

Texas: \$84M judgment against online travel companies reversed



David M. Kall | Thursday, December 7, 2017

Between 2006 and 2016, various governments sued online travel companies (OTCs) 92 times, in 34 states, the District of Columbia, and Puerto Rico, for their alleged failures to pay hotel occupancy taxes, according to the Tax Foundation's February 2016 [special report](#). Generally, consumers pay the hotel tax to the OTC upon booking a hotel room online through the OTC. The OTC then forwards a portion of that tax to the hotels, after keeping some of it, the difference between the retail and wholesale rate, as a facilitation or service charge, also called a commission or markup. The litigation typically centers on whether the OTCs should be paying the hotel tax on the amounts they keep as their facilitation or service fees. Governments assert that they are entitled to tax on the full amount of the hotel taxes.

The special report reveals that the OTCs have been fighting back with significant success: in 39 cases in 23 states, courts concluded that OTC services are not taxable under hotel occupancy tax statutes. In only 10 cases, in six states and the District of Columbia, have courts decided that OTC services are taxable under hotel occupancy tax laws.

The Tax Foundation opines that “[w]hile it is important that state and local governments collect revenue to provide services for their constituents, that need cannot justify discriminatorily taxing non-residents, or taxing only services primarily used by nonresidents while everything else is exempt.” Thus, the group favors a federal solution that “should maintain settled practices in hotel occupancy taxation: hotel occupancy taxes will be calculated by the amounts hotels receive in payment from the hotel occupant.” It

texas 84m judgment against online travel companies reversed

would not give OTCs preferential tax treatment or a blanket exemption.

Texas litigation

Until the Tax Foundation's wish comes true, individual courts must continue to work these clashes out one by one. We described a new victory for the OTCs this week in our article addressing the 7th Circuit Court of Appeals' decision favoring Expedia, Priceline, Travelocity, and Orbitz against 13 municipalities in Illinois. The case, *Village of Bedford Park, et al. v. Expedia, Inc., et al.*, follows a previous win in state court for a different group of OTCs, Expedia, Orbitz, Hotels.com, and Hotwire, against the City of Chicago, in *The City of Chicago v. Expedia, Inc., et al.*

And in Texas, the 5th Circuit issued an [opinion](#) on Nov. 29, 2017, in the case *City of San Antonio, Texas v. Hotels.com, L.P. et al.*, featuring a ruling in favor of yet another group of OTCs: Hotels.com LP, Hotwire, Expedia, Orbitz, and Travelocity.com. This one was years in the making.

City of San Antonio was a class action suit that 173 municipalities in Texas launched in 2009, on the above-described question of whether the OTCs' service fees, charged for "facilitating a hotel reservation[,] is included in the 'cost of occupancy', and...subject to the municipalities' hotel occupancy tax ordinances."

The lower court answered this in the affirmative in April 2013, awarding the municipalities \$55,146,489 in unpaid taxes, interest, and penalties. After two years of additional litigation, the court increased its final judgment to \$84,123,089, after accounting for increased penalties, and the taxes and interest that had accrued since the April 2013 judgment.

Background

The court first detailed the process by which travelers book their reservations through the OTCs, and the pricing model, the "merchant model," that the OTCs utilize. Under the merchant model, the "hotel and the OTC enter into a contract by which the OTC agrees to display information about the hotel on the OTC's website, and the hotel agrees to provide reservations at a discounted room rate through that website. A hotel decides when to make reservations available to the OTCs, how many reservations to provide, and the room rate the hotel will charge. Only the hotel can issue a reservation."

As for payment, "[w]hen a traveler makes a reservation, the OTC charges the traveler an amount that includes the discounted room rate, a tax-recovery charge, and a service fee...The OTC retains its service fee as compensation for its online services. Therefore, although the hotel determines the discounted room rate, an OTC decides the total amount the traveler pays when booking through the OTC's website...The OTC later forwards the amount of the discounted room rate and applicable taxes to the hotel, which remits the taxes to the taxing authority. The OTC is the merchant of record in the transaction with the traveler."

The ordinances at issue require "every person owning, operating, managing, or controlling any hotel" must collect and pay the occupancy tax to the taxing authority."

The court's analysis

In its examination, the court conceded that in the absence of a Texas Supreme Court precedent, it was obligated to follow the decision of an intermediate state court in a 2011 case, *City of Houston v. Hotels.com, L.P.* Originally, *Houston* was also a class action, and involved an ordinance that was very similar to those before the Fifth Circuit in *City of San Antonio*.

Next, the court noted that when a statute is ambiguous, such that it is "susceptible to more than one reasonable interpretation," it must be construed "strictly against the taxing authority and liberally for the

texas 84m judgment against online travel companies reversed

taxpayer.” On this rationale, the court declared, “from [the] cities’ point of view, at best, the hotel occupancy tax ordinances are ambiguous, in which case the ambiguity is resolved in favor of OTCs; at worst, the ordinances can only reasonably be read to tax the discounted room rate paid to hotels.”

After whittling down the minutiae of the sides’ claims, the court’s conclusion rested on the pro-taxpayer presumption, and the precedent recognized and set in *City of Houston*: “[t]he hotel offers *occupancy* in exchange for payment of the invoiced discounted [room] rate. An OTC, on the other hand, does not have rooms or *occupancy*...the OTCs have websites and provide information...Therefore, only the discounted room rate paid [to] the hotel is the cost of occupancy.”

Ultimately, the court proclaimed, “[y]ears of litigation and conflicting results in several courts confirm the scope of the hotel occupancy tax provisions does not clearly include the retail rate.”



David M. Kall

[Team member bio](#)