

PUBLICATION

Spotlight on Kentucky: Federal Appeals Court Upholds OTC Defense to Kentucky Tax Claim

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The U.S. Sixth Circuit Court of Appeals issued an opinion on December 22, 2009 in favor of on-line travel companies (OTC) under Kentucky law. The decision upheld a lower court ruling that dismissed the claims of Kentucky counties for unpaid transient room taxes on the OTC mark-up of hotel room rates. In *Louisville/Jefferson Metro Government v. Hotels.com, L.P. et al*, the federal appeals court affirmed the district court's interpretation of the Kentucky legislation authorizing the taxes. The typical arrangement for OTC wholesale model pricing, where the OTC remits to the hotel the negotiated wholesale room rate and the local taxes calculated on that rate, was challenged by two counties seeking the tax on the spread or margin netted by the OTC.

At issue was the language of the Kentucky transient room tax, which is imposed on "the rent for every occupancy of a suite, room, or rooms, charged by all persons, companies, corporations, or other like or similar persons, groups or organizations doing business as motor courts, motels, hotels, inns or like or similar accommodations businesses." Ky. Rev. Stat. Ann. § 91A.390(1). The statute predates the OTC merchant model, a fact noted by both courts. Instead, the case focused on whether the OTC provider is an accommodations business under Kentucky law. The Sixth Circuit relied on a 2004 Kentucky Court of Appeals decision that upheld the transient room tax levied on rental revenues from furnished apartments rented to corporate customers on an extended stay basis. The Kentucky tax is not consumer-based, the court held. Instead, the tax is imposed on the accommodations business operator. Unlike the corporate lodging service provider, "the OTCs in the present case do not physically control or furnish the rooms they advertise." The court observed that OTCs do not "supply" or "provide" rooms to guests "because they take no part in making the room physically available."

Both courts also rejected an expansive reading of the enabling tax statute based on Kentucky (and general) principles of statutory construction. Tax statutes with qualifications are read narrowly, according to their plain meaning, and not construed expansively. This statute's use of restrictive language limited the tax to taxpayers imbued with "ownership and physical control over the rooms for rent [which] are simply shared characteristics of motor courts, motels, hotels, and inns." The trial and appeals courts refused to expand the meaning of the phrase "like or similar accommodations businesses" to parties not in physical possession or control of lodging premises, like OTCs. The Sixth Circuit followed a recent ruling by the Fourth Circuit construing a North Carolina tax statute to a similar result, holding no liability for the OTCs on the transient room tax. The court contrasts the language of the Kentucky transient room tax statute with a transient room tax imposed on "the charge to the public" as was the subject of the recent ruling of the Georgia Supreme Court construing the city of Columbus statute to an opposite result.

The federal appeals court concluded that other arguments under Kentucky law for challenging the transient room tax statute would be unavailing, and the Kentucky law presumption in favor of a taxpayer was not overcome by the municipalities. So until the Kentucky General Assembly changes the wording of the transient tax statute or the ruling is overturned by the entire Sixth Circuit or the U.S. Supreme Court, the merchant model survives intact in the Bluegrass State.

For more information about this recent decision, please contact a Baker Donelson attorney.

