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FROM: Joe Savarise, Executive Director, Ohio Hotel & Lodging Association  
TO: Senate Finance Committee  
DATE: June 6, 2017  
RE: Sub. House Bill 49 – Interested Party

Chairman Oelslager, Ranking Minority Member Skindell, Vice Manning, and members of Senate Finance, thank you for the opportunity to permit me to add my voice in favor of efforts to support Ohio's communities, our travel economy, and tax parity for entities selling hotel accommodations in Ohio, in the form of Online Travel Company Tax Parity.

I'm Joe Savarise, Executive Director for the Ohio Hotel and Lodging Association (OHLA). Ohio is home to nearly 1,500 licensed and active hotel properties providing more than 131,000 rooms to guests across the state. We employ more than 35,000 people directly and 93,000 hotel-related jobs, produce nearly \$800 million in employee wages and are an integral part of Ohio's vital travel economy. With more than **26 million room nights sold in Ohio annually**, hotels have a \$25.5 billion total economic impact in our state, and support \$3.4 billion in taxes.

I stand before you to express support for the simple fix for Online Travel Company (OTC) tax parity as a vital step in eliminating ambiguity in Ohio's tax code as it relates to OTCs. Ohio's travel economy businesses and leaders support the widely-held belief that the intent of the law is to require business to remit taxes based on the total amount for hotel lodging as advertised by the intermediary and paid by the consumer, just as businesses in other sectors must.

OTC tax parity is a simple step to modernize the Ohio Revised Code and ensure out-of-state OTCs remit tax on the full price paid to them by consumers for hotel rooms. This solution will provide much needed sales tax revenue to the state, and to your local communities, without creating a new tax or raising existing tax rates.

Currently, out-of-state conglomerates like Expedia and its brands such as Hotels.com, Orbitz, Travelocity, Hotwire and many others sell hotel rooms to consumers at full price, but calculate tax on a lesser amount. This provides those companies a sizable dividend at the expense of Ohio taxpayers. No other business is permitted to do this in Ohio. It has been conservatively estimated that this costs our state and local governments between \$10 and \$30 million per year.

Entities that sell accommodations in Ohio are already required to collect and remit sales tax. Their own internal memoranda from counsel and their accounting firms, uncovered during discovery in legal actions in other states, recognize this fact. Included with your written testimony is just one of these documents which states that although **"...tax authorities in the states could make winning arguments that we are subject to tax in their state ... the stakes are high enough that we should resist, delay and make it as difficult as possible for any state to require us to collect..."**

Online travel companies have always been liable for this tax, but exploit ambiguity in the code. They collect but do not remit the full amount, at the expense of Ohio taxpayers. The amendment removes the ambiguity and clarifies that there is tax parity between OTCs and hotels that sell their rooms directly. This is not a new tax, or a tax increase. Consumers will pay the same price, because raising their prices will make OTCs uncompetitive.

**This simple clarification to Ohio’s code will apply to hotel bookings made by consumers inside or outside of Ohio that stay in hotels located here, because this is where the nexus exists for Ohio -- with those brick-and-mortar businesses located within our borders.** The National Council of State Legislatures has recommended addressing this issue, and in the past several years, at least 10 states have acted to create OTC tax parity.

### **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 of this year, 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 to address OTC tax parity has occurred in recent years include:

- |                          |                        |
|--------------------------|------------------------|
| 1) Georgia (2009)        | 5) Oregon (2013)       |
| 2) New York (2010)       | 7) Hawaii (2015)       |
| 1) North Carolina (2011) | 8) Rhode Island (2015) |
| 2) South Carolina (2011) | 9) Maryland (2016)     |
| 3) D.C. (2011)           | 10) Indiana (2016)     |
| 4) Montana (2012)        |                        |

Tax fairness requires modernization of our code to reflect the new realities of e-commerce. We can achieve this without creating a new tax, or raising rates on existing taxes. We simply seek to ensure that all entities selling hotel rooms participate on equal terms. We endorse the simple and specific mechanism that will make this happen: defining an online travel company, a "hotel intermediary," as a vendor.

We believe that Ohio's proposal is an even simpler, more straightforward approach. Tax fairness requires modernization of our code to reflect the new realities of e-commerce. Thank you.

**Seeking support of an amendment to do the following:**

- 1) Responding to Sixth Circuit Court of Appeals (September 10, 2012)  
Define a Hotel Intermediary: A hotel intermediary is a person, other than a hotel, a person paid a commission by the hotel (i.e., a travel agent), or a person that separately itemizes its service fee, that arranges for hotel lodging.
- 2) Specifies that, for the purposes of the sales and use tax on hotel lodging, the "price" on the basis of which a hotel intermediary must collect and remit the tax is the total amount paid by the customer for the hotel lodging, as advertised by the intermediary. A hotel intermediary is a person, other than a hotel, a person paid a commission by the hotel (i.e., a travel agent), or a person that separately itemizes its service fee, that arranges for hotel lodging. Absolves a hotel of liability for unpaid sales or use tax related to lodging arranged through a hotel intermediary.

**MSB Occupancy Tax Analysis**  
**July 28, 2003**

**What is a hotel "occupancy" tax?**

This is a tax on the sale of the occupancy of a hotel room. It is a state tax (there is no federal occupancy tax) that is imposed at the state or local level depending on the state, and in many states it is imposed at both levels. Technically, this is a tax imposed on the consumer, but it is collected and remitted to the taxing authority by the seller of the hotel room. The tax is assessed on the *entire price of the occupancy*, and tax authorities typically define this entire price as the price that the consumer perceives to be the price of the hotel room.

In general, occupancy tax rates vary from 8% to 18% of a hotel room sales price, and in some jurisdictions taxing authorities may also impose a fixed dollar surcharge per hotel night. Applicability of occupancy tax also varies from state to state, with some states only taxing sales by "hotel operators," and other states more broadly taxing sales by any entity deemed to be selling the hotel occupancy (e.g., dealer, vendor, retailer, reseller, etc.).

Expedia is not currently collecting occupancy tax in any state, but we are taking a reserve each quarter based on an estimate of uncollected taxes that we may ultimately owe. We calculate this reserve using actual tax rates and assigned probability weightings (based on our assessment of our legal exposure) for those states that generate the most merchant hotel revenue for Expedia. Based on this analysis, Expedia had a reserve in the amount of \$10.3 million at the end of Q2-03.

**How is this relevant to Expedia?**

The headline is that, if Expedia is forced to collect occupancy tax in every state and cannot pass on that tax cost to consumers, Expedia will experience roughly a 13% (average of 8% and 18%) hit to its domestic merchant hotel raw margin. To scope this on an aggregate basis and in absolute dollars, Expedia's net revenue for its domestic merchant hotel business last quarter was approximately \$87M. A 13% tax on this amount would have reduced Q2-03 net revenue by roughly \$11M, and this amount would have dropped directly to the bottom line as there is not any variable cost reduction associated with this margin reduction.

How would this margin reduction happen? If Expedia is deemed to be a hotel operator or an entity that is selling hotel rooms, then arguably the *entire price* of the hotel room (base price, plus any mark-up, fee, etc.) that Expedia is selling is subject to occupancy tax. Because Expedia does not currently collect any tax on its net revenue, taxing this entire price would significantly impact Expedia's margins, briefly demonstrated as follows:

	Expedia Today <sup>(1)</sup>	Expedia Subject to OT (passing on tax cost) <sup>(2)</sup>	Expedia Subject to OT (absorbing tax cost)
Net Rate <sup>(3)</sup>	100	100	100
Mark-up	30	30	30
Tax (assuming 13%) <sup>(4)</sup>	13	17.55 <sup>(5)</sup>	17.55 <sup>(5)</sup>
Fee	5	5	.05 <sup>(6)</sup>
Total Charged to Customer	148	152.55	148
Net Revenue	35	35	30.05
Raw Margin	23.65%	22.94%	20.30%

- (1) Today, Expedia collects tax on the net rate (but not on the mark-up or fee) and then remits this tax amount to the hotelier who remits to the state.  
(2) This column demonstrates passing on the tax cost to consumers by increasing the "taxes and service fees" line item. We could also pass on the tax by increasing the display price (sum of net rate and mark-up). For a discussion of each alternative, see "If we do begin paying occupancy tax in any state, should we pass on the tax costs to consumers?" below.  
(3) "Net" rate is the amount that Expedia must remit, plus any applicable taxes, to the hotelier once invoiced.  
(4) Using 13% because it is the average between 8% and 18%. If we were to more precisely model occupancy tax impact, we would use weighted average.  
(5) This contemplates a tax on (i) the mark-up (displayed as part of price), and (ii) the fee (tacked on prior to purchase), as most tax authorities see these as two components of the same net revenue amount. As discussed below, it is possible that, if we clearly break out the fee (rather than keeping it opaque under a "taxes and service fees" line item), we could shield this amount from occupancy tax in some jurisdictions.  
(6) This amount is actually \$5, but because Expedia is absorbing \$4.55 in tax, I have simply made this \$0.05. The "taxes and service fees" line item would be \$18.00, maintaining status quo with respect to this line item. For a discussion of why we have this fee, how we calculate it, etc., see "If we do begin paying occupancy tax in any state, should we pass on the tax costs to consumers?" below.

In those jurisdictions that require "hotel operators" to collect occupancy taxes, we believe we have a strong position that we are not subject to occupancy tax collection responsibilities because Expedia does not own or operate a hotel in any jurisdiction. In those jurisdictions that require entities selling hotel occupancy to collect occupancy taxes, we believe that our position is weaker, but still defensible. Our position is that Expedia is simply an intermediary facilitating the customer's purchase, and that the hotel is doing all of the selling, renting, etc. For a detailed discussion of these arguments, see the memoranda prepared by Holland & Knight dated January 29, 2003 and April 16, 2003.

#### What about Expedia's agency hotel business?

Occupancy taxes are not an issue in our agency hotel business because the hotel pays tax on the entire price paid by the customer. We derive our net revenue in this business from commissions paid by the supplier to Expedia (rather than a mark-up) in transactions separate from the sale of the hotel room.

#### In which states are occupancy taxes an issue?

Every state has some form of occupancy tax, whether it is at the state or local level. However, certain state and local tax authorities have historically been more aggressive than others in pursuing occupancy tax collection. We have focused our lobbying and analysis efforts to date, first, on these aggressive jurisdictions and, second, on those jurisdictions that comprise the largest portions of our merchant hotel revenue.

Set forth below is a table of the jurisdictions that we have lobbied to date, and the status of our interaction:

State(s)	Status
Florida	Currently engaged in informal, anonymous discussions with Florida Department of Revenue's top administrators and policy group to obtain a favorable determination. Request for a formal ruling will follow any favorable informal determination. However, Florida DOR has recently proposed a compromise that Expedia register as a tax collector in their state, in exchange for forgiveness of uncollected historical occupancy taxes. We consider this a preliminary proposal and part of ongoing dialogue.
New York	Expedia met with New York's top administrators, policy group and general counsel's office. Following that meeting, New York requested that Expedia submit a ruling request because New York anticipated issuing a favorable ruling based on Expedia's facts. The ruling request is pending.
Texas	Texas issued an adverse ruling in response to an anonymous ruling request filed by Expedia through PWC. Even though the rationale utilized by the Texas Comptroller to justify taxation does not appear to be consistent with Texas law, no further action has been taken because the ruling was anonymous. Expedia may approach Texas again, but only after obtaining favorable rulings from other jurisdictions.

(1) Hotels.com is also currently seeking an anonymous ruling from Louisiana. Because of this, Expedia expects to be interacting with that state in some form in the near future.

In addition to the foregoing lobbying activities, we have undertaken liability analysis for 16 jurisdictions that represent approximately 92% of Expedia's domestic merchant hotel revenue. The following table summarizes the current state of this analysis:

State(s)	State Tax	Local Tax	Risk(2)	% EI Revenue(3)
Arizona	Yes	permissible	Low	2.1%
California	No	yes	High(4)/Low	15.8%
Colorado	Yes	yes	Moderate	1.6%
Florida	Yes	yes	High	14.9%
Georgia	Yes	yes	Moderate(5)	1.7%
Hawaii	Yes	no	Low	5.8%
Illinois	Yes	yes	Low	4.4%
Louisiana	Yes	yes	Mod. to High	2.7%
Massachusetts	Yes	yes	Low	3.6%
Nevada	No	yes	Low	18.2%
New Jersey	Yes	yes	Low	0.6%
New York	Yes	yes	Low/Moderate(6)	11.7%
Pennsylvania	Yes	yes	Low	0.9%
Texas	Yes	yes	Low(7)	2.9%
Virginia	Yes	yes	High	1.1%
Washington, D.C.	N/A	yes	High	2.8%

(1) All information (except revenue information) based on memoranda prepared by Holland & Knight dated January 29, 2003 and April 16, 2003.

(2) Risk that Expedia would not ultimately prevail in occupancy tax dispute. Does not assess risk that state or local jurisdiction may pursue Expedia for occupancy taxes.

(3) Percentages based on total Expedia domestic merchant hotel revenue from Jan-02 through Jun-03 (six quarters).

(4) High in San Francisco and low in Los Angeles and Monterey County. PWC assigned moderate level of risk in San Francisco; however, according to Holland & Knight, PWC did not address key provision in San Francisco occupancy tax regulations.

(5) PWC believes this is a high risk.

(6) Moderate for New York State.

(7) PWC believes this is a moderate risk.

Three things to note regarding the preceding liability analysis: First, this analysis must be dynamic in that, as the Expedia and Hotels.com business models continue to evolve, this analysis must evolve with them. For example, to the extent that Expedia begins taking inventory risk, whether it be through minimum room allotments or otherwise, the risk profile set forth in the fourth column will significantly increase.

Second, as mentioned in footnote (2) to the table, this analysis does not assess whether state or local tax authorities will pursue Expedia for occupancy taxes. This "risk of pursuit" is difficult to assess. However, I believe that this risk is high in many states and accelerates in other states as (1) occupancy tax issues grow in prominence across the country, and (2) state and local economies continue to suffer. I see this acceleration

hitting hyper-speed should Expedia or Hotels.com begin collecting occupancy tax in any given jurisdiction.

Third, this analysis does not capture the possibility that a state might simply legislate over any outcome (e.g., regulatory or court decision) that is not in their interest. We could burn hundreds of thousands (if not millions) of dollars in litigation costs in a state, only to have that state or one of its local governments successfully lobby their legislature to change the law to capture us. No one has more lobbying power within a given state than the state itself or its local governments. We might be able to counter-balance this power if we have a large constituency base in the relevant state, but I believe it would be an uphill battle in most instances.

#### **What can Expedia do in order to minimize occupancy tax exposure?**

Due to the variability in applicability among the states, there is no silver bullet. That being said, I do believe that Expedia has been taking a sound approach to date (e.g., assembling a strong team of experts to lobby the seemingly more aggressive tax authorities). However, three decision points are quickly evolving in regard to minimizing occupancy tax exposure: (1) is there anything that we can do now in order to strengthen our position with respect to the tax authorities we are dealing with now or in the future; (2) if any tax authority threatens litigation in order to force us to pay occupancy tax, do we litigate or simply become a tax collector in that state and take the associated margin squeeze; and (3) if we do begin paying occupancy tax in any state, should we pass on the tax costs to consumers. Addressing each of these questions in turn:

#### **Is there anything that we can do now in order to strengthen our position with respect to the tax authorities?**

The general answer to this question is "yes." However, this answer raises a secondary question of how much positional strength any action will give us, and we must weigh that strength against any negative impact that the action will have on our business. We must be very careful that the tail does not wag the dog here. I have summarized my view of this cost/benefit analysis below. If you would like, I can walk you through the table and elaborate on some of the finer points; but for the most part I think it is self-explanatory.

Before reviewing the table, please note that I do not believe that any of the actions discussed below are enough in themselves to be dispositive. Each action gives us a supporting fact and the more supporting facts the better; however, even if we took every action recommended below, **various tax authorities could still make strong arguments (possibly even winning arguments) that we are subject to occupancy tax in their state.**

Action	Legal Benefit	Difficulty of Implementation	Negative Impact on Business	MSB Recommend?
Hotels.com (and IAC) report revenue on net basis	High	Medium. Would entail changing certain Hotels.com systems and disclosure practices and effective IAC messaging to street.	Low. No bottom line impact, but will reduce Hotels.com and IAC top line.	Yes. Expedia went to net revenue reporting in 2001 and there was no impact on business or stock price.
No minimum room allotments in hotel contracts	High	Medium. Easy for future contracts. Difficult for existing contracts.	High. Critical provision(s) when hotels are nearing max occupancy.	No(1)
Take minimum room allotments but give hotel flexibility in retrieving rooms	Medium -- or more accurately, depends how structured. The more it looks like MRA, the <u>less</u> helpful it will be from a legal pov.	Medium. Easy for future contracts. Difficult for existing contracts.	Medium -- or more accurately, depends how structured. The more it looks like MRA, the <u>more</u> helpful it will be from a business pov.	Yes, if possible to draft provision that gives us comfort wrt supply availability, but also gives hotels supply flexibility.(2)
Have cancellation policies track hotel's policies	Medium. Arguable indicia of lack of ownership, but has only been raised as issue by Texas.	Medium. Easy for future contracts. Difficult for existing contracts.	Medium. For merchant hotels, EI does not refund service fee on cancellation.	No. Not enough legal value to make us refund fee imo.(3)
Break-out all components in purchase path(4)	High. Anytime we clearly call out our mark-up for the customer, the better argument we have that not part of room price.	Medium. This would entail special design and coding.	High. Breaking out components would cause problems with our suppliers and our customers.	No
Keep net revenue opaque, but have accompanying qualitative disclosure that multiple components present (4)	Medium. Less effective than breaking out components, but better than no disclosure at all.	Medium. This would entail special design and coding.	Low	Yes
Make back-end fee bear rational relationship to processing costs	Low	Medium. This would entail special design and coding.	High. Our fee currently significantly exceeds our processing costs.	No
Revise public disclosures to characterize EI as intermediary rather than retailer, reseller, vendor, etc.	Medium. This would be "High" imo if there were not so many historical statements to contrary.	Medium. Easy to implement policy, but more difficult to police.	Medium. There is a resource cost associated with changing this disclosure and policing it.	Maybe(5)
Lobby state tax authorities	High. If tax authority shows interest in occupancy tax issues, we should aggressively engage.	Medium to High. This entails substantial internal and external resources.	Low	Yes
Lobby state legislatures	Low. Possibly pushed up to a "Medium" if we have a constituency base in state.	Medium to High. This entails substantial internal and external resources.	Low	Yes, in selected states where we have constituency base and we believe that there will be benefit.

(1) While Expedia has not had such allotments to date (and Hotels.com has), we believe that such allotments will be critical to our hotel business going forward.  
 (2) To the extent that Expedia has any inventory risk as part of these allotments, we believe that it is very damaging to our positional strength.  
 (3) However, it is important to note that, even though the Expedia hotel team believes that this amount is large, we do not currently track how much these non-refundable fees contribute to net revenue. The Expedia finance team tells me that we do not have this information because it is difficult to track; however, one could also argue that, if it was a very big number, we would figure out how to track it. We can surely investigate this more to the extent we are interested in taking this action.  
 (4) The earlier that this is done in the purchase path the better.  
 (5) My only hesitation here relates to prohibiting words that characterize Expedia as a "retailer," "merchandiser," etc. In the war over screen bias, we have publicly taken the position that we are a travel retailer that must have the freedom to merchandize its products as supplier relationships and customer preferences dictate. We are trying to combat the notion that we are akin to a utility that must neutrally present information to consumers at all times (similar to a CRS). Maybe we can back-off from this rhetoric in light of the DOT's statements in the NPRM that it does not intend to regulate Internet travel websites, but the reality is that the bias debate rages on, and it would be very awkward change or refrain from our arguments at this time.

The fifth and sixth rows in the preceding table partially address the question of whether we should alter how we display prices in order to enhance our occupancy tax position. This question can only be assessed in the light of how we display prices today. Additionally, anytime we are discussing how we display prices, consumer confusion -- and, more specifically, consumer class actions supported by allegations of confusion -- become relevant to the analysis. Accordingly, I have prepared an additional table below that is specific to price displays and adds these two elements to the analysis.

Display Alternative(s)	Impact on Occupancy Tax Position	Impact on Class Action Position	Impact on Business	Assessment of Alternative
Keep net revenue opaque by combining with net rate and/or tax	Moderate to negative. Less effective than breaking out all components. Preserves argument that part of room price.	Moderate to negative. Unless combine all components up front (which is untenable from a competitive standpoint) then subject to confusion arguments.	Neutral. This is what we are doing today.	We could continue to do this and it may not impact positional strength wrt occupancy tax or class actions.
Break-out all components in purchase path(2)	Positive. Anytime we clearly call out our mark-up for the customer, the better chance we have of it not being subject to tax.	Positive. Removes confusion argument, particularly if break-out is early in purchase path.(3)	Negative. Breaking out components would cause problems with our suppliers and our customers.	We should not do this.
Keep net revenue opaque, but have accompanying qualitative disclosure that multiple components present(2)	Moderate. Less effective than breaking out components, but better than no disclosure at all. Preserves argument that GP is part of hotel sale.	Moderate. Unless combine all components up front (which is untenable from a competitive standpoint) then subject to confusion arguments, but better than no disclosure at all.	Neutral. There are design and coding issues, but should not greatly impact business.	We should do this under the theory that "every little bit helps."

(1) I believe that all of these display alternatives are fairly easy to implement, however, I have not spoken to our development teams in length about this. I am making presumptions based on similar design and coding we have implemented in the past.

(2) The earlier that this is done in the purchase path the better.

(3) We would most likely want to combine our margin and fee in this instance so that we are not exposed to additional arguments regarding customer confusion.

**If any tax authority threatens litigation, do we litigate or simply become a tax collector in that state?**

There is not a simple answer to this question. However, it appears that the stakes are high enough that we should resist, delay and make it as difficult as possible for any state to require us to collect occupancy tax. This does not mean that I am advocating that we litigate in every instance; but I do think that we should consider it a potentially useful tool in the face of the obstinate tax regulator.

I am guessing that most tax regulators -- even the most obstinate -- will offer up some sort of settlement before threatening litigation (as discussed above, Florida is currently offering to forgive all back taxes if we register as a tax collector going forward). If faced with this or any other settlement offer versus litigation, we will be at a crossroads. We will need to assess at that time (1) our positional strength, (2) the resources of the tax authority, (3) the state's appetite for litigation, (4) our resources and appetite for such litigation, (5) the state "domino effect" of a settlement, (6) whether state/local authorities will be inclined to seek a legislative solution, (7) whether the state legislatures would be

inclined to effect legislative solutions, etc. All of these are variables that will change over time.

**If we do begin paying occupancy tax in any state, should we pass on the tax costs to consumers?**

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. Let me explain these competitive dynamics by explaining the two ways that we might pass on these costs:

The first way to pass on this tax cost is to simply increase the “taxes and service fees” line item, which is added to the customer’s bill once they arrive at the “details” page for their transaction. Referring to the first table in this Q&A (and in this case, the third column of that table), our displayed price would hold steady at \$130 (retaining the competitiveness of our displayed price); however, the “taxes and service fees” line item would increase to \$22.55, making the total price paid by the customer \$152.55 and holding our net revenue at \$35.

There are two problems with this approach: First, this “taxes and service fees” line item includes an Expedia fee of roughly 3% of the net rate, bringing the line item to roughly 11% to 21% of the net rate. There is no magic to these numbers – Expedia’s hotel team simply feels that somewhere around 11% to 21% is the maximum amount that customers will tolerate (or ignore) being added to their bill prior to check out. This is either because they chalk it all up to tax and the extra 3% gets lost in the noise, or because they have simply gotten used to the age-old “shipping and handling” add-ons. We believe that, if this amount were to jump to 13% or 23% of the net rate, consumers would feel compelled to go to the supplier websites in order to avoid the additional taxes and/or fees. Second, I am not sure that we will forever have the luxury of having this back-end “taxes and service fees” line item. The DOT requires that all taxes and fees be included in the first price that an air customer sees. I would not be surprised if at some point the FTC or a state regulator requires similar display rules for hotel transactions.

The second way that Expedia could pass on this tax cost is to increase its mark-up in each transaction by the tax amount. So, again, using the numbers from the first table in this Q&A, our mark-up would increase to \$34.55, making the displayed price \$134.55, rather than \$130. The total price to consumers including net rate, mark-up, taxes and fees would equal \$152.55 and our net revenue would hold constant at \$35. The obvious downside to this is that it would immediately raise our displayed price to consumers making us less competitive with the supplier websites (who do not need to worry about an intermediary mark-up). Shoppers tend to make their purchase decisions on the first price they see, and a couple of percentage points difference is often enough to lose the beauty contest. This gross-up would also not be possible under the Hilton and Starwood contracts, as those contracts have provisions that limit the mark-up on their respective supply.

In the end, whether we can or should pass on occupancy tax costs to our customers is something that we will need to assess and reassess in the future. If we start paying substantial occupancy taxes, I am guessing that the pain will become too great to simply absorb, say, 13% of our merchant hotel margins across the board. Presumably we would need to do some testing to understand how uncompetitive we can be with supplier websites (on the front-end or back-end) before we start seeing abandonment that outweighs the benefits of passing on the costs. Maybe we put some of the occupancy tax costs into the mark-up (and therefore the display price), some into the "taxes and service fees" line item and absorb the rest. Only time and future competitive pressures will tell; however, the reality is that we face a demand curve and any increase in our pricing will presumably affect our volume.

**What would the future impact be on IAC to the extent that its travel websites are liable for this tax?**

I believe that IAC will end up paying some amount of occupancy tax over the next five years, whether it is in one jurisdiction or 100 jurisdictions. Despite this belief, modeling this future impact is difficult because when IAC will begin paying this tax in a given state depends on many factors, including when we begin interacting with the state, how long our interaction will last, whether we choose to litigate an adverse decision, how long such litigation will last, etc. A more complex model could also include whether we pass on tax costs to customers, the loss of time value in funds that we remit to state (rather than hotelier), compliance costs (paying multiple states with multiple billing systems every month), whether individual tax rates stay constant; whether we would be subject to penalties, whether we could settle and what form any settlement might take, what role legislature might play, etc., etc.

**What about Europe?**

Although, this Q&A focuses on occupancy tax collection for our domestic merchant hotels, we may encounter similar issues regarding VAT taxes for our European merchant hotels. While we have had PWC analyzing this issue for some time, we are not currently reserving for these amounts based on our current assessment of our potential VAT liability.