



Sponsor Testimony
Representatives Dave Greenspan
House Bill 571

Chair Schaffer, Vice-Chair Scherer, Ranking Member Rogers and members of the House Ways and Means committee. Thank you for allowing us the opportunity to provide testimony on House Bill 571.

A tax disparity exists in Ohio between different entities that sell an identical product for an identical price. This disparity robs the State of Ohio and local jurisdictions of essential revenue, deprives our community convention and visitors bureaus of a part of their lifeline and resources needed for business-creating activities, and most importantly, uses Ohio's public policy as a means to pick winners and losers and provide unfair advantages in a vital sector of our economy.

The transactions in questions are sales of hotel accommodations, and the disparity exists in the form of the state and local sales and lodging taxes collected from consumers and remitted by entities that sell hotel rooms.

There are most commonly two methods to purchasing a hotel room. Many consumers will book directly with a hotel, or hotel brand, whether that entails use of the hotel or brand website, calling

a hotel's booking number, or booking directly at the hotel itself. A very large portion of the hotel market involves the use of out-of-state online travel companies, or OTCs, by consumers to book rooms in the same hotel and lodging properties that also book directly.

In these transactions using out-of-state OTCs, a smaller amount of tax is remitted to state and local jurisdictions, even though it is collected from the consumer. At the same time, Ohio's hotel operators – many of them locally-owned and operated enterprises, making bricks-and-mortar investments in our communities, creating jobs, and helping grow our economy, remit the full amount of tax that is due.

This is a long-standing problem that we can address with simple legislation.

The Intent of HB 571

HB 571 was introduced with the intent and effect of the clarifying the Ohio Revised Code to create a level economic playing field and to codify the obvious -- that taxing jurisdictions did not intend to provide out-of-state online travel companies with an economic advantage over lodging facilities with respect to taxation. Rather, OTCs must operate like any other seller of goods, and collect and remit sales tax on the sales price of their goods paid by the consumer, and not the amount akin to a wholesale price.

Additionally, the sales and lodging tax on accommodations is borne by the room guest, not by the OTC that sold the room. This legislation merely clarifies that it makes no difference what

mechanism is used to book a room on behalf of the room guest; the tax is calculated on the price charged to the room guest for the room regardless.

As an example, consider a scenario with a room rate of \$100, and a 10 percent tax. (Note that in this example, the tax rate is low for simplicity. Virtually every hotel transaction in Ohio is taxed at higher than a 10 percent rate – sometimes as high as 17.5 percent.) While the amount the OTC pays the hotel for the room is \$80, the room guest would pay the OTC the full price for the room, plus the 10 percent tax -- \$110. However, the OTC would remit only \$88 to the hotel. \$80 representing the amount akin to a wholesale rate, and \$8 in occupancy taxes.

When booking through the hotel's website, the consumer pays the same \$100 rate and 10 percent tax, but all \$10 of the tax is remitted to state and local jurisdictions.

In other words, for the same room, in the same hotel, sold at the exact same price to the guest, in this scenario the taxing jurisdiction collects 20 percent less in occupancy taxes simply because the room stay was purchased via an OTC rather than from the hotel. This amount is referred to herein as the "Spread Amount".

Not surprisingly, some tax statutes and ordinances are unclear as to how the tax applies to rooms purchased through an OTC, simply because they were enacted before the growth of the OTC industry and even before the onset of Internet commerce. For example, some statutes simply provide that the tax applies to "amounts received by the hotel." Other statutes more clearly state that the tax applies to the full room rate. However, what is abundantly clear and beyond dispute

is that Ohio and its local jurisdictions did not intentionally design their sales and lodging tax codes to collect a lesser amount of tax if a room is purchased via an OTC.

Recovering the Spread Amount is significant, as according to some government officials, state and local governments are losing tens of millions a year in such revenue. Some courts across the county have held that the OTCs' practice of not remitting the Spread Amount violates tax code on other jurisdictions. One court even found that OTCs had intentionally disregarded their collection obligations on the basis that it was cheaper to not comply with the law and litigate against any collection efforts. The outcome of any litigation on this issue generally turns on the precise wording of the occupancy tax statute or ordinance at issue. In some cases, the decision points back to the need for legislatures to address the issue.

The Need for Clarification

By way of background, OTCs do not own, operate or invest in lodging facilities. They do not bear any of the economic risk associated with a lodging facility. Rather, an OTC serves as an intermediary or "middle man" between the lodging facility and the room customer.

In a typical contract with a lodging facility, an OTC negotiates a discounted room rate, akin to an OTC "wholesale" rate, with hotels. OTCs do not purchase the room per se, nor does they commit to purchasing a pre-determined number of rooms, nor pay a deposit for the room. When a room guest books a room through an OTC, the OTC generally charges the room guest the same exact amount as if he or she had booked the room directly with the lodging facility. After the stay,

when the OTC pays the hotel, many OTCs only remit occupancy tax based on the negotiated OTC “wholesale” rate.

TAX INCREASE Argument:

To eliminate any ambiguity, legislation has been enacted, or is pending, in numerous jurisdictions to clarify that OTCs must collect and remit applicable taxes on the full room rate paid by the consumer. To forestall these legislative efforts, opponents have argued that the clarifying legislation amounts to a tax increase. This argument is without merit.

The room guest bears the economic burden of the occupancy tax. OTCs are only responsible for collecting and remitting the proper amount of tax. Since the occupancy tax is borne by the guest, and the guest will not be obligated to pay more as a result of the clarifying legislation, how could the legislation be viewed as a tax increase?

Secondly, the legislation makes no reference to changing existing tax rates. It merely ensures equal application of the existing rate to all identical transactions.

INCREASE COST OF TRAVEL Argument:

Increasing the room rate would place OTCs at a competitive disadvantage, as acknowledged in an unsealed Expedia internal memorandum dated July 28, 2003 (quoted below):

Regarding the question of whether we should pass on occupancy tax costs to our customers, the current answer is “no” – or maybe a more accurate answer is that we do not currently believe that is possible from a competitive standpoint.

The enactment of any clarifying legislation will not legally obligate room guests to pay a higher room rate, nor should it have the practical effect of causing room guests to pay more for a room stay. This so-called “increase cost of family vacation” argument is essentially a political tactic. At the end of the day, the customer will pay the same amount.

DORMANT COMMERCE CLAUSE Argument

Another unpersuasive argument raised by opponents is that the dormant Commerce Clause to the U.S. Constitution prohibits a State from requiring OTCs to collect and remit any hotel occupancy tax.

Simply put, the dormant Commerce Clause is a judicial doctrine that prevents States from enacting laws that unduly burden interstate commerce. OTCs often argue that since their transactions occur online, they do not have “substantial nexus” with the taxing jurisdiction. No court has yet accepted this argument.

Even Expedia's advisors seem to believe that there are little grounds for disputing that substantial presence exists in these taxing jurisdictions, per an unsealed memorandum from PricewaterhouseCoopers to Expedia dated January 31, 2003 (quoted below):

The analysis herein assumes that Travelscape has nexus, or a taxable presence, in each jurisdiction discussed below. Although Travelscape may have some arguments to defend this nexus assumption, it is likely the applicable jurisdictions will aggressively pursue tax collection given Expedia's continued presence in each of these markets, if the jurisdiction determines the services are taxable.

In short, the argument that [Ohio] lacks the constitutional authority to tax the sale of in-state rooms to in-state consumers is incorrect.

- 1) Ohio would not be imposing an occupancy tax on OTCs, merely the obligation to collect and remit such tax. This imposition is constitutional because OTCs have willingly inserted themselves into the taxing regime.
- 2) It is constitutional because OTCs are, in essence, sellers of in-state-real property to in-state consumers. It is well-established that out-of-state sellers of goods whose inventory is located in the taxing jurisdiction, or who use in-state independent contractors to provide such goods to their consumers, have substantial nexus with such jurisdiction. As such, the argument that OTCs do not have substantial nexus with Ohio, or that this type of legislation would violate the dormant Commerce Clause, is completely at odds with the case law.

NATIONAL PERSPECTIVE

Governments across the country have come to the conclusion that this unfair difference in tax remittance needs to be addressed. In fact, the National Council of State Legislatures issued guidance in 2014 which stated:

“To ensure full collection of taxes that are due and to promote equity and fairness in the tax code, states should consider requiring online travel companies to remit taxes based on the rental price paid by the user.”

The Supreme Court of Georgia in 2009 upheld a permanent injunction requiring Expedia to collect and remit occupancy taxes on the full room rate. The court reasoned that occupancy taxes:

“...do not contemplate taxing the transaction between Expedia, or any other intermediary such as a traditional travel agent, and the hotel. The facts also show that Expedia is not the end-consumer, is not a member of the public at large, and it is not the occupant of the hotel room. Therefore, the wholesale rate which Expedia, a non-occupant, pays for the room cannot be the rate on which the tax is based.” [Expedia, Inc. v. City of Columbus]

In another example, the United States District Court for the Northern District of Illinois ruled in 2011 that local occupancy tax ordinances covered online travel companies:

“[T]he legislature intended to tax the amount customers pay to occupy a hotel room in Rosemont....There is no dispute, however, that [the OTCs] do not obtain the right to occupy any room at any time during a transaction and their customers do so only after paying [the OTCs]. Because the record establishes that [the OTCs’] customers cannot occupy hotel rooms in Rosemont unless they pay the full amount [the OTCs] charge, [the OTCs’] fees and mark-ups are part of the rental rate subject to Tax.” [Village of Rosemont v. Priceline.com]

Most recently, the Colorado Supreme Court ruled that OTCs owed millions in hotel room taxes. On April 24, 2017, the court stated online booking companies failed to remit the right amount of lodging tax, because they sell hotel rooms to consumers:

“Although the OTCs maintain that even in merchant-model transactions they do not sell, or furnish for consideration, a right to occupy or use the hotel rooms in question, no matter what terminology they may choose to use in describing their transactions, as a functional matter that is precisely what they do.” [City and County of Denver v. Expedia Inc.]

Places where state-level action, either in the legislature or the courts, to address OTC tax parity has occurred in recent years include:

- 1) Georgia (2009)
- 2) New York (2010)
- 3) North Carolina (2011)
- 4) South Carolina (2011)
- 5) D.C. (2011)
- 6) Montana (2012)
- 7) Oregon (2013)
- 8) Wyoming (2015)
- 8) Hawaii (2015)
- 10) Rhode Island (2015)
- 11) Maryland (2016)

12) Indiana (2016)

In testimony to come, you will hear from representatives from local governments, and from your local destination marketing organizations, who will explain how the revenue generated by hotel sales supports public services, infrastructure, community programs and economic development. With the pressure increasing to help local governments each day, we have the means to produce a real result for them now.

When consumers make other purchases on any other product in Ohio, they expect to pay, and have vendors remit, tax on the retail rate. All of Ohio's hotel businesses follow this simple principle. It is time to end the tax avoidance that the out-of-state online travel companies profess to practicing in their own internal memoranda. There is too much at stake for the state, and most importantly for our local communities, to allow this to continue any longer. Thank you for your support in favorably reporting this critical legislation for passage by the House.