

PUBLICATION

Spotlight On North Carolina: Federal Appeals Court Rules that County Cannot Collect Occupancy Taxes from Online Travel Companies

January 22, 2009

On January 14, 2009, the U.S. Fourth Circuit Court of Appeals released *Pitt County v. Hotels.com, L.P. et al.* As in other cases filed by various cities, counties and other local jurisdictions around the country, this North Carolina case arises from a dispute over the calculation and collection of hotel occupancy taxes for rooms rented to consumers by online travel companies (OTCs) and represents a significant victory for OTCs facing occupancy tax collection disputes in North Carolina.

Pitt County, North Carolina filed a class action suit in state court against a number of OTCs seeking payment of the county's hotel occupancy tax based on the retail rate the OTCs charged to consumers instead of the lower wholesale rate charged to the OTCs by the hotel operators for the rooms. Pitt County illustrated its claim using a hypothetical situation where an OTC purchases a hotel room from a hotel operator for a wholesale rate of \$70.00 and re-lets the room to a consumer for a retail rate of \$100.00 per night. The hotel operator pays Pitt County an occupancy tax of 3 percent of the \$70.00 per night wholesale rate for the room, and neither the hotel operator nor the OTC pay any occupancy taxes on the \$30.00 difference between the \$100.00 per night retail rate and the wholesale rate. Pitt County claimed that the OTCs were responsible for the occupancy tax on the difference between the \$70.00 per night wholesale rate and the \$100.00 per night retail rate charged by the OTCs, in the same manner as taxes are charged on the retail room rate paid by the guest and collected by the hotel for rooms sold under conventional travel agent commission arrangements. The state court action was transferred to federal district court at the request of the OTCs. The federal district court dismissed the suit, and the county appealed to the U.S. Fourth Circuit Court of Appeals.

The Court of Appeals resolved the dispute in favor of the OTCs, dismissing the county's lawsuit and holding that the county could not collect the occupancy tax from an OTC. The Court of Appeals found that the specific language of the statute authorizing Pitt County to impose an occupancy tax only allowed collection of the occupancy tax from businesses meeting the definition of "retailers" in North Carolina's state sales tax statute. The relevant North Carolina sales tax statute defines "retailers" in the room and lodging context as "[o]perators of hotels, motels, tourist homes, tourist camps, and similar type businesses and persons who rent private residences and cottages to transients. . . ." Because the OTCs have no role in the day-to-day operation or management of the hotels, the Court of Appeals concluded that the OTCs do not operate the hotels, so they do not fall within the statute's definition of "retailers" and cannot be compelled to pay occupancy taxes to the county.

The Court of Appeals rejected Pitt County's argument that OTCs are "retailers" because their business and the business of hotel operators are "similar type businesses" described in the definition of "retailers," finding that the businesses of renting rooms online and of operating hotels, motels, tourist homes or tourist camps are not similar types. Pitt County also argued that the Court's construction of the statute would create a loophole that would allow hotels to avoid the occupancy tax, a concern raised in the 2006 decision of the U.S. District Court for the Southern District of Illinois in *City of Fairview Heights v. Orbitz, Inc.* The Court of Appeals responded that the job of closing loopholes (if they exist) belongs to the North Carolina legislature, not the Court. In addition, the Court of Appeals observed that, though it found no ambiguity in the statute's definition of "retailers" as to its application to OTCs, it would reach the same result even if it found that the statute was

ambiguous because North Carolina law, like the law in many other states, provides that when the meaning of a taxing statute is doubtful, it should be construed against the state and in favor of the taxpayer.

Cities, counties and other local jurisdictions, nationally, have been keen to tax the full, marked-up rates of the OTCs in the same way that they taxed the full commissionable rates of hotel rooms rented through the traditional travel agent channels. This Court determined that only those defined as a "retailer" by the language of the statute assume the obligations of tax collection. Thus, this victory for OTCs hinged on the specific definition of a "retailer" in North Carolina's state sales tax statute. The decision draws no distinction between traditional wholesalers, who commit to buy room inventory and are legally obligated to pay the hotel, whether or not the inventory is resold, and OTC's, which buy at the wholesale price only if the inventory sells at retail.