$100), lodging (\$100), and ticket (\$150) is subject to Wisconsin sales tax by Travel Agent B. That portion of the \$400 selling price which is allocated to transportation to the game (\$50) is not subject to Wisconsin sales tax.

In the above example, Travel Agent B would be required to charge Wisconsin sales or use tax on \$350 of the \$400 selling price of the game day package (i.e.,

\$100 lodging + \$150 ticket + \$100 meals). Travel Agent B may purchase the admission, meals, and lodging for resale and therefore is not required to pay the sales tax to the suppliers of these items. No sales or use tax would be due on the purchase or sale of the transportation service.

If you have any questions concerning the taxability of sales made by travel agents, please feel free to contact the Wisconsin Department of Revenue at (608) 266-2776 or by e-mail at sales10@dor.state.wi.us. 