

July 6, 2010

In Re: Expedia, Inc.

Docket No: 36HRMERZZ9933

STATEMENT OF RECORD:

1. On June 11, 2007, Expedia, Inc. (hereafter "Petitioner") filed a Petition for Review and Waiver of Interest and Penalty with the Tax Review Board requesting a hearing on a Philadelphia Department of Revenue assessment for Hotel Room Rental Tax for the years 2001 to 2005.
2. Prior to the start of the evidentiary hearing on October 28, 2008, the Tax Review Board issued an Order regarding the confidentiality of certain proprietary or contractual information to be used at the hearing. In addition, the Tax Review Board denied Petitioner's request to limit public access to the hearing and related documents.
3. A public hearing was held before the Tax Review Board on October 28, October 30, December 4 and December 11, 2008, following which the matter was taken under advisement pending the submission of briefs by the parties.
4. On February 9, 2010, the Tax Review Board announced its decision to grant the petition and abate the assessment based on its finding that Petitioner did not fall into the category of "operator" as required by The Philadelphia Code Chapter 19-2402(1) for the imposition of the Hotel Room Rental Tax. A letter memorializing this decision was mailed to the parties on February 19, 2010.
5. On March 23, 2010, the Tax Review Board issued an amended decision letter to clarify that the decision rendered on February 9, 2010 applied to the Hotel Room Rental Tax assessment for the years 2001-2005.
6. The City of Philadelphia Department of Revenue filed an appeal to the Philadelphia Court of Common Pleas on March 4, 2010. A second appeal was filed by the City of Philadelphia on April 6, 2010 following the amended decision letter of March 23, 2010. By Order dated June 22, 2010, these two appeals were consolidated.

FINDINGS OF FACT:

1. The Petition for Appeal filed with the Tax Review Board (TRB) was for the Hotel Room Rental Tax assessment for the years 2001 to 2005. Tax principal assessed was \$566,144.00, with interest of \$286,403.72 and penalties of \$442,926.33 as of the October 30, 2008 TRB hearing, for a total due at that time of \$1,295,473.95.
2. Petitioner operates an on line travel service that allows its customers to access travel information and to make travel arrangements through its website. Customers can make reservations for hotels, air flights, rental cars, events and activities through the website.
3. During the years in question, Petitioner entered into contracts with hotels located in Philadelphia. Each contract allowed Petitioner to book reservations on behalf of its customers with the contracting hotel on its website. Each contract details the terms and rates under which Petitioner can book reservations for the particular hotel and states the conditions under which the hotel will make rooms available to those who used Petitioner's web site to make their reservation.
4. The contract language used by the hotels and Petitioner states that Petitioner facilitates the booking of a hotel room reservation. The contract is not a rental or sales agreement for certain hotel rooms or a specific block of rooms or number of rooms. Exhibit 8, ¶2.

5. Petitioner provides a travel and reservation service. Its website allows a traveler to search and compare hotels, hotel rates, and hotel availability in a particular City for a specified time period. Should a traveler be interested in reserving a room at a hotel shown by Petitioner, Petitioner's computer system will check with the hotel's reservation system on the traveler's behalf to see if that hotel has a room available to meet the traveler's requirement.
6. Pursuant to the contracts reviewed by the TRB, the hotels were operated separate and apart from Petitioner. The hotels granted to Petitioner the right to request reservations on behalf of Petitioner's customers and often deemed a reservation requested by Petitioner as one requested by Petitioner's customers. The hotels themselves set the reservation and cancellation policies.
7. The hotels provided room rates to Petitioner, presumably at a discounted amount. Petitioner would add what it called a "facilitation fee" for accepting the reservation request and booking the reservation with the hotel on behalf of its customer. These two amounts would be presented to the customer as the cost for reserving the room through Petitioner. If the customer chose to go ahead with the reservation, Petitioner would add a tax recovery charge and service fee. Petitioner would notify the hotel, make the reservation, assuming the hotel made a reservation available for that day at that price, charge the customer and provide a confirmation number.
8. Petitioner would collect an amount equal to the City's Hotel Room Rental Tax as a percentage of the net amount charged by the hotel, and not on its facilitation fee.
9. This reservation and confirmation were not room specific but were a general reservation and confirmation for a certain type of room at the hotel on the days requested by the customer.
10. When the customer arrived at the hotel, the customer was required to check in with the hotel's personnel and the hotel bore all responsibility for selecting and providing the hotel room and providing the room key. Even when a room was "guaranteed," the hotel was not absolutely required to give the customer one of the hotel's rooms. If the hotel failed to provide a room for the customer, the hotel was then responsible for attempting to secure accommodations at a comparable hotel for the customer, at no additional cost since the customer had already made payment for the reservation.
11. If the hotel provided a room for the customer, the customer was required to provide the hotel with security for any incidental charges incurred during the stay.
12. During the customer's stay at the hotel, Petitioner had no responsibility with regard to the maintenance of the hotel or the room, or any amenities normally provided by the hotel. Petitioner would not have any on-site staff to interact with the travelers who made their reservations through its website.
13. The contracts reviewed by the TRB did not convey to Petitioner any direct interest in the hotel's rooms and did not evidence that the hotels were selling rooms to Petitioner. The hotels were the lessors and simply agreed to make rooms available at particular prices for the purpose of having Petitioner be able to make reservations on behalf of its customers. There was no unalterable requirement that a contracting hotel would have a specific number of rooms available or a block of rooms set aside for Petitioner's customers. The hotel retained the right to modify the number of rooms available to Petitioner's customers.
14. A traveler who showed up at a hotel with a reservation booked through Expedia was no different than a traveler who had made a reservation through a traditional travel agent or by directly contacting the hotel, except that the payment for the reservation had been made through Petitioner. There was no special guarantee or specific room provided to

Petitioner's customers. Notably, booking a reservation through Petitioner was not the same as pre-paying in full for a room in advance directly with the hotel where, then, the customer had not only a reservation but a legal right to a room.

15. Though the City Auditor who produced the assessment concluded that Petitioner was an "operator" under the ordinance, she had no support for that conclusion, did no independent determination of the applicability of the Hotel Room Rental Tax to Petitioner, did not look at the definition of "operator," did not review any of Petitioner's contracts, did not review Petitioner's website, did not conduct a full audit, did not speak with Petitioner's representatives, had no knowledge of Petitioner's operations, and did not check or verify any data provided by Petitioner. She simply analyzed the rental figures provided in order to determine the amount of the assessment.
16. Other city representatives reviewed only one of many contracts prior to making the determination that Petitioner was an "operator" under the ordinance. This contract, Expedia Exhibit 8, ¶8, is specific in its language that the terms of the Agreement do not constitute a sale or rental of rooms. The contract refers to the role of Petitioner as facilitating or booking room reservations, and the role of the hotel to "make available for booking" a number of rooms, ¶4.
17. Pursuant to the contracts with the hotels, the hotels maintain control over the availability of rooms, and Petitioner is not penalized if it fails to request reservations for the available rooms. Petitioner is not required to book any rooms or reservations. There is no penalty or cost to Petitioner if there are no reservations through its services. Exhibit 16, ¶8.
18. After checkout at the hotel by a traveler who reserved through Petitioner, the hotel would provide an invoice to Petitioner for the contracted room rate and applicable Hotel Room Rental Tax on that rate; the Hotel then would assume responsibility for transmitting the collected Hotel Room Rental Tax to the City Department of Revenue.

Conclusions of Law:

1. Petitioner's request that the Tax Review Board have its hearing closed to the public, or in the alternative maintain confidentiality of certain unnamed documents or contracts, to be decided by Petitioner, was denied. The decision of the Tax Review Board was that pursuant to The Philadelphia Code Chapter 19-1700 and Tax Review Board Regulations, the appeal hearing for Petitioner would be a public hearing with tax returns, if presented, being held as confidential and all other documents would be part of the public record, unless otherwise agreed to by the parties.

Pursuant to agreement by the parties, the Tax Review Board issued an Order dated October 28, 2009. The public hearing before the TRB then proceeded in accordance with that Order.

2. The testimony provided by the City representatives demonstrates that the City has not provided a sufficient evidentiary foundation for the assessment of the Hotel Room Rental Tax on each and every transaction in hotels in the City with which Petitioner was involved based on the City's pre-assessment review of only one hotel contract. And, review of that one hotel contract indicates there is an insufficient evidentiary foundation even for the portion of the assessment related solely to transactions under that contract.
3. Strictly construing the Hotel Room Rental Tax and construing doubts in favor of the Petitioner, it was the finding of the Tax Review Board that Petitioner did not meet the

definition of “operator” as stated in The Philadelphia Code Chapter 19-2401(7) and therefore did not incur liability for the Hotel Room Rental Tax on the facilitation fee charged to its customers for the reservation service it provided.

The City’s assessment of the Hotel Room Rental Tax under The Philadelphia Code Chapter 19-2402 for the reservation and booking activities provided by Petitioner was challenged by Petitioner on the following grounds: (a) Petitioner does not meet the requirements of ordinance for imposition of the tax because it does not fit into the definition of “operator” and the fees collected are not “consideration” as defined, and (b) the imposition of the tax on Petitioner violates the Commerce Clause of the U.S. Constitution.

The Philadelphia Code §19-2402(1) imposes a Hotel Room Rental tax on “the consideration received by each operator of a hotel within the City from each transaction of renting a room or rooms to accommodate transients.”

“Operators” are those who “maintain, operate, manage, own, have custody of, or otherwise possess the right to rent or lease overnight accommodations in any hotel to the public for consideration.” The Philadelphia Code §19-2401(7).

A "Transient" is "[a]ny individual who obtains an accommodation in any hotel for himself by means of registering at the facility for the temporary occupancy of any room for the personal use of that individual by paying to the operator of the facility a fee in consideration thereof." The Philadelphia Code §19-2401(15).

A "Transaction" is the activity involving the obtaining by a transient or patron of the use or occupancy of a hotel room from which consideration emanates to the operator under an express or an implied contract." The Philadelphia Code §19-2401(14).

A "Patron" is "[a]ny person who pays the consideration for the occupancy of a room or rooms in a hotel." The Philadelphia Code §19-2401(15).

It is not until an individual has registered at a hotel facility and has obtained and paid for a room, that the actual rental has occurred and the Hotel Room Rental Tax is due; the transient may pay the operator directly or a Patron may pay on the transient's behalf.

The Philadelphia Code § 19-2405 (4, 6) imposes stringent duties on the operator of each facility: " Every operator shall transmit to the Department, on or before the fifteenth (15th) day of each month, a return for the month preceding the month in which the return is made, which return shall report the amount of consideration received for the transactions during the month for which the return is made, the amount of tax due from the operator for that month, and such other information as the Department may require. . . Every operator shall maintain records, which shall be made available to the Department upon its request, which shall include, but not be limited to, the number of transactions in each hotel reflected on an hourly, daily, or weekly basis, the rate(s) charged for each occupancy, the consideration received from all transactions during the month for which each return is made, as well as such other information as the Department may require."

Thus, the ordinance presumes that operators are in charge of the hotel facility's records in such a way that the operator is able to timely file a return regarding every transaction which occurred in the operator's hotel in the preceding month.

It was the City's position that Petitioner is responsible to pay Hotel Room Rental Tax on the amount of money it charges its customers over and above the room rental rate that a hotel will charge Petitioner because Petitioner meets The Philadelphia Code definition of "operator". The City contends that through the contractual arrangements between Petitioner and the hotel owners, Petitioner "possess(es) the right to rent or lease" the hotel rooms within the meaning of The Philadelphia Code §19-2401(7), and therefore the facilitation fee charged by petitioner is subject to the tax as part of the consideration paid for the room rental.

Petitioner asserts that it "facilitates" reservations for travelers, and further, that its share of the quoted hotel room rate is a facilitation fee that is separate and apart from the room rental consideration paid to the hotel and on which the Hotel Room Rental Tax is recovered from the traveler, transmitted to the hotel, and remitted to the City by the hotel.

The TRB evaluated the activities of Petitioner to determine if at any point it had the "right to rent" a room or in any way acted as a hotel "operator" as per the Philadelphia Code. The TRB also reviewed the provided contracts between Petitioner and Philadelphia hotels to evaluate what rights, if any, had been contractually transferred by the hotels to Petitioner.

A. Petitioner's Activities

Petitioner's business activity is conducted primarily through its website. A customer or traveler can access petitioner's website to search for hotel information, including hotel description, room availability for a specific time period and cost. Information is usually available for multiple hotels fitting the traveler's stated criteria for location and dates, thus allowing a traveler to review, compare and contrast available hotel options.

Upon making a decision, a traveler identifies to Petitioner the hotel for which a reservation is being requested. Petitioner's computer system has already checked with the hotel to determine the availability of the type of hotel room requested by the traveler. If the requested type of hotel room is available, Petitioner will request and accept payment from the traveler, including the stated room rental rate, applicable service fees and tax recovery charges. The room rental rate will consist of 2 parts: the room rate quoted by the hotel to Petitioner, and the higher amount charged by Petitioner to the traveler which consists of the hotel's stated rate plus Petitioner's added on fee that is shown to the traveler as the room rate. Petitioner then requests the hotel to reserve the room for the traveler and, once confirmed, the traveler receives confirmation information via the website; when computerized, this process is often almost instantaneous

Petitioner does not own the brick and mortar hotel, has no physical presence at the hotel, and has no responsibility for the operation or management of the hotel. Petitioner does not have a dedicated block of rooms set aside for its customers that is standing vacant and ready for it to book customers to fill them. There is no penalty or loss to Petitioner if it fails to book a room at a particular hotel with which it has contracted.

Petitioner does not have any access or control over the property such as an owner or operator would be expected to possess.

Petitioner's customers are not treated differently in any way from a traveler who books a reservation in a manner other than through Petitioner's website. When Petitioner's customers arrive at a hotel, it is the hotel management that is responsible for seeing that there is a room ready and waiting. If the hotel has overbooked reservations, Petitioner's customers are again treated like any other. They must rely on the hotel to find them other accommodations. The only distinguishing item between Petitioner's customers and any others who have booked reservations at a hotel is that Petitioner's customers made their reservations and payments to the hotel by using Petitioner's services.

Petitioner does not have possession of any rooms at the hotel so that it can insure that its customers will always have their reservations honored regardless of what else the hotel may be doing to fill the hotel. The hotel always retains control of its rooms and their availability.

Approximately thirty (30) days after a traveler has reserved a room through Petitioner and has completed her stay, the hotel then bills Petitioner for the rate agreed upon between the hotel and Petitioner and an amount equal to the Hotel Room Rental Tax applicable to that rate. Petitioner remits payment of the bill to the hotel.

B. The Contractual Relationship between Petitioner and Hotels

The TRB had the opportunity to review several different contracts that Petitioner had entered into with various Philadelphia hotels to determine if Petitioner had contractually obtained the rental rights to hotel rooms.

The City representatives in preparation for conducting the "pick-up" conceded that they had reviewed only one contract, Expedia Exhibit 8. This contract specifically states "nothing in this Agreement constitutes a sale or rental of rooms." ¶8. It provides that the hotel will "make available for booking" rooms at the property (¶4) and expressly provides that Petitioner does not incur any risk or penalty for "failure to book" any rooms. ¶8.

The language throughout the contract refers to Petitioner's role as facilitating or booking reservations for the hotel. It refers to Petitioner's services as providing a system for travelers "to shop for, reserve, book and pay for travel services". ¶1

The contract provides a process for Petitioner to "reserve rooms for guests", ¶7, and does not provide any guarantee that a request will always mean that a room in the hotel is available for Petitioner's customer seeking the reservation. The hotel is only required to "make available for booking" rooms at its property, ¶4, but the hotel retains the right to change the available number or reduce it to zero.

C. Discussion:

1. The TRB looked at the totality of the activity and contracts to determine if Petitioner fit into the ordinance definition of "operator" and determined that Petitioner does not meet the definition and is therefore not subject to Hotel Room Rental Tax.

Petitioner's activities with regard to the hotels do not establish that it "possesses the right to rent or lease" hotel rooms. Petitioner's only activity is to provide information about hotel availability, amenities and rates to potential travelers. Should a traveler request a reservation, Expedia has to confirm with the hotel that the requested room is available and then request the reservation from the hotel. It cannot, independent of the hotel management, reserve and rent a room. It does not have a set of rooms set aside that it can offer and book without permission of the hotel management. It then collects payment from its customers, remits to the hotels out of that payment the agreed upon room rental rate and an amount equal to the applicable taxes much like a Patron under the ordinance, and keeps for itself its charges to its customers for services rendered on the customer's behalf.

The City pointed out that in its advertising and in certain older SEC filings, Petitioner uses the language that it "sells" hotel rooms. The hyperbole of the television commercial language is not controlling and doesn't reflect the reality of Petitioner's business model. Petitioner pointed out that the use of the word "sell" even in the older SEC filings was puffery, that the full business model was described in the SEC filings and demonstrates, and that the newer SEC filings removed the word "sell."

The contract language further confirms the reality of the relationships between Petitioner and the hotels. Petitioner is permitted to book reservations and contracts with the hotels for the right to do so on behalf of Petitioner's customers, and does so in order to attempt to direct to the hotels a greater volume of business. The hotels are absolutely not ceding to Petitioner any rights to any rooms or responsibilities for these rooms or the hotel premises or rental records.

Petitioner does not acquire the "right to rent or lease" hotel accommodations and therefore does not become a hotel operator subject to the Hotel Room Rental Tax.

Concurred:

Monique DeLapenha, Esq., Chair
T.David Williams, Esq.
LaVon Wells-Chancy, CPA

Dissented:

Joseph Ferla