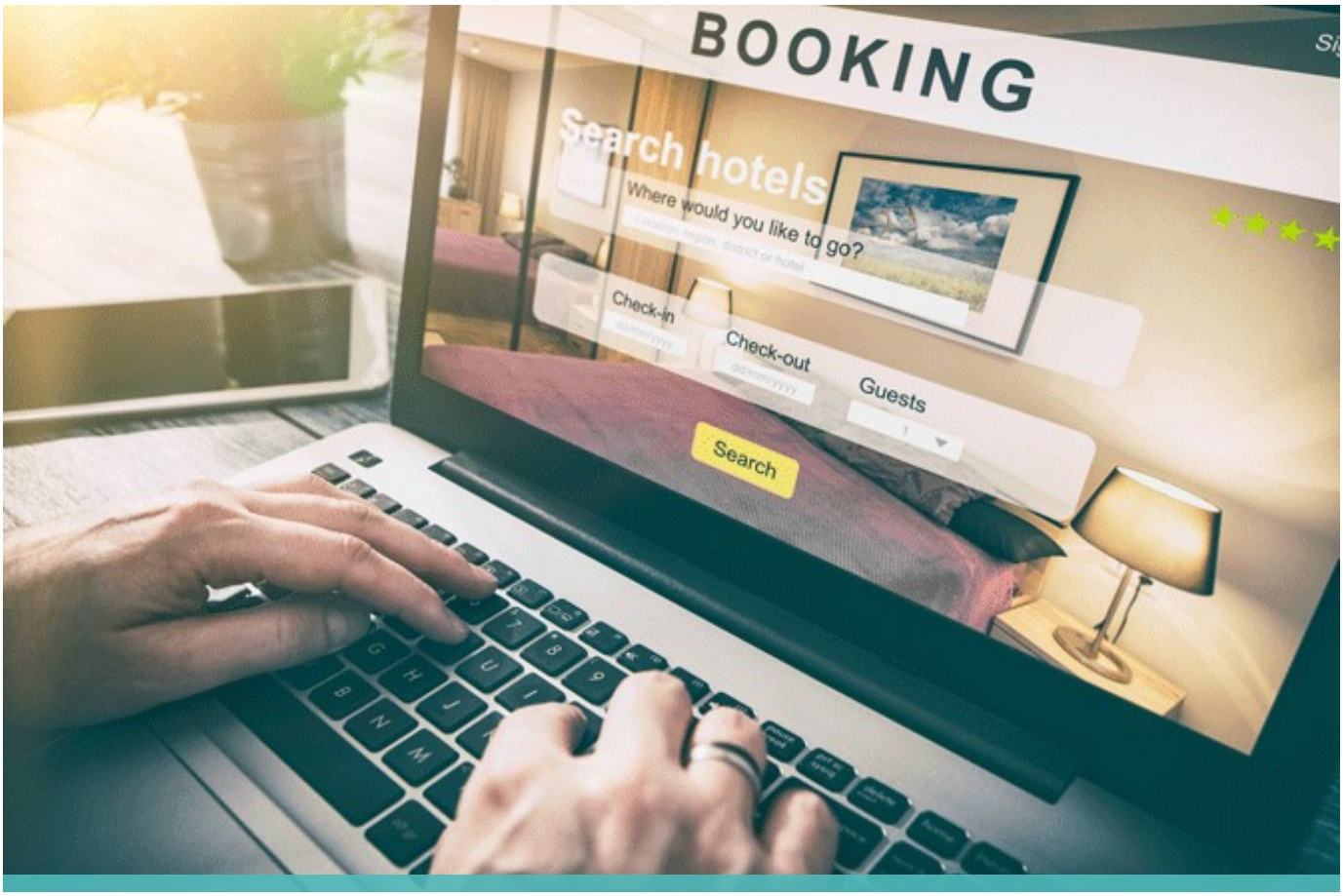
Illinois: Another win for online travel companies



David M. Kall | Thursday, December 7, 2017

Earlier this year, we discussed the result in the case *The City of Chicago v. Expedia, Inc., et al*, in which an Illinois state appellate court sided with the defendants, online travel companies Expedia, Orbitz LLC, Hotels.com LP, and Hotwire Inc., and reversed the lower court's $29.1 million judgment in the city of Chicago's favor.

The court held that the travel companies could not be subject to the Chicago Hotel Accomodations Tax. This was due to the nature of the business model under which they operate, and the fact that they were not considered to be owners, managers or operators of hotel accommodations.

Now, two federal courts have reached conclusions that are also favorable to online travel companies. We explain one, the Fifth Circuit case *City of San Antonio, Texas v. Hotels.com, L.P. et al.*, in a different article posted this week.

The other is out of the 7th Circuit, in the case *Village of Bedford Park, et al. v. Expedia, Inc., et al.*, in which 13 Illinois municipalities claimed that Expedia, Priceline, Travelocity, and Orbitz, owe tax to them under their local hotel tax ordinances. As in the *City of Chicago* case, at issue in the *Village of Bedford Park, et al.* suit were the ways the online travel agencies (OTAs) function with respect to their contracting and billing practices, and the applicability of certain municipal ordinances.

Background

As the court explained:

> The OTAs operate their online travel websites under the "merchant model"; customers pay an OTA directly to reserve rooms at hotels the OTA has contracted with. The participating hotels set a room rental rate. The OTA charges the customer a price that includes that rate, the estimated tax owed to the municipality, and additional charges for the OTA's services. After the customer's stay, the hotel invoices the OTA for the room rate and taxes, and remits the taxes collected to the municipality.

The crux of the municipalities' argument was that "they have been shorted tax revenue over the years because the OTAs do not remit taxes on the full price that customers pay."

Of significance to the OTA's practices was that the contracts between hotels and the OTAs showed that "the OTAs do not actually buy, and never acquire the right to enter or grant possession of, hotel rooms. Instead, the OTAs take reservation requests from customers and transmit those to the hotels. The contracts require the hotels to honor those requests, but the customer does not obtain the right to occupy the room until he checks in at the hotel."

Additionally, "a customer will likely only deal with the OTA prior to checking in because OTAs handle reservation modifications, cancellations, and refunds. The OTAs generally enforce a hotel's cancellation policies, but sometimes set their own policies and charge their own cancellation fees. The OTAs also often provide customer service support, but some contracts specify that the OTAs will refer hotel-specific questions to the hotels."

Regarding the ordinances, the federal court acknowledged that though there are unique aspects to each municipality's laws, there are three general categories that are relevant to the dispute:

1. Those laws that place the duty to collect and remit the tax on owners, operators, and managers of hotels or hotel rooms.
2. Those that apply to all persons engaged in the business of renting hotel rooms.
3. Those that incorporate elements of both, referred to as hybrids.

The Analysis

The court observed that seven of the municipalities, Arlington Heights, Bedford Park, Oak Lawn, Orland Hills, Orland Park, Schaumburg, and Tinley Park, have ordinances that place the duty to collect the tax from a renter and remit it to the municipality on owners, operators, and managers of hotels or hotel rooms. Therefore, the court reasoned, "if the OTAs are not owners, operators, or managers, they have no obligations under these ordinances." The lower court found that in these communities, the OTAs were not owners, operators, or managers, so could not be duty-bound to collect the taxes, and the 7th Circuit agreed.

Three municipalities, Rockford, Willowbrook, and Lombard, "impose a tax squarely on those engaged in renting hotel rooms or engaged in the business of renting hotel rooms." The court emphasized that "the OTAs do not own hotels or hotel rooms and they cannot independently grant consumers access to hotel rooms. Therefore, they cannot rent hotel rooms to customers."

Nor are the OTA's in these three municipalities "engaged in the business" of renting hotel rooms. Citing 2004 case law authority, the court asserted that "a seller is only engaged in the business of selling if he does it routinely or commercially. The OTAs do not rent hotel rooms, so of course they do not do so routinely or commercially. Thus, the OTAs are not engaged in the business of renting rooms and are not subject to these three ordinances."

The remaining three municipalities, Des Plaines, Warrenville, and Burr Ridge, have hybrid ordinances. The court concluded that "the OTAs are not required to pay taxes to the municipalities under any of them," detailing its rationale as follows:

- Des Plaines: Here, the municipality "appears to tax all 'persons engaged in the business of renting, leasing or letting rooms in a hotel or motel.'" But the ordinance places the duty of keeping records on operators, and the duty of filing returns and paying taxes to the city, on the owners.
- Similarly in Warrenville, the ordinance "imposes a tax on those engaged in the business of renting," but places the duty to pay on the owners.
- "Burr Ridge's ordinance includes language about both engaging in the business of renting[,] and owners, operators, and managers. But as the OTAs are neither engaged in the business of renting, nor [are they] owners or operators of hotels, they have no obligations regardless of how these ordinances are interpreted."

The stakes

Bloomberg characterized the win for the OTAs as "a major victory against Illinois municipalities seeking millions of dollars in unpaid lodging taxes." For Lombard in particular, the piece called the outcome "a particular blow," because it had won a $460,000 judgment in the court below. The piece quoted one expert, who noted that "the Seventh Circuit is continuing a pattern in which courts have held the OTCs harmless for local hotel and motel taxes."

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Team member bio