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GROUPON AND EXPEDIA: A COMPARISON OF TWO  
MODERN ONLINE TRENDS CREATING A *PARALLEL*  
TAX INQUIRY

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CHANTELLE L. LYTLE<sup>1</sup>

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*“Simplicity in modern taxation is a problem of basic architectural design. Present legislation is insufferably complicated and nearly unintelligible. If it is not simplified, half of the population may have to become tax lawyers and tax accountants.”*<sup>2</sup>

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<sup>1</sup> Chantelle L. Lytle, J.D. ‘13, Elon University School of Law; Associate Attorney, Nelson Mullins Riley & Scarborough LLP, Columbia, South Carolina. Thank you to Professor Andrew J. Haile of Elon Law for the suggestion of pursuing this topic and the feedback that followed.

<sup>2</sup> Henry C. Simons. Davis & Langford, *Tax Quotes – Just for Fun*, DAVIS & LANGFORD CERTIFIED PUBLIC ACCTS., [http://www.johnscreekcpa.com/Home/Tax\\_Quotes/](http://www.johnscreekcpa.com/Home/Tax_Quotes/) (last visited Nov. 18, 2012).

## I. INTRODUCTION

Americans are surf-and-spenders. In 2011, we spent more than 200 billion dollars on online shopping,<sup>3</sup> or, as the pastime is often phrased, shopping while surfing (the web). There is no denying that American shoppers have welcomed the online purchasing arena. Gone are the days of spending hours in store dressing rooms, trying on each item of clothing. No longer do we smell each candle in the aisle before choosing the best scent or examine each banana in order to find the ripest batch. Forgotten are the days of cutting coupons from the Sunday newspaper and of speaking with a hotel agent on the telephone to reserve a room.

Granted, that may be a bit theatrical. As to the latter two, though, the coupon-cutting and telephone-reserving have been largely replaced with the recent trends of Groupon, Inc. (“Groupon”) and Expedia, Inc. (“Expedia”). Groupon, featuring “daily deals” on prized items at discounted prices, and Expedia, offering one-stop travel booking, are both accessible with the click of your cursor.<sup>4</sup> While undeniably convenient in their ease of access through the internet portal, these two online companies present a novel tax question: *When a Groupon or Expedia purchase is made, should sales and hotel taxes, respectively, be remitted based on the full value of the item or service sold or, rather, the lower, discounted value?* Stated in tax jargon, what is the appropriate *tax base* when calculating the Groupon sales tax and the Expedia hotel tax—the full or lower, discounted value?

When determining the proper tax base, the Groupon tax consideration asks whether the *customer*, when redeeming her Groupon for the item or service sold, should pay sales tax to *the merchant* based on the discounted amount she paid to Groupon or rather, the higher, full value of the item or service.<sup>5</sup> In merely a varied application of the same tax inquiry, the Expedia consideration asks whether *Expedia* should remit hotel taxes to *the hotel* based on the discounted room rate

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<sup>3</sup> Stu Woo, *Online-Retail Spending at \$200 Billion Annually and Growing*, WALL ST. J. (Feb. 27, 2012, 12:31 AM), <http://blogs.wsj.com/digits/2012/02/27/online-retail-spending-at-200-billion-annually-and-growing/>.

<sup>4</sup> See *About Us*, GROUPON, <http://www.groupon.com/about> (last visited Nov. 18, 2012); *About Expedia.com*, EXPEDIA, <http://mediaroom.expedia.com/about-expediacom-180> (last visited Nov. 18, 2012).

<sup>5</sup> See Janet Novack, *Social Confusion: How Do Sales Taxes Apply To A Groupon?*, FORBES (Feb. 18, 2011, 5:39 PM), <http://www.forbes.com/sites/janetnovack/2011/02/18/social-confusion-how-do-sales-taxes-apply-to-a-groupon/>.

that Expedia negotiated with and paid to the hotel or instead, the higher, marked-up retail room rate paid by the customer to Expedia.<sup>6</sup>

Alongside setting forth a parallel tax question, the majority of regulatory and judicial bodies considering the Groupon and Expedia inquiries have rightfully determined that the appropriate tax base should comprise the *lower* applicable value. Regarding Groupon and other comparable daily-deal companies (“DDC(s)”), sales tax treatment of their daily-deal coupons is divided among the states, with a slight majority imposing sales tax based on the discounted value of the item or service sold.<sup>7</sup> Likewise, as for Expedia and other online travel companies (“OTC(s)”), the majority approach is similar to Groupon’s, with several courts holding that Expedia and other OTCs must remit hotel taxes based only on the discounted room rate<sup>8</sup> (yet, the majority approach leans *less* toward favoring taxation based on the discounted value when considering the increasing number of out-of-court settlements and the rise in legislative amendments, all imposing taxation based on the *higher*, retail room rate).<sup>9</sup>

This paper examines the tax treatment of Groupon and similar DDCs, as well as the tax treatment of Expedia and other comparable OTCs. Despite identifying certain differences between the tax controversies surrounding Groupon and Expedia, this article argues that the underlying controversies confronting both companies ultimately pose different versions of the *same* legal question: To what tax base do the applicable taxes apply—the discounted or higher, full value of the item or service sold? While a uniform treatment of this question is noticeably absent, the majority tax approach within both entities is the same—taxing the lower applicable amount. This paper contends that such an outcome reflects the proper normative treatment—in both situations the same legal question applies and, although based on differ-

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<sup>6</sup> Charisse Jones, *Cities, States in Hotel Tax War with Orbitz, Expedia, Others*, USA TODAY (Oct. 22, 2010, 7:29 PM), [http://travel.usatoday.com/hotels/2010-10-22-hoteltaxes22\\_CV\\_N.htm](http://travel.usatoday.com/hotels/2010-10-22-hoteltaxes22_CV_N.htm).

<sup>7</sup> See Andrew D. Grace, *Sales and Use Taxation of Daily Deal Vouchers*, ST. TAX TODAY, Aug. 27, 2012, at pts. IV, IV(A), IV(2), IV(3), available at 2012 STT 166-5.

<sup>8</sup> See Joseph Henchman, *Taxation of Online Travel Services: Lawsuits Generally Not Succeeding In Effort to Expand Hotel Taxes to Online Travel Services*, TAX FOUND. 1, 3 (May 2012), [http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr198\\_travel.pdf](http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr198_travel.pdf).

<sup>9</sup> See, e.g., Karen Setze, *FTA Panelist: Online Travel Companies Faring Worse Than Advertised in Court*, ST. TAX TODAY, June 15, 2011, available at 2011 STT 115-2; Tom Gilroy, *Online Travel Firms Sue North Carolina to Block State’s New Tax Amendments*, TAX MGMT. WKLY. ST. TAX REP., Feb. 11, 2011.

ent statutory regimes, the same answer should also apply: taxes should be calculated based on the lower tax base.

Part II of this paper discusses Groupon. It explains how Groupon operates, the tax question resulting from these operations, the varying regulatory approaches to answering this tax question, and the approach applied by a significant number of jurisdictions. Likewise, Part III discusses the same issues as they relate to Expedia. Parts II and III conclude with a discussion of the preferred lower tax base, supported by statutory interpretation and economic considerations. Finally, the paper concludes in Part IV.

## II. Groupon

### A. *What is Groupon?*

Founded in 2008, Groupon is among several “internet-based ‘deal-of-the-day’ discount coupon programs,” noted as being the “biggest and most widely subscribed to” along with LivingSocial.<sup>10</sup> Through its website, Groupon offers “heavily discounted vouchers (or Groupons) on behalf of local vendors.”<sup>11</sup> Groupons come in the form of many products and services, including food, dance lessons, scuba-diving lessons, and Lasik eye surgery.<sup>12</sup> Similar business models have emerged and it is perhaps unsurprising that Facebook is reported to be “launching a similar program in key test markets.”<sup>13</sup> Indeed, a May 2011 study conducted by Shop.org, a section of the National Retail Federation, found that 82% of online consumers are aware of websites like Groupon, LivingSocial, and Gilt City.<sup>14</sup> Named by Forbes.com as one of the “fastest growing companies in Web history,”<sup>15</sup> in 2011, Groupon sold

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<sup>10</sup> *About Us*, *supra* note 4; Sylvia F. Dion, *State Tax Issues to Consider With ‘Groupons’ and Other Third-Party ‘Deal-of-the-Day’ Programs*, BNA TAX MGMT. WKLY. ST. TAX REP., Mar. 23, 2012.

<sup>11</sup> Diann L. Smith, Marlys A. Bergstrom, Mark A. Yopp & Madison J. Barnett, *Prepaid Discount Vouchers: The Not-So-Final Frontier*, ST. TAX TODAY, May 16, 2011, available at 2011 STT 944.

<sup>12</sup> *Id.*

<sup>13</sup> Stephen P. Kranz, Lisbeth A. Freeman & Mark W. Yopp, *Taxing the Virtual World . . . And Beyond*, ST. TAX TODAY, May 2, 2011, at pt. I(B), available at 2011 STT 844.

<sup>14</sup> Martha Kessler, *Groupon Craze, Other Online Daily Deals Raise Questions About How State Sales Tax Should Be Applied to the Activity*, BNA TAX MGMT. WKLY. ST. TAX REP., Nov. 4, 2011.

<sup>15</sup> Sylvia F. Dion, *Wondering How Sales Tax Applies to a Groupon? So Are Many of The States!*, THE ST. AND LOCAL TAX “BUZZ” (June 10, 2011), <http://www.thestateandlocaltaxbuzz.com/2011/06/wondering-how-sales-tax-applies-to.html>.

1.62 billion dollars in these online coupons.<sup>16</sup> With sales in the billions, it is unsurprising that states have focused their attention on Groupon and similar companies concerning how these online coupons are taxed.<sup>17</sup> However, before considering the different ways in which sales tax can be applied to a Groupon item or service, it is first necessary to understand the mechanics of a Groupon sale.

A deal-of-the-day or “daily deal voucher” is defined as “a coupon purchased by a consumer from a third-party operator that is then redeemed for food, goods, or services at a reduced price at specific businesses.”<sup>18</sup> When a daily deal voucher purchase is made, three parties interact: the customer who purchases the daily deal voucher (e.g., Buyer Bruce); the company that sells the daily deal voucher (e.g., Groupon); and the merchant that accepts the voucher (e.g., ABC Carwash).<sup>19</sup>

The transaction among these three parties occurs in the following way: First, subscribers to Groupon receive a “‘Daily Deal’ e-mail” which describes the discounted products and services offered, oftentimes located in the subscriber’s local area.<sup>20</sup> As Groupon proclaims, these deals are for “the best stuff to do, see, eat, and buy in 48 countries, and soon beyond.”<sup>21</sup> Interested subscribers must act quickly, as Groupon specifies a limited time to buy the deal, oftentimes “only a few hours or days.”<sup>22</sup> Second, once the minimum number of subscribers buys the offer, “the deal becomes effective, or as Groupon says, ‘the deal is on.’”<sup>23</sup> Third, after buyers remit payment to Groupon using their credit card, Groupon sends them an electronic “voucher.”<sup>24</sup> Finally, the customer may redeem their item by giving the “voucher” to the merchant “as a printed certificate or virtual mobile device coupon.”<sup>25</sup>

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<sup>16</sup> *Groupon is a Headache for State Tax Administrators*, CITIZENS FOR TAX JUST. (Apr. 2, 2012, 2:00 PM), [http://www.ctj.org/taxjusticedigest/archive/2012/04/groupon\\_is\\_a\\_headache\\_for\\_stat.php](http://www.ctj.org/taxjusticedigest/archive/2012/04/groupon_is_a_headache_for_stat.php).

<sup>17</sup> See *id.*; Dion, *supra* note 15.

<sup>18</sup> Grace, *supra* note 7.

<sup>19</sup> See *id.* at pt. I.

<sup>20</sup> Dion, *supra* note 10. Groupon also lists available daily deals on its website. See GROUPON, <http://www.groupon.com/san-francisco> (last visited Nov. 18, 2012).

<sup>21</sup> *About Us*, *supra* note 4.

<sup>22</sup> Dion, *supra* note 10.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

Once the initial online sale of the daily deal is complete and the buyer's payment is processed, Groupon pays the agreed-upon percentage of the payment to the merchant.<sup>26</sup> The percentage split varies among merchants' contracts, but oftentimes, the customer's payment is divided evenly between Groupon and the merchant, each receiving 50%.<sup>27</sup> For example, considering Buyer Bruce mentioned previously, imagine that a full-service carwash is worth \$40 at ABC Carwash. If ABC Carwash contracts with Groupon to offer a daily voucher of \$20 for the service, an agreed-upon 50-50 split would necessitate Groupon and the carwash each receiving \$10 upon the sale. Thus, ABC Carwash has received \$10 for a sale worth \$40, amounting to a \$30 loss.<sup>28</sup> Despite this loss, merchants like ABC Carwash continue to contract with Groupon, as such losses are outweighed by the "primary benefit" of "the potential to increase the merchant's customer base and create repeat customers."<sup>29</sup> As one commentator noted favorably of the transaction, "The consumer gets 50 to 80 percent off, the merchant gets exposure and a guaranteed number of new customers, and Groupon collects 50 percent of the money earned."<sup>30</sup>

While these stages of a Groupon sale can be fairly described as uncontroversial, one aspect of the process has generated much inquiry, forming the basis for this paper. Concerning the applicable sales tax for each item or service sold in the form of a daily deal, notably, Groupon does *not* charge sales tax upon the online purchase of these daily vouchers.<sup>31</sup> Rather, Groupon requires *merchants* to assume responsibility for such taxes when a Groupon is redeemed.<sup>32</sup> Indeed, "Groupon's Merchant Account Terms and Conditions Agreement *requires merchants* to acknowledge that they are registered for sales tax collection purposes and will be responsible for *collecting and remitting all applicable taxes*."<sup>33</sup> When considering the effects of this requirement, one commentator states:

Groupon puts the onus of incredibly complex issues like taxation . . . on the merchant. These are issues that multinationals with armies of lawyers struggle with. If you're running a small coffee shop, restaurant or nail

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> For a similar example, see *id.*

<sup>29</sup> *Id.*

<sup>30</sup> Smith, Bergstrom, Yopp & Barnett, *supra* note 11.

<sup>31</sup> Dion, *supra* note 10.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* (emphasis added).

salon, you likely have no idea what any of this stuff means. *Because Groupons are so new, no one really does.*<sup>34</sup>

This, in turn, has resulted in the tax implications explored in the next section.

## B. *The Tax Base: Differing Approaches to Groupon's Situation*

### 1. Resulting Tax Question

Flowing from Groupon's requirement that merchants assume tax responsibility inevitably creates the conundrum of determining exactly what that sales tax is *and* how to calculate it. Returning to Buyer Bruce, consider the hypothetical outlined above: Buyer Bruce purchases for \$20 a daily deal on Groupon for a full-service carwash at ABC Carwash. The full value of the carwash is worth \$40. After ordering the full-service carwash at ABC Carwash, the total amount of the bill is \$40. Bruce pays the bill by giving his Groupon to the cashier. Upon redeeming his Groupon, one of three things can occur regarding the *collection* of the applicable sales tax: (1) ABC Carwash will *not* collect sales tax from Bruce; (2) ABC Carwash will require Bruce to pay sales tax in cash; or (3) ABC Carwash will allow Bruce to use his daily deal for the total amount owed for the carwash, including the sales tax.<sup>35</sup> Likewise, if ABC Carwash collects sales tax from Bruce, one of two things can occur regarding the *calculation* of the applicable sales tax: (1) ABC Carwash will calculate the sales tax based on \$20, the discounted price that Bruce actually paid for the daily deal; or (2) ABC Carwash will calculate sales tax based on \$40, the full, undiscounted price of the service purchased.<sup>36</sup>

For some, these options may appear to set forth little, if any, meaningful difference. In other words, *who cares*, you ask. For several interested parties, the decision made by ABC Carwash, and all other participating merchants of Groupon, of whether and how much sales tax to collect from Groupon users, has significant effects.<sup>37</sup> For

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<sup>34</sup> Rakesh Agrawal, *A Look at Groupon's Extremely Lopsided Merchant Agreement*, REDESIGN (June 7, 2011, 1:00 PM), <http://blog.agrawals.org/2011/06/07/an-analysis-of-the-groupon-merchant-agreement/> (emphasis added).

<sup>35</sup> See Novack, *supra* note 5; Stephen Blair, *Sales Tax on Transactions Involving Groupons – What's the Deal?*, ALPERN ROSENTHAL (Apr. 5, 2012), <http://www.alpern.com/sales-tax-groupon>.

<sup>36</sup> See Novack, *supra* note 5; Blair, *supra* note 35.

<sup>37</sup> Steven Roll & Christine Boeckel, *State Treatment of Social Media Coupons is Evolving, Lacks Uniformity, Experts Say*, BNA TAX MGMT. WKLY. ST. TAX REP., June 15, 2012.

merchants, “[t]he ‘stakes are high.’”<sup>38</sup> If the merchant charges excessive sales tax on the Groupon purchase, there is the potential for class action lawsuits filed by angered customers.<sup>39</sup> Indeed, a merchant who “collects tax when none was due” is said to have “over-collected” and is “at risk” of being subject to these lawsuits or even, “violating consumer protection laws.”<sup>40</sup> Conversely, if a merchant does not collect *enough* sales tax on the Groupon purchase, “the retailer can be liable for sales tax, interest, and penalties.”<sup>41</sup>

For *states*, there are significant effects in the form of lost revenue.<sup>42</sup> “[S]tates are recognizing the potential for lost revenue because the existing rules on the impact of discounts on sales price could greatly diminish the sales tax base.”<sup>43</sup> For *Groupon and similar DDCs*, the appeal of the daily-deal industry may decline if consumers are forced to pay sales tax on the full value of the Groupon item or service.<sup>44</sup> As a result, for *consumers*, with the average local sales tax rate levying at 9.6%<sup>45</sup> nationwide, it is clear that their pockets are directly affected by the decision.<sup>46</sup> As the next section discusses, among those states that have offered formal guidance on the matter, the approach varies state-to-state,<sup>47</sup> an outcome that may ultimately raise more questions than answers for these affected parties.

## 2. Varied Tax Treatment

Conflicting; contrary; erratic; incoherent; incompatible; irreconcilable; uncertain; unpredictable; unstable.<sup>48</sup> These are just some of

<sup>38</sup> *Id.*

<sup>39</sup> Janet Novack, *24 States Moving Towards Decision on Taxing Groupon*, *LivingSocial Deals*, FORBES (Mar. 26, 2012, 12:19 PM), <http://www.forbes.com/sites/janetnovack/2012/03/26/24-states-moving-towards-decision-on-taxing-groupon-livingsocial-deals/>.

<sup>40</sup> Roll & Boeckel, *supra* note 37.

<sup>41</sup> *Id.* See, e.g., *Retail Sales Tax*, WASH. ST. DEP'T OF REVENUE, <http://dor.wa.gov/content/findtaxesandrates/retailsalestax/> (“The seller is liable to the Department of Revenue for sales tax, whether or not it is collected.”) (last visited Nov. 18, 2012).

<sup>42</sup> Dion, *supra* note 10.

<sup>43</sup> *Id.*

<sup>44</sup> Novack, *supra* note 39.

<sup>45</sup> A February 2012 *Forbes* article confirms this percentage. See William P. Barrett, *Average U.S. Sales Tax Rate Drops—A Little*, FORBES (Feb. 2, 2012, 1:07 PM), <http://www.forbes.com/sites/williambarrett/2012/02/02/average-u-s-sales-tax-rate-drops-a-little/>.

<sup>46</sup> See Novack, *supra* note 39.

<sup>47</sup> See, e.g., Grace, *supra* note 7, at pt. IV; Dion, *supra* note 10; Roll & Boeckel, *supra* note 37.

<sup>48</sup> *Inconsistent*, THESAURUS.COM, <http://thesaurus.com/browse/inconsistent?s=t>.



the synonyms for “inconsistent”<sup>49</sup>—a term that best summarizes the recent, yet minimal, state guidance instructing merchants on how sales tax should be applied to Groupon purchases. Considering this issue during a session of the ABA Section of Taxation meeting on May 11, 2012, one speaker reflected, “We’re in a definite gray area . . . with a lot of uncertainty.”<sup>50</sup> Likewise, a former state tax official stated of the issue, “It is a bit of a mess, but that is true of a lot of breaking issues . . . [t]here will be a period of time when retailers are in a difficult position.”<sup>51</sup> To color the area greyer, because the question is so recent, only ten states have offered formal guidance on the matter.<sup>52</sup> To affirm such uncertainty even further, it is notable that twenty-four states comprising the Streamlined Sales Tax Governing Board have attempted to reach an agreement on a uniform tax treatment of Groupon sales.<sup>53</sup> However, this effort failed on May 24, 2012 “when the measure was narrowly defeated by a small group of states already administering different tax treatment schemes.”<sup>54</sup>

While a uniform tax treatment among the states has so far proven elusive, the options are clear: of those states offering guidance on this issue, there are “two camps”: first, “those that impose tax on the *full sales price*,” and second, “those that impose tax on the *discounted sales*

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<sup>49</sup> *Id.*

<sup>50</sup> John Buhl, *ABA Meeting: ‘Deal of the Day’ Sites Raise Sales Tax Issues*, ST. TAX NOTES MAG., May 21, 2012, available at 64 State Tax Notes 513.

<sup>51</sup> Kessler, *supra* note 14.

<sup>52</sup> To configure this number, three recent sources on the issue were considered. Two of these sources confirmed that the following seven states have offered formal guidance: California, Illinois, Iowa, Kentucky, Maine, Massachusetts, New York. The remaining differences in the sources’ findings are indicated after each citation. See Steven Roll & Deborah Swann, *In Search of New Revenue, States Eye New Types of Transactions and Funding Sources*, BNA TAX MGMT. WKLY. ST. TAX REP., May 18, 2012 (concluding that nine states have issued formal guidance; includes Kansas and Texas where the latter source does not; does not include Mississippi where the latter source does). See also Grace, *supra* note 7, at pt. IV (concluding that eight states have issued formal guidance; includes Mississippi where the former source does not; does not include Kansas or Texas where the former source does). It is noted later in this paper that it is unclear whether Texas has offered *formal* guidance on the matter. A third source identifies Wisconsin as releasing formal guidance on the issue, making it the tenth state to do so after considering the aforementioned sources. See *Discounted Certificates, Product Vouchers Not Subject to Wisconsin Sales Tax*, ST. TAX TODAY, Aug. 9, 2012, available at 2012 STT 154-30.

<sup>53</sup> John Buhl, *Governing Board Panel Still Struggling to Resolve ‘Deal of the Day’ Issue*, ST. TAX TODAY, July 19, 2012, available at 2012 STT 139-1; Grace, *supra* note 7, at pt. IV.

<sup>54</sup> Roll & Boeckel, *supra* note 37.

*price.*<sup>55</sup> Of the ten states that have offered guidance, six have instructed merchants to impose sales tax on the *discounted* sales price of the Groupon, narrowly claiming a majority on this issue.<sup>56</sup> Consider again Buyer Bruce who purchased a \$20 Groupon for a full-service wash at ABC Carwash, having a full retail value of \$40. When Buyer Bruce redeems his Groupon, whether sales tax will be assessed on \$20 or \$40 will depend on which state ABC Carwash is located in.<sup>57</sup>

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<sup>55</sup> *Covering Corporate Income Tax Nexus, Sales Tax Nexus, State Tax Add-Backs, I.R.C. § 338(H)(10) Elections, Bankruptcy Issues, Intangible Holding Companies, Throwback/Throwout Rules, Income Tax Sourcing of Services and Intangibles, Sales Tax Sourcing, Net Operating Losses, and Combined Reporting, States Identify Sourcing Rules, Clarify Application to Various Interstate and Intrastate Transactions*, BNA TAX MGMT. WKLY. ST. TAX REP., Apr. 27, 2012 [hereinafter "*Covering Corporate Income Tax Nexus*"].

<sup>56</sup> See Grace, *supra* note 7, at pt. IV(A) (naming the following states as applying sales tax to the discounted value: California, Illinois, Kentucky, Maine and Massachusetts). See also Marlia Berg, *Wisconsin Declines to Tax "Deal of the Day" Vouchers at Time of Sale*, THE SALT MINDS BLOG (Aug. 1, 2012, 5:47 PM), <http://community.cchgroup.com/community/corporations/the-salt-minds-blog/blog/2012/08/01/wisconsin-declines-to-tax-deal-of-the-day-vouchers-at-time-of-sale> (discussing a recent Wisconsin decision to apply sales tax to the discounted value of a voucher).

<sup>57</sup> See Blair, *supra* note 35.

If ABC Carwash is located in California,<sup>58</sup> Illinois,<sup>59</sup> Kentucky,<sup>60</sup> Maine,<sup>61</sup> Massachusetts,<sup>62</sup> or Wisconsin<sup>63</sup> (“the discounted value states”), Buyer Bruce will owe taxes based on \$20, the discounted amount he paid for the daily deal. Of the guidance offered by these six states, Kentucky is claimed to “provide[ ] the best rationale for why it taxes only the amount paid for the daily deal voucher.”<sup>64</sup> The December 2011 edition of “Kentucky Sales Tax Facts” states:

When a consumer redeems the voucher at the local business for a taxable product, *the tax is due on the total price the customer paid for the voucher* rather

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<sup>58</sup> *Special Notice: Application of California Sales Tax to Deal-of-the-Day Instruments*, CAL. ST. BD. OF EQUALIZATION (Nov. 2011), <http://www.boe.ca.gov/news/pdf/1297.pdf>; see also Grace, *supra* note 7, at pt. IV(A); *California BOE Explains Application of Sales Tax to Internet Deals of the Day*, ST. TAX TODAY, Nov. 25, 2011, available at 2011 STT 227-4.

<sup>59</sup> Ill. Gen. Information Ltr. ST 12-0009-GIL (Feb. 28, 2012), available at <http://tax.illinois.gov/LegalInformation/Letter/rulings/st/2012/ST-12-0009.pdf> (stating that a General Information Letter “is not a statement of Department policy and is not binding on the Department”); see also Grace, *supra* note 7, at pt. IV(A); Christine Boeckel, *Illinois Letter Explains Sales Tax Applied to Groupons, ‘Deal-of-the-Day’ Instruments*, BNA TAX MGMT. WKLY. ST. TAX REP., Mar. 16, 2012.

<sup>60</sup> *Kentucky Sales Tax Facts*, KY. DEP’T OF REVENUE (Dec. 2011), <http://revenue.ky.gov/NR/rdonlyres/3AE1FCEB-309A-438E-82E2-E1DAEA004DE7/0/SalesTaxFactsDec2011.pdf>; see also Grace, *supra* note 7, at pt. IV(A).

<sup>61</sup> *Instructional Bulletin No. 39*, ME. REVENUE SERVS.: SALES, FUEL & SPECIAL TAX DIV. (Jan. 17, 2012), <http://www.maine.gov/revenue/salesuse/Bull39Final011712.pdf>; see also Grace, *supra* note 7, at pt. IV(A).

<sup>62</sup> *Directive 12-4: Application of Sales Tax to Sales and Redemption of Qualifying Promotional Vouchers*, MASS. DEP’T OF REVENUE (July 16, 2012), <http://www.mass.gov/dor/businesses/help-and-resources/legal-library/directives/directives-by-decade/2012-directives/dd-12-4.html>; see also Grace, *supra* note 7, at pt. IV(A); *Massachusetts Releases Draft Directive on Sales Tax Treatment of ‘Deal of the Day’ Vouchers*, ST. TAX TODAY, June 19, 2012, available at 2012 STT 118-13; Nancy Emison, *Massachusetts Explains Taxation of Promotion Vouchers or ‘Groupons’*, BNA TAX MGMT. WKLY. ST. TAX REP., July 20, 2012. Prior to Massachusetts’ most recent directive on June 14, 2012, the State had an opposite approach, requiring merchants to collect taxes based on the “full amount of the price of the good or service with no reduction in the tax base for the amount of the daily deal vouchers.” Grace, *supra* note 7, at pt. IV(A). See also Sylvia F. Dion, *Massachusetts Issues Final ‘Groupon – Sales Tax’ Guidance: DOR Directive 12-4*, THE ST. AND LOCAL TAX “BUZZ” (July 23, 2012), <http://www.thestateandlocaltaxbuzz.com/2012/07/massachusetts-finally-issues-final.html>; Sylvia F. Dion, *Massachusetts Issues Final Directive on Applying Sales Tax to Third-Party ‘Deal-of-the-Day’ Qualifying Promotional Vouchers*, BNA TAX MGMT. WKLY. ST. TAX REP., Aug. 17, 2012. This may be why some news coverage of the topic incorrectly includes Massachusetts with those states that assess sales tax on the full undiscounted value of the Groupon. See, e.g., Roll & Swann, *supra* note 52.

<sup>63</sup> *Sales of Discounted Certificates and Product Vouchers*, WIS. DEP’T OF REVENUE (Aug. 3, 2012), <http://www.revenue.wi.gov/taxpro/news/discert.html>. See also *Discounted Certificates, Product Vouchers Not Subject to Wisconsin Sales Tax*, *supra* note 52. Berg, *supra* note 56.

<sup>64</sup> Grace, *supra* note 7, at pt. IV(A). This article does not consider Wisconsin.

than the total value of the voucher . . . [because] the portion of the purchase price of the voucher retained by the online company is considered an expense of the seller and part of gross receipts as provided in [the Kentucky Revised Statutes].<sup>65</sup>

In other words, Kentucky's tax base includes "the amount retained by (or paid to) the daily deal voucher operator."<sup>66</sup> Thus, at a Kentucky ABC Carwash, the tax base is \$20. Likewise, Illinois' General Letter Ruling can be read to apply the same rationale that "the tax base should include all expenses of the retailer."<sup>67</sup>

While this guidance is seemingly direct, Buyer Bruce is not certain to owe taxes based only on the \$20 in these six states, as some have twists to their general approach. For example, in Kentucky, Buyer Bruce will owe taxes based on the discounted value of \$20 *only if*: (1) "the voucher indicates the discounted price" (\$20); *or* (2) ABC Carwash "know[s] and retain[s] documentation of the discounted price."<sup>68</sup> If one of these two requirements does not occur, Buyer Bruce will owe sales tax "on the total face value of the voucher,"<sup>69</sup> the \$40. However, this rarely occurs, as "merchants who enter into a contract with Groupon . . . are involved in establishing the specifics of the deal offer and likely would be aware of and have retained documentation of the discounted sales price."<sup>70</sup> Likewise, Illinois imposes a similar knowledge requirement, stating that if the merchant knows how much the customer paid for the Groupon, then the discounted amount is

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<sup>65</sup> *Id.* (emphasis added); *see also Kentucky Sales Tax Facts, supra* note 60.

<sup>66</sup> Grace, *supra* note 7, at pt. IV(A).

<sup>67</sup> *Id.* (identifying the Illinois guidance as a "Private Letter Ruling"). However, the State identifies the letter as a General Information Letter, which influences the legal effect of the document, as stated above. *See Ill. Gen. Information Ltr. ST 12-0009-GIL, supra* note 59 (stating that a General Information Letter "is not a statement of Department policy and is not binding on the Department"). For clarification of the "all expenses" language in the text, consider the following: "In responding to the taxpayer's inquiry of how to tax the use of daily deal vouchers, Illinois first states that its sales tax is imposed on the gross receipts from sales of tangible personal property made in the course of business. The letter goes on to define gross receipts as 'the total selling price . . . [defined as] the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property . . . and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever.'" Grace, *supra* note 7, at pt. IV(A).

<sup>68</sup> *See* Dion, *supra* note 10 (citing the Kentucky revenue publication); *Kentucky Sales Tax Facts, supra* note 60.

<sup>69</sup> Dion, *supra* note 10; *see Kentucky Sales Tax Facts, supra* note 60.

<sup>70</sup> Dion, *supra* note 10.

taxable.<sup>71</sup> Otherwise, taxes are owed on the undiscounted full value.<sup>72</sup> These requirements rarely have meaningful effects, though, as the purchase price is usually listed on the voucher.<sup>73</sup>

Another twist to the discounted value states, set by California, provides that upon redemption of a daily deal voucher, “the retailers’ gross receipts subject to tax include the consideration paid by the customer for the [daily deal voucher] *plus any additional cash, credit, or other consideration* paid to the retailer when the product is purchased with the exception of sales tax.”<sup>74</sup> To illustrate the effect of California’s twist on the general rule, consider the following example:

[A] \$50 deal-of-the-day is offered for \$105 worth of custom picture framing. The customer redeems the coupon for a custom frame priced at \$120 (i.e., the customer owes an additional \$15 since the voucher only covers up to \$105 worth of framing).<sup>75</sup>

Applying California’s guidance, “sales tax is due on \$65—the \$50 the customer paid for the voucher plus the additional \$15.”<sup>76</sup> Imagine that you are a single-owner frame shop in a state like Kentucky, Illinois or California—would the marketing advantage of selling your products on Groupon *be worth* having to understand and follow these tax requirements? Granted, the simpler alternative would tax the entire price *or* not tax the \$15 at all—neither of which are preferable to a lower tax base, which comes, of course, with complexities like those in California.

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<sup>71</sup> *Id.*; Blair, *supra* note 35 (citing Ill. Gen. Information Ltr. ST 12-0009-GIL, *supra* note 59); see also Sylvia F. Dion, *Groupons, Sales Tax and More – The Issues Continue*, THE ST. AND LOCAL TAX “BUZZ” (Mar. 27, 2012), <http://www.thestateandlocaltaxbuzz.com/2012/03/groupons-sales-tax-and-more-issues.html>.

<sup>72</sup> Blair, *supra* note 35 (citing Ill. Gen. Information Ltr. ST 12-0009-GIL, *supra* note 59).

<sup>73</sup> Novack, *supra* note 39.

<sup>74</sup> *Special Notice: Application of California Sales Tax to Deal-of-the-Day Instruments*, *supra* note 58 (emphasis added).

<sup>75</sup> Dion, *supra* note 10 (citing a September 2011 Tax Information Bulletin). See *Tax Information Bulletin, Publication No. 388*, CAL. ST. BD. OF EQUALIZATION (Sept. 2011), <http://www.boe.ca.gov/news/pdf/sep11TIB.pdf>.

<sup>76</sup> Dion, *supra* note 10; see *Tax Information Bulletin, Publication No. 388*, *supra* note 75.

Now, assume ABC Carwash relocates. If ABC Carwash operates in Kansas,<sup>77</sup> Mississippi<sup>78</sup> or Iowa<sup>79</sup> (“the full value states”), the same Buyer Bruce will owe taxes based on \$40, the full value of the item or service purchased. In Iowa, however, if the voucher states “on its face the price paid by the purchaser,” sales tax is owed only on the discounted value.<sup>80</sup> Because “most vouchers *do list* the purchase price on the voucher,” the discounted price will most likely be taxed.<sup>81</sup> Iowa’s guidance simply reverses the construct of Kentucky’s—where Kentucky’s general rule taxes the discounted value, but *only if* the voucher states the discounted price or the merchant has knowledge and documentation of such price, Iowa’s general rule taxes the full value *unless* the voucher states the discounted price.<sup>82</sup>

Finally, if ABC Carwash is located in New York,<sup>83</sup> noted as being “the most schizophrenic of all the states” in its application,<sup>84</sup> Buyer Bruce may owe taxes on \$20 *or* \$40. If Buyer Bruce’s voucher is for a “specific service or product,” he will be taxed based on the \$20, the amount he paid for the voucher.<sup>85</sup> However, if the voucher “has a stated face value,” he will be taxed based on the \$40, the undiscounted sales price.<sup>86</sup> Confused yet? In a memorandum from the New York

<sup>77</sup> *Opinion Letter, Letter No. O-2012-004*, KAN. OFF. OF POL’Y & RES. (Sept. 11, 2012), <http://rvpolicy.kdor.ks.gov/Pilots/Ntrntpil/IPILv1x0.NSF/ae2ee39f7748055f8625655b004e9335/43b32a87bf9d4bad86257a7d006108b4?OpenDocument>; *see also* Roll & Swann, *supra* note 52; *Kansas DOR Explains Sales Tax Treatment of Promotional Campaigns by Retailers*, ST. TAX TODAY, Sept. 24, 2012, available at 2012 STT 185-16.

<sup>78</sup> *Part IV: Sales and Use Tax*, MISS. DEP’T OF REVENUE TITLE 35, 16 (July 13, 2012), [http://www.dor.ms.gov/docs/sales\\_PartIVeffective7.13.2012.pdf](http://www.dor.ms.gov/docs/sales_PartIVeffective7.13.2012.pdf); *see also* Grace, *supra* note 7, at pt. IV(2); Christine Boeckel, *Mississippi Amends Sales, Use Tax Rule to Clarify Tax on Prepaid Discount Vouchers*, BNA TAX MGMT. WKLY. ST. TAX REP., June 29, 2012.

<sup>79</sup> *Groupons – Iowa Sales Tax*, IOWA DEP’T OF REVENUE, <http://www.iowa.gov/tax/business/groupons.html> (last visited Nov. 18, 2012); *see also* Grace, *supra* note 7, at pt. IV(2); Christine Boeckel, *Iowa Issues Release, Provides Guidance: Sales Tax Application to Groupon Discounts*, BNA TAX MGMT. WKLY. ST. TAX REP., Feb. 24, 2012.

<sup>80</sup> Dion, *supra* note 10 (citing *Groupons – Iowa Sales Tax*, *supra* note 79).

<sup>81</sup> Grace, *supra* note 7, at pt. IV(2). As a result of the ultimate application of the Iowa rule, several articles have mistakenly included Iowa with those states that, as a general matter, assess taxes based on the discounted value of the voucher. *See, e.g.*, Roll & Boeckel, *supra* note 37; Roll & Swann, *supra* note 52.

<sup>82</sup> *See* Dion, *supra* note 10.

<sup>83</sup> *Sales Tax Treatment Relating to the Sale and Redemption of Certain Prepaid Discount Vouchers, No. TSB-M-11(16)S*, N.Y. ST. DEP’T OF TAX’N AND FIN. (Sept. 19, 2011), [http://www.tax.ny.gov/pdf/memos/sales/m11\\_16s.pdf](http://www.tax.ny.gov/pdf/memos/sales/m11_16s.pdf); *see also* Grace, *supra* note 7, at pt. IV(2).

<sup>84</sup> Grace, *supra* note 7, at pt. IV(2).

<sup>85</sup> *See id.*

<sup>86</sup> *See id.*

Department of Taxation and Finance, the terms “specific product or service voucher” and “stated face value voucher” are defined, albeit unconvincingly.<sup>87</sup> Unlike Kentucky, Illinois and California, where the general rule is followed by a series of twists in New York the general rule is a twist in and of itself.

### C. *The Best Tax Approach*

Before considering which state’s tax treatment of Buyer Bruce is most preferable, it is important to note that states’ consideration of the Groupon issue is not limited to these ten states. In addition to those ten states that have offered *formal* guidance regarding the tax treatment of Groupon daily deal vouchers, a March 2012 survey from the Streamlined Sales Tax Governing Board gathered the informal guidance of several states.<sup>88</sup> As states continue to wrestle with how to tax Groupon and other DDC vouchers, it is clear that a resolution is needed. Fast. In the meantime, those states having yet to issue formal guidance on the matter should fall in line behind those states comprising a majority and do the following: *require merchants to assess Groupon sales tax only on the discounted value.*

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<sup>87</sup> See *Sales Tax Treatment Relating to the Sale and Redemption of Certain Prepaid Discount Vouchers*, No. TSB-M-11(16)S, *supra* note 83. See also Timothy P. Noonan & Lance E. Rothenberg, *Taxing Groupon-Type Coupons: New York Tax Department Guidance*, ST. TAX NOTES MAG., Oct. 17, 2011, *available at* 62 State Tax Notes 171; Martha Kessler, *New York Addresses Sales Tax of Groupon-Like Vouchers, Coupons*, BNA TAX MGMT. WKLY. ST. TAX REP., Sept. 23, 2011 (stating that a “specific product or service voucher is a voucher without a specific stated value that may be redeemed only for a specified product or service or combination of products and/or services” and that a “stated face value voucher is a voucher with a specifically stated value, and when redeemed, the value of the voucher is applied toward the price of the products or services purchased by the customer.”).

<sup>88</sup> Grace, *supra* note 7, at pt. IV; John Buhl, *Survey Looks at ‘Deal of the Day’ Transactions*, ST. TAX NOTES MAG., Mar. 26, 2012, *available at* 63 State Tax Notes 1002. The following states provided comments in the survey: Arkansas, Indiana, Iowa, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Missouri, Nebraska, North Carolina, North Dakota, Rhode Island, Texas and Washington. See *Deal of the Day Voucher Survey 2012: State Comments from the Survey*, STREAMLINED SALES TAX GOVERNING BD., INC., <http://www.streamlinedsalestax.org/uploads/downloads/SLAC%20Meeting%20Materials/2012/SL12005%20Sales%20Price%20deal%20voucher%20survey%20comments.pdf> (last visited Nov. 18, 2012). For additional commentary on Texas’ approach, see Novack, *supra* note 5. For a recent article very briefly addressing additional states, see Michael A. Grim, Mark A. Lloyd & Daniel G. Mudd, *Stay Out of the Rough: Collecting State Sales Tax on Groupon and Living Social Deals*, BINGHAM GREENEBAUM DOLL (Sept. 24, 2012), <http://www.bgdllegal.com/news/2012/09/24/articles/stay-out-of-the-rough-collecting-state-sales-tax-on-groupon-and-living-social-deals/>.

## 1. STATUTORY INTERPRETATION

As set forth above, of those states offering guidance on this issue, there are “two camps”: “those that impose tax on the *full sales price*,” and “those that impose tax on the *discounted sales price*.”<sup>89</sup> Imagine that the labels of “full” and “discounted” are removed, leaving only “sales price.” Considering this term alone, some states’ definition of “sales price” necessitates the proper tax being assessed based on the amount that the consumer paid to Groupon for the item or service.

Consider North Carolina’s General Statutes, for example. North Carolina defines “sales price” as “[t]he total amount or consideration for which tangible personal property, digital property, or services are sold, leased, or rented. The consideration may be in the form of cash, credit,<sup>90</sup> property, or services.”<sup>91</sup> Based on this definition of “sales price” alone, one can rightfully conclude that the taxable value should be the *lower* amount—the total amount paid for the item or service sold by Groupon. After all, in the example above Buyer Bruce has only given \$20 consideration for the car wash. Thus, based on statutory interpretation, the discounted price is the proper value to tax.

## 2. Economic Considerations

Apart from statutory interpretation, an economic solution to the Groupon debate should focus on the *consumer*, not the states’ or Groupon’s potential revenues or even the unfortunate position of merchants due to Groupon’s delegation of tax responsibility. When Buyer Bruce purchases a carwash in the form of a Groupon for \$20, he should be taxed only on the \$20 that *he actually paid*. Bruce bought the carwash from Groupon (favorably, at a discounted price) rather than from ABC Carwash itself (for the full price)—as a result, he should not be taxed as though he bought the service for full value at ABC

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<sup>89</sup> *Covering Corporate Income Tax Nexus*, *supra* note 55 (emphasis added).

<sup>90</sup> For further guidance of what the term “sales price,” specifically “credit” includes, see N.C. GEN. STAT. ANN. § 105-164.3(37)(a)(b) (West 2011).

<sup>91</sup> N.C. GEN. STAT. ANN. § 105-164.3(37) (West 2011). In support of this position, other states have statutory language similar to North Carolina. *See, e.g.*, S.C. CODE ANN. § 12-36-130 (2000) (defining “sales price” as “the total amount for which tangible personal property is sold, without any deduction for the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses, or any other expenses.”); TENN. CODE ANN. § 67-6-102 (West 2013) (defining “sales price” as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following . . .”).



Carwash. As one commentator noted, “[P]aying sales tax to a vendor after already paying for the good or service in a previous transaction *disconnects the purchase from the tax incident*—a disconnect that will undoubtedly lead to customer complaints.”<sup>92</sup> Put differently, sales tax “should be paid on the amount paid by the consumer, not some *subjective value* that the consumer *didn’t pay*.”<sup>93</sup> Otherwise, “angry customers [will] demand[ ] to know why they’re paying tax on \$80 for something they only paid \$40 for.”<sup>94</sup>

Until undecided states set forth formal guidance, merchants are left to simply *estimate* the proper tax amount; consumers will remain confused, possibly angered depending on the tax outcome; and Groupon will rest easy, thanks to its Merchant Account Terms and Conditions Agreement<sup>95</sup> relinquishing it of any tax concerns. As one author so fittingly stated, “If only Groupon could arrange a coupon for 50 percent off sales tax . . . Now that would be something.”<sup>96</sup>

### III. EXPEDIA

#### A. *What is Expedia?*

Presenting a similar tax question, Expedia, a self-proclaimed “on-line travel agency,”<sup>97</sup> has recently caught the attention of many states, courts, and legislatures.<sup>98</sup> Online travel companies (“OTC(s)”) such as “Expedia, Hotels.com, Orbitz, Priceline, and Travelocity” attract consumers by “aggregat[ing] information that allows travelers to sort through hotels and book a room on a central website.”<sup>99</sup> As a result, OTCs have created a platform for “consumers to easily compare hotels based on different criteria (including price, location, and customer ratings) and at the same time book a reservation and pay for it.”<sup>100</sup>

<sup>92</sup> Kranz, Freeman & Yopp, *supra* note 13, at pt. II(B) (emphasis added).

<sup>93</sup> Joseph Henchman, *Nebraska Pushing States to Tax “Full Value” of Groupon and Living-Social Deals* (July 19, 2012), <http://taxfoundation.org/blog/nebraska-pushing-states-tax-full-value-groupon-and-livingsocial-deals> (emphasis added).

<sup>94</sup> *Id.* See also Buhl, *supra* note 50 (stating that taxing the full value of the Groupon good or service would be an “aberration” and that “it makes the most sense to apply the tax to what the consumer pays the retailer.”).

<sup>95</sup> Dion, *supra* note 10.

<sup>96</sup> Kranz, Freeman & Yopp, *supra* note 13, at pt. II(B).

<sup>97</sup> *About Expedia.com*, *supra* note 4.

<sup>98</sup> See Henchman, *supra* note 8.

<sup>99</sup> Joseph Henchman, *Cities Pursue Discriminatory Taxation of Online Travel Services*, ST. TAX TODAY, Mar. 1, 2010, available at 2010 STT 39-3.

<sup>100</sup> *Id.*

Alongside benefiting travelers, OTCs also benefit hotels, allowing them to “reach a market . . . that they otherwise would not reach.”<sup>101</sup>

Introduced by Microsoft in 1996, Expedia accumulated 3.45 *billion dollars* in revenue and 29.1 *billion dollars* in gross bookings in 2011 alone.<sup>102</sup> Like Groupon, with revenues this great, it is unsurprising that attention has turned to Expedia and similar OTCs regarding the tax treatment of these transactions. Likewise, before considering the different ways in which hotel taxes can be applied to an Expedia purchase, it is first necessary to understand the mechanics of each sale.

First, consider the consumer who books a room *directly* from a hotel or through a travel agent, termed the “[A]gency [M]odel.”<sup>103</sup> In this scenario, a customer calls the hotel or a “traditional travel agent” to reserve a room and upon checkout, will “pay for the room and applicable occupancy taxes to the hotel based on the *retail price* of the room.”<sup>104</sup> For example, if the room rate is \$200 per night with hotel taxes of 10%, the traveler owes \$20 in hotel taxes *in addition to* the \$200 room rate.<sup>105</sup> The hotel retains the room rate and remits the hotel taxes to the government.<sup>106</sup> Under this Model, whether the traveler books the room “directly with the hotel or via a travel agent [who is paid a commission by the hotel],” the hotel taxes are based on the retail price of the room,<sup>107</sup> the \$200.

Now consider the transaction in dispute, often termed the “[M]erchant [M]odel,” when a traveler reserves a hotel room through an OTC.<sup>108</sup> Similar to the three participants of a Groupon voucher sale,<sup>109</sup> an Expedia transaction involves: the customer who purchases the hotel room (e.g., Buyer Bruce); the company that sells the hotel room (e.g., Expedia); and the merchant that accepts the reservation upon redemption (e.g., Heartbreak Hotel).<sup>110</sup> As shall be shown, although the tax obligation differs between Groupon and Expedia with

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<sup>101</sup> *Id.*

<sup>102</sup> *Company Facts & History*, EXPEDIA INC., <http://www.expediainc.com/company.cfm> (last visited Nov. 18, 2012).

<sup>103</sup> James Mak, *What Should be the Appropriate Tax Base for OTCs' Hotel Room Sales?*, ST. TAX TODAY, Sept. 17, 2012, at pt. II, *available at* 2012 STT 180-6.

<sup>104</sup> *Id.* (emphasis added).

<sup>105</sup> Henchman, *supra* note 8, at 3.

<sup>106</sup> *Id.*

<sup>107</sup> Mak, *supra* note 103, at pt. II.

<sup>108</sup> *Id.*

<sup>109</sup> Grace, *supra* note 7, at pt. I.

<sup>110</sup> *See, e.g.*, Henchman, *supra* note 99.

respect to the party responsible for submitting the tax payment owed, such *functional* distinctions do not render Groupon and Expedia unrelated. Ultimately, the two entities share the common tax inquiry of what constitutes the proper tax base.

To illustrate, consider again Buyer Bruce, who, after having abandoned Groupon purchases due to the sales tax uncertainties, decides to travel to Key West, Florida to regain his peace-of-mind. Buyer Bruce visits Expedia's website and selects a hotel from the options listed.<sup>111</sup> Of the hotels that Buyer Bruce may choose from, Expedia has already contracted with each hotel chain to obtain a discounted rate for the hotels' normally higher-priced rooms.<sup>112</sup> Through these contracts, hotels sell the rooms to the OTCs at a lower, "wholesale" rate, after which, the OTCs sell the rooms to travelers at higher, "retail" rates.<sup>113</sup> As a result, OTCs control the price charged to customers and thus, "the profit . . . [made] from the markup" between the wholesale price and the retail price.<sup>114</sup> In return, hotels can "reach a market" that without OTCs, "they would not otherwise reach."<sup>115</sup>

Upon booking a hotel room from Expedia, Buyer Bruce will make *one* online payment to the OTC.<sup>116</sup> This payment includes: the *room rate*, as agreed upon by Heartbreak Hotel; *taxes* owed on this room rate; and the remainder, which Expedia retains as a *service* or *facilitation fee*.<sup>117</sup> To finalize the transaction, *after* Buyer Bruce enjoys his hotel stay in the Keys, Heartbreak Hotel will send a bill to Expedia for "the negotiated [*lower*] *wholesale price*" of the room, which the OTC pays along with the "hotel occupancy tax on the *wholesale rate*."<sup>118</sup> Then, the hotel "remits the taxes on the *wholesale rate*" to the taxing authority.<sup>119</sup> Consider the following illustration:

[A] hotel agrees to a contract whereby it will receive only \$70 a night for any OTC-facilitated rentals of the normally \$100-a-night room (plus \$15 in tax). . . . If the traveler using the OTC website books the room at \$90 a night inclusive of taxes and fees, \$70 is forwarded to the hotel as a room charge, 15 percent of that amount (\$10.50) is forwarded to the hotel to

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<sup>111</sup> See *id.*

<sup>112</sup> See Henschman, *supra* note 8, at 3.

<sup>113</sup> See Mak, *supra* note 103, at pt. II.

<sup>114</sup> *Id.*

<sup>115</sup> Henschman, *supra* note 8, at 3.

<sup>116</sup> See *id.*

<sup>117</sup> See *id.*

<sup>118</sup> See Mak, *supra* note 103, at pt. II (emphasis added).

<sup>119</sup> *Id.* (emphasis added).

pay hotel taxes to the government, and the remainder (\$9.50) is retained by the OTC as its service fee on the transaction.<sup>120</sup>

Resulting from this transaction are three differences between Groupon and Expedia sales. While these differences are not significant to the ultimate inquiry of the appropriate tax base, the distinctions are nonetheless useful in understanding how the two entities operate. First, where the initial Groupon sale does *not* include sales tax,<sup>121</sup> the Expedia payment due at the time of booking *includes* applicable hotel occupancy taxes, paid by Buyer Bruce to Expedia.<sup>122</sup> Where Groupon imparts to the *merchants* the responsibility of collecting sales tax,<sup>123</sup> OTCs “calculate[ ] and [are] responsible for collecting the occupancy tax from the customer.”<sup>124</sup> Second, as a result, when Buyer Bruce checks out from Heartbreak Hotel, he will not be charged any hotel taxes,<sup>125</sup> unlike a Groupon customer who, in some states, will remit sales tax to the merchant upon redeeming his voucher.<sup>126</sup> However, similarly, both the participating merchant and hotel in a Groupon and Expedia sale, respectively, are responsible for remitting the appropriate taxes to the government.<sup>127</sup>

Finally, Groupon and Expedia transactions differ in the amounts represented by the ‘discounted’ and ‘full’ values. In an Expedia sale, the *higher*, “*retail*” rate is the amount that the *traveler* pays to Expedia,<sup>128</sup> unlike Groupon where the higher rate represents the undiscounted value of the voucher.<sup>129</sup> Likewise, in an Expedia sale, where the *lower*, “*wholesale*” rate represents the contracted-for *amount paid by Expedia* to the hotel chain,<sup>130</sup> this same discounted value in a Groupon sale is the amount paid by *the consumer to Groupon*.<sup>131</sup> Despite these distinctions

<sup>120</sup> Henchman, *supra* note 8, at 3.

<sup>121</sup> Dion, *supra* note 10.

<sup>122</sup> See Henchman, *supra* note 8, at 3.

<sup>123</sup> Dion, *supra* note 10.

<sup>124</sup> Mak, *supra* note 103, at pt. II.

<sup>125</sup> See *id.* (noting that while the hotel will not bill the customer for room rates or occupancy taxes upon checkout, it *will* collect “[P]ayment for incidental (non-lodging) items such as long-distance telephone calls, pay-to-view premium movies, room service, or drinks from the minibar purchased during the visit.”).

<sup>126</sup> See, e.g., Grace, *supra* note 7, at pt. IV.

<sup>127</sup> Dion, *supra* note 10; Mak, *supra* note 103, at pt. II.

<sup>128</sup> See Mak, *supra* note 103, at pt. II.

<sup>129</sup> See Blair, *supra* note 35.

<sup>130</sup> See Mak, *supra* note 103, at pt. II.

<sup>131</sup> See Blair, *supra* note 35.

between the operation of Groupon and Expedia sales, a parallel tax inquiry has resulted: which base (the retail or discounted value) to tax.

B. *The Tax Base: Differing Approaches to Expedia's Situation*

1. Resulting Tax Question

Flowing from Expedia's responsibility to remit taxes to the participating hotels, like Groupon, is the conundrum of determining what the proper amount of the tax is *and* how to calculate it. As set forth, the Groupon inquiry asks whether the *customer*, when redeeming her Groupon for the item or service sold, should pay sales tax to the *merchant* based on the lower, discounted amount she paid to Groupon or rather, the higher, full value of the item or service.<sup>132</sup> Concerning the OTC tax inquiry, the application of the same question is slightly different due to the different structure of the transaction at issue—the question does not consider what the *customer* remits upon hotel check-out (as an Expedia customer pays *all* applicable hotel taxes at the time of online booking).<sup>133</sup> Rather, the question considers what amount the *OTC* must remit to the *hotel*, which includes the taxes that will eventually be paid to the taxing authority.<sup>134</sup> However, both inquiries ultimately, in different form, ask the *same* question: what is the appropriate tax base?

Through OTCs' contracts with hotel chains, the OTCs "agree to collect occupancy taxes on the rooms they sell at the rate they determine."<sup>135</sup> Unlike Groupon, where *merchants* must determine and collect sales tax,<sup>136</sup> *OTCs* "have sole discretion in determining whether to apply the tax to the *wholesale* rate . . . as opposed to the *retail* rate."<sup>137</sup> As a result, when Buyer Bruce books a hotel room on Expedia, hotel taxes are assessed based on the *lower*, wholesale rate.<sup>138</sup> However, if Buyer Bruce were to book the *same room* through the hotel directly or a traditional travel agent, hotel taxes would be assessed on the *higher*, retail rate of the room.<sup>139</sup>

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<sup>132</sup> Novack, *supra* note 5.

<sup>133</sup> See Mak, *supra* note 103, at pt. II.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* (external citation omitted) (external quotation marks omitted).

<sup>136</sup> Dion, *supra* note 10.

<sup>137</sup> Mak, *supra* note 103, at pt. II (emphasis added) (external citation omitted) (external quotation marks omitted).

<sup>138</sup> See *id.*

<sup>139</sup> See *id.*

The resulting tax discrepancies, based only on *how* the room was booked, have resulted in litigation, frequently claiming that OTCs “negotiate room prices with hotels at a wholesale rate, then charge travelers who book through their websites a higher retail rate. However, the companies remit taxes only on the lower wholesale rate.”<sup>140</sup> For example, “the companies buy blocks of rooms for \$100 each, sell them for, say \$150, and pay the room tax only on the \$100.”<sup>141</sup> As a result of recent lawsuits “pitting state and local governments against the OTCs,”<sup>142</sup> courts are now deciding whether OTCs must remit hotel occupancy taxes based on either: (1) the lower, “wholesale” room rate paid by Expedia to the participating hotel; *or* (2) the higher, “retail” rate that the consumer pays to Expedia for the same room.<sup>143</sup>

Similar to the Groupon inquiry, some may wonder whether these two options offer any meaningful difference. For two parties, the consequences of this tax decision are grave. For *states*, an estimated “\$276 to \$396 million in hotel tax revenue is lost each year due to the OTCs’ practice of taxing the ‘wholesale’ room rate instead of the retail room rate.”<sup>144</sup> This is lost revenue that would have “promot[ed] tourism and in some cases, pa[id] for schools, law enforcement and other municipal services.”<sup>145</sup> Conversely, for *OTCs like Expedia*, the difference is a matter of *their own* revenue. OTCs, advocating for taxation based on the wholesale rate, have argued that “the difference between the price they negotiate with hotels and what they charge customers on their

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<sup>140</sup> Henchman, *supra* note 8, at 3 (external quotations omitted).

<sup>141</sup> *Id.* n.4 (external citation omitted) (external quotation marks omitted).

<sup>142</sup> Mak, *supra* note 103, at pt. II.

<sup>143</sup> *See id.*; Henchman, *supra* note 8, at 1-3. As noted in the example of an OTC transaction accompanying *infra* note 150, consumers pay the same price to reserve a hotel room through an OTC as they would booking with the hotel itself—in other words, the consumer is not receiving a discounted rate through the OTCs according to this example, such that a third consideration is warranted (*e.g.*, a lower rate paid by the consumer to the OTC). Another noteworthy consideration concerning the OTC tax question facing courts is the limitation on OTCs’ ability to manipulate the total amount of taxes owed. Because hotel operators negotiate with OTCs for the highest amount possible for the wholesale rate, OTCs cannot unilaterally reduce the amount of the tax base. In effect, interested parties, hotel operators, function to benefit the tax authority by trying to increase the tax base.

<sup>144</sup> Jess Reagan, *Update on Online Travel Company Litigation*, OFF. OF THE IND. ATT’Y GEN. (June 13, 2011), at 3, [http://www.taxadmin.org/fta/meet/11am/PPTs/Reagan\\_061211.pdf](http://www.taxadmin.org/fta/meet/11am/PPTs/Reagan_061211.pdf) (emphasis removed); *see also* Mak, *supra* note 103, at pt. I (stating that “[t]he difference in tax revenue collectively amounts to roughly \$ 340 [sic] million, assuming an average hotel occupancy tax rate of 12.62 percent, which was the average tax rate in the United States in 2008.”).

<sup>145</sup> Jones, *supra* note 6.

websites represents a fee for ‘facilitating’ the transaction”—in other words, that this difference “should not be subject to hotel occupancy taxes.”<sup>146</sup> Finally, unlike a Groupon sale, where the decision of whether and how much sales tax to assess directly affects *customers*,<sup>147</sup> Expedia customers are not affected in such a manner. They pay the *same* hotel tax regardless of whether they book directly with the hotel or through an OTC.<sup>148</sup> Rather, “[t]he difference is how that money is divided up later on.”<sup>149</sup> For example:

[A] consumer pays a room rate of \$100. A local occupancy tax of 10% tacks on another \$10, and so the guest pays \$110. But an [OTC] may have negotiated a discounted room rate of \$80 with that hotel. A guest who booked through that third-party portal still pays \$110, but the online company will give the hotel \$80 for the room, plus \$8 for the tax, keeping the remaining \$22 as its fee. If the room had been booked directly with the hotel, the municipality would receive \$10 in taxes.<sup>150</sup>

As discussed in the next section, the varied tax treatment on this issue, like Groupon, may have ultimately raised more questions than answers.

## 2. Varied Tax Treatment

Remember the list of synonyms used to describe the inconsistent state guidance concerning the Groupon issue? Those terms are also well suited for the recent court decisions considering the taxation of Expedia sales. Unlike Groupon, where, *if* guidance is provided, the requisite sales tax treatment is set forth in each state’s Department of Revenue publications,<sup>151</sup> it has primarily been the courts that have decided the amount of hotel taxes OTCs should remit to hotels.<sup>152</sup> In May 2012, the Tax Foundation reported that cities and counties had filed around seventy lawsuits across twenty-five states and the District of Columbia.<sup>153</sup> The Tax Foundation also reported pending cases in Ha-

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<sup>146</sup> See Tom Gilroy, *Cities and States, Mired in Suits Over Hotel Taxes, Change Laws to Address Practices of Online Companies*, BNA TAX MGMT. WKLY. ST. TAX REP., Jan. 21, 2011.

<sup>147</sup> See Novack, *supra* note 39.

<sup>148</sup> Jones, *supra* note 6.

<sup>149</sup> *Id.* (external quotations omitted).

<sup>150</sup> *Id.*

<sup>151</sup> See, e.g., Dion, *supra* note 10 (citing several states’ Department of Revenue publications).

<sup>152</sup> See Henchman, *supra* note 8, at 1.

<sup>153</sup> *Id.*

waii,<sup>154</sup> Maryland, Michigan, Montana,<sup>155</sup> Pennsylvania, and Texas.<sup>156</sup> As of September 2012, most of these seventy lawsuits are “either on appeal or still at the trial level.”<sup>157</sup>

While each of these twenty-five states has their own governments and respective hotel occupancy statutes, collectively, the lawsuits typically:

[I]nvolve claims by the local governments that [OTCs] are in violation of their hotel occupancy tax ordinances due to a failure to pay the hotel occupancy tax on the amount of the transaction that accrues to the OTC, described . . . as a facilitation fee, service fee, commission, markup, or difference between the ‘retail’ and ‘wholesale’ rates.<sup>158</sup>

States claim that because the OTCs’ “activities fall under existing statutes as ‘hotel operators’ or ‘hotel room wholesalers,’” the statute thus encompasses taxation of the OTC service fees.<sup>159</sup> One summary of these claims states: “Customers pay one total amount to the [OTCs], which then is divided among the hotel, the government, and the [OTC]. The cities’ claim is essentially that some portion of the profit kept by the [OTC] is in reality ‘owed’ taxes.”<sup>160</sup>

As of May 2012, the Tax Foundation reported that of the twenty-five states where lawsuits have been filed, OTCs had prevailed in eighteen states,<sup>161</sup> finding that OTCs must assess taxes only on the lower, wholesale rates. Conversely, governments, at the time of the Report, had prevailed in only three states and the District of Columbia.<sup>162</sup> Based on these numbers alone, it appears that, like Groupon, a critical

<sup>154</sup> See Tom Gilroy, *Hawaii Insists Online Travel Companies Pay \$170 Million in Back Hotel Occupancy Taxes*, BNA TAX MGMT. WKLY. ST. TAX REP., Apr. 1, 2011.

<sup>155</sup> See Amy Hamilton, *Online Travel Companies Move to Have Montana Lodging Tax Case Dismissed*, ST. TAX TODAY, Aug. 26, 2011, available at 2011 STT 166-19.

<sup>156</sup> Henchman, *supra* note 8, at 2, 13. These states are *not* in addition to the twenty-five states mentioned previously. *Id.* Cities in Arizona have also recently elected to pursue litigation to recover hotel taxes from OTCs. See, e.g., Amy B. Wang, *Chandler Added to Lawsuit vs. Online Travel Companies*, AZCENTRAL.COM (Oct. 8, 2012, 10:58 PM), <http://www.azcentral.com/community/chandler/articles/20121007chandler-added-lawsuit-vs-online-travel-companies.html>.

<sup>157</sup> Mak, *supra* note 103, at pt. I.

<sup>158</sup> Henchman, *supra* note 8, at 6.

<sup>159</sup> *Id.* at 4.

<sup>160</sup> *Id.* at 5.

<sup>161</sup> *Id.* at 3.

<sup>162</sup> *Id.* For those cases that have rendered a decision on the merits, the Tax Foundation Report provided a summary of each in alphabetical order by state. While many of these cases are mentioned in this paper, the Report illustrates the rationales for each decision. See *id.* at 13-24.



mass of jurisdictions are imposing taxes on the relevant *discounted* amount. However, this OTC wins-to-losses ratio is somewhat distorted, as it does not consider the number of lawsuits that have been settled or dismissed on various procedural grounds, as discussed below.

Similar to Groupon purchases, where the sales tax assessed depends on the location of the merchant,<sup>163</sup> the amount of hotel taxes that OTCs will be required to remit depends on the location of the participating hotel.<sup>164</sup> As of the May 2012 Tax Foundation Special Report, courts in the following *fourteen states* have held that OTCs' service fees are *not* subject to hotel occupancy taxes, or, in other words, that OTCs are required to remit taxes only on the lower, wholesale value of the hotel room paid by Expedia to the hotel: Alabama,<sup>165</sup> California,<sup>166</sup>

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<sup>163</sup> See Grace, *supra* note 7, at pt. IV (discussing various states' sales tax approaches to daily deal vouchers).

<sup>164</sup> See Henschman, *supra* note 8, at 13-24 (providing a summary of court decisions, alphabetized by state, of the requisite tax amount OTCs must remit to participating hotels).

<sup>165</sup> *Id.* at 14 (citing *City of Birmingham v. Orbitz, Inc.*, No. CV 09-3607 JSV (Ala. Cir. Ct. Mar. 24, 2011), *aff'd*, No. 1100874 (Ala. Apr. 13, 2012) (stating that OTCs "are not hoteliers. . . . They provide a service to the public for which they are compensated by their customers. This compensation is not subject to the lodging tax.")).

<sup>166</sup> Henschman, *supra* note 8, at 14 (citing *City of Santa Monica v. Expedia*, No. SC108568 (Cal. Super. Ct. L.A. County Mar. 16, 2011) (stating that "[i]f the 'commission' is a charge for some other service, and thus should be separately identified in the consumer's bill, it is not subject to transient occupancy tax."); Carolyn B. Kuhl, *California Superior Court Dismisses Transient Occupancy Tax Case Against Online Travel Companies*, ST. TAX TODAY, Mar. 21, 2011, available at 2011 STT 54-15. See also Henschman, *supra* note 8, at 14-15 (*Priceline.com, Inc. v. City of Anaheim*, No. JCCP 4472, 2010 WL 8721517 (Cal. Super. Ct. L.A. County Feb. 1, 2010)); Carolyn B. Kuhl, *California Superior Court: Online Travel Companies Not Liable For Occupancy Tax*, ST. TAX TODAY, Feb. 5, 2010, available at 2010 STT 24-5.

Florida,<sup>167</sup> Georgia,<sup>168</sup> Kentucky,<sup>169</sup> Missouri,<sup>170</sup> New Mexico,<sup>171</sup> New

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<sup>167</sup> Henchman, *supra* note 8, at 15-16 (citing *Leon Cnty. v. Expedia, Inc.*, No. 2009-CA-4319 (Fla. Cir. Ct. Apr. 19, 2012)). See also Henchman, *supra* note 8, at 16 (citing *Orange Cnty. v. Expedia, Inc.*, No. 48-2006-CA-2104-O (Fla. Cir. Ct. Jan. 20, 2011)). In a separate case, *Orbitz, LLC v. Broward Cnty.*, on July 13, 2012, a Florida Circuit Court granted summary judgment to OTCs. See Tom Gilroy, *Florida Court Backs Online Travel Firms, Denies Hotel Tax Claims by Broward County*, BNA TAX MGMT. WKLY. ST. TAX REP., Aug. 3, 2012.

<sup>168</sup> A Supreme Court of Georgia case is interpreted as positing that while “OTCs are not operators of hotels and are not obligated to pay taxes, [they] must remit any taxes they collect.” Henchman, *supra* note 8, at 17-18 (citing *Expedia, Inc. v. City of Columbus*, 681 S.E.2d 122, 128 (Ga. 2009) (stating that “[s]ince Expedia has chosen to represent the room rate to the public as the price a customer must pay to secure his right to occupy the room, the City has no choice . . . but to tax the customer for the published room rate demanded by Expedia.”)). Ultimately, this opinion is interpreted as a win for the city, as it requires OTCs to remit hotel taxes, if collected, based on the higher, retail rate. See Tom Gilroy, *Georgia Supreme Court Reaffirms Hotel Occupancy Tax Due on Full Price of Rooms*, BNA TAX MGMT. WKLY. ST. TAX REP., May 20, 2011. Because Expedia and other OTCs *do* collect taxes from customers, as agreed upon in their respective contracts, the retail rate ultimately applies. See William Hays Weissman, *Taxing the Internet, Sort Of*, ST. TAX TODAY, Oct. 26, 2009, available at 2009 STT 204-3.

<sup>169</sup> Henchman, *supra* note 8, at 18 (citing *City of Bowling Green v. Hotels.com, L.P.*, 357 S.W.3d 531, 533 (Ky. Ct. App. 2011) (stating that “[t]he OTCs did not provide physical accommodations within the City of Bowling Green.”)). The Kentucky Supreme Court later “denied a motion to rehear [the] case.” Jessica M. Karmasek, *Courts Say Online Travel Companies Can't Be Taxed*, LEGAL NEWSLINE (Mar. 9, 2012, 9:20 AM), <http://legalnewsline.com/news/235454-courts-say-online-travel-companies-cant-be-taxed>. The United States Court of Appeals for the Sixth Circuit also held that the services fees are not subject to hotel tax, on appeal from the U.S. District Court for the Western District of Kentucky. See Henchman, *supra* note 8, at 13 (citing *Louisville/Jefferson Cnty. Metro Gov't v. Hotels.com, L.P.*, 590 F.3d 381 (6th Cir. 2009)).

<sup>170</sup> Henchman, *supra* note 8, at 18-19 (citing *St. Louis Cnty. v. Prestige Travel, Inc.*, No. SC91228, 2011 Mo. LEXIS 198, at \*11 (Mo. June 28, 2011) (stating that “it is clear the obligation to file the tax was placed solely on those ‘engaged in the business of operating a hotel or motel.’”)).

<sup>171</sup> Henchman, *supra* note 8, at 19 (citing *City of Gallup v. Hotels.com, L.P.*, No. CV 07-644 JC/RLP, 2009 U.S. Dist. LEXIS 126818 (D.N.M. Mar. 1, 2010)).

York,<sup>172</sup> North Carolina,<sup>173</sup> Ohio,<sup>174</sup> Oklahoma,<sup>175</sup> Pennsylvania,<sup>176</sup> Tennessee<sup>177</sup> and Texas.<sup>178</sup> Conversely, courts in the following *five states* have held that OTC service fees *are* subject to hotel taxes, or, in other words, OTCs are required to remit taxes on the higher, retail rate paid

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<sup>172</sup> Henchman, *supra* note 8, at 19 (citing *Expedia, Inc. v. City of N.Y. Dept. of Fin.*, No. 6174, 650761/09, 2011 N.Y. App. Div. LEXIS 8467 (N.Y. App. Nov. 29, 2011)). The Court held that “the New York City Department of Finance could not expand the hotel occupancy tax to include OTC service charges because the relevant statute authorizes taxation only of the actual hotel occupants.” Jennifer Carr, *State and Local Tax Legal Developments: A Year in Review*, ST. TAX TODAY, Dec. 19, 2011, available at 2011 STT 243-6.

<sup>173</sup> The Fourth Circuit held that OTC services fees are not subject to hotel tax, affirming the decision of the U.S. District Court for the Eastern District of North Carolina. See Henchman, *supra* note 8, at 13 (citing *Pitt Cnty. v. Hotels.com, L.P.*, 553 F.3d 308, 314 (4th Cir. 2009)). The Court “held that hotel taxes are owed only by retailers that operate retail facilities, and that online travel companies are not hotel operators.” Henchman, *supra* note 99.

<sup>174</sup> Henchman, *supra* note 8, at 19 (citing *City of Findlay v. Hotels.com, L.P.*, 441 F. Supp. 2d 855 (N.D. Ohio 2006)). Recently, on September 10, 2012, in *City of Columbus v. Hotels.com, L.P.*, the United States Court of Appeals for the Sixth Circuit affirmed the District Court’s decision. See Boyce F. Martin, *U.S. Sixth Circuit: OTCs Not Obligated to Collect, Remit Local Ohio Occupancy Tax*, ST. TAX TODAY, Sept. 11, 2012, available at 2012 STT 176-19; Tom Gilroy, *Sixth Circuit: Online Travel Firms Not Subject to Ohio Cities’ Hotel Occupancy Tax Statutes*, BNA TAX MGMT. WKLY. ST. TAX REP., Sept. 21, 2012.

<sup>175</sup> Henchman, *supra* note 8, at 20 (citing *State v. Priceline.com, Inc.*, No. CJ-2010-8952 (Okla. Dist. Ct. Mar. 22, 2011)). See also Tom Gilroy, *Sales Tax Disputes with Online Travel Sites Focus of Oklahoma Ruling*, TAX MGMT. WKLY. ST. TAX REP., Mar. 18, 2011.

<sup>176</sup> Henchman, *supra* note 8, at 21 (citing *City of Phila. v. City of Phila. Tax Rev. Bd.*, No. 216 CD 2011, 2012 Pa. Commw. LEXIS 47 (Pa. Cmmw. Ct. Feb. 2, 2012)). One article states, quoting the *City of Philadelphia* opinion, that “Expedia does not ‘operate’ hotels, and therefore are not liable for a tax on their services.” Karmasek, *supra* note 169. The Pennsylvania Supreme Court has denied the city’s “petition for allowance of appeal.” *Pennsylvania Supreme Court Denies Petition for Allowance of Appeal in Hotel Room Tax Matter*, ST. TAX TODAY, Aug. 27, 2012, available at 2012 STT 166-26.

<sup>177</sup> Henchman, *supra* note 8, at 22 (citing *City of Goodlettsville v. Priceline.com, Inc.*, No. 3:08-cv-00561, 2012 U.S. Dist. LEXIS 21195 (M.D. Tenn. Feb. 21, 2012)). One article summarized the opinion as stating that “it was up to the cities to rework the current tax laws if they want to be able to go after the companies for taxes.” Karmasek, *supra* note 169.

<sup>178</sup> Henchman, *supra* note 8, at 22 (citing *City of Hous. v. Hotels.com, L.P.*, No. 14-10-00349-CV, 2011 Tex. App. LEXIS 8448 (Tex. Ct. App. Oct. 25, 2011)); Tom Gilroy, *Texas Judge Sides With Online Travel Companies Against City of Houston*, TAX MGMT. WKLY. ST. TAX REP., Jan. 29, 2010. See also Henchman, *supra* note 8, at 23 (citing *City of Orange v. Hotels.com, L.P.*, 2007 WL 2787985 (E.D. Tex. Sep. 21, 2007)).

by the customer to Expedia: Georgia,<sup>179</sup> Illinois,<sup>180</sup> South Carolina,<sup>181</sup> Texas<sup>182</sup> and D.C.<sup>183</sup>

At first glance, it may appear that OTCs are prevailing on this issue, with a majority of courts finding that OTCs' service fees are *not* subject to hotel occupancy taxes, or, in other words, that OTCs are required to remit taxes only on the lower, wholesale value of the room. As in the case of Groupon, where a majority of states have required merchants to tax only the discounted value of the voucher, one could assert that the same is true for Expedia—that a critical mass is also imposing taxes only on the discounted value (in this case, the lower, wholesale rates). However, unlike Groupon, where the states' respective Departments of Revenue answer the tax question, here, courts

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<sup>179</sup> Carr, *supra* note 172 (citing *City of Atlanta v. Hotels.com, L.P.*, No. S11A0508, 2011 Ga. LEXIS 386, at \*6 (Ga. May 16, 2011)). Note that *Henchman*, *supra* note 8, at 17, describes *City of Atlanta* as *not* subjecting OTC service fees to hotel tax. However, other sources confirm that *City of Atlanta* held *against* the OTCs, holding that they owe hotel taxes on the higher, retail room rate. See, e.g., *Georgia Supreme Court: Online Travel Companies Must Collect Hotel Tax On Retail Rate*, ST. TAX TODAY, May 17, 2011, available at 2011 STT 95-11. For a Georgia case holding that OTC service fees are *not* subject to hotel taxes, see *Expedia, Inc. v. City of Columbus*, 681 S.E.2d 122 (Ga. 2009).

<sup>180</sup> *Henchman*, *supra* note 8, at 18 (citing *Village of Rosemont v. Priceline.com, Inc.*, No. 09-C-4438, 2011 U.S. Dis. LEXIS 119231 (E.D. Ill. Oct. 14, 2011)). See Ronald A. Guzman, *U.S. District Court: Online Travel Companies Must Collect and Remit Local Hotel Tax*, ST. TAX TODAY, Oct. 21, 2011, available at 2011 STT 204-12.

<sup>181</sup> *Henchman*, *supra* note 8, at 21 (citing *Travelscape, LLC v. S.C. Dep't of Revenue*, 705 S.E.2d 28 (S.C. 2011) (finding that OTC services fees are subject to hotel tax because OTCs are "engaged . . . in the business of furnishing accommodations.")). See also Tom Gilroy, *South Carolina Supreme Court Upholds Expedia \$4.7 Million Sales Tax Assessment*, TAX MGMT. WKLY. ST. TAX REP., Jan. 8, 2011.

<sup>182</sup> *Henchman*, *supra* note 8, at 23 (citing *City of San Antonio v. Hotels.com, L.P.*, No. SA-06-CA-381-OG, 2011 U.S. Dist. LEXIS 72665 (W.D. Tex. July 1, 2011)). However, for two Texas cases holding that OTC service fees are *not* subject to hotel taxes, see *City of Hous. v. Hotels.com, L.P.*, No. 14-10-00349-CV, 2011 Tex. App. LEXIS 8448 (Tex. App. Oct. 25, 2011); *City of Orange v. Hotels.com, L.P.*, No. 1:06-CV-413, 2007 WL 2787985 (E.D. Tex. Sep. 21, 2007).

<sup>183</sup> *Henchman*, *supra* note 8, at 24 (citing *District of Columbia v. Expedia, Inc.*, No. 2011-CA-002117-B (D.C. Super. Ct. Oct. 12, 2011) (stating that "[i]t is not the transaction between the hotel and the OTC that is the retail sale; rather, it is the subsequent sale to the ultimate purchaser.")). See also Joseph Henchman, *D.C. Judge Rules Online Travel Companies Must Pay Hotel Tax on their Services*, TAX FOUND. (Sept. 26, 2012), <http://taxfoundation.org/blog/dc-judge-rules-online-travel-companies-must-pay-hotel-tax-their-services>; John Buhl, *District of Columbia Court Rules Online Travel Companies Owe Hotel Taxes*, ST. TAX TODAY, Sept. 25, 2012, available at 2012 STT 186-3.

have decided this inquiry.<sup>184</sup> This has had implications not arising in the Groupon context.

As of June 15, 2011, *sixteen* cases were “dismissed for procedural reasons, such as failure to exhaust administrative remedies, denial of class certification, or lack of standing;”<sup>185</sup> *five* cases were “dismissed without prejudice;”<sup>186</sup> and in *ten* cases, “the [OTCs] have paid several million dollars to settle.”<sup>187</sup> Indeed, nearly *9 million dollars* “has been disclosed as paid in settlement of these OTC cases.”<sup>188</sup> The rulings that favor the OTCs, though currently greater in number than those for the government plaintiffs, must be considered alongside these recent settlements between the OTCs and state and city governments. The opinions favoring OTCs are also deflated by the rising number of jurisdictions that are amending their hotel occupancy statutes and setting forth other guidance, requiring OTCs to assess taxes based on the higher, retail rate of the rooms.<sup>189</sup> The North Carolina Legislature

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<sup>184</sup> The Multistate Tax Commission is also involved, “providing two different approaches for states to choose from in its draft model statute on tax collection and remittance procedures for hotels and online travel companies.” Amy Hamilton, *Online Travel Companies Voice Concerns with MTC Draft Model Statute*, ST. TAX TODAY, Apr. 11, 2012, available at 2012 STT 70-1.

<sup>185</sup> Setze, *supra* note 9.

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> Reagan, *supra* note 144, at 7. See, e.g., Sara K. Clarke, *Expedia Settlement Makes Tourist Tax Collections Soar*, ORLANDO SENTINEL (Nov. 2, 2011), [http://articles.orlandosentinel.com/2011-11-02/business/os-tdt-hotel-tax-20111102\\_1\\_tax-collections-expedia-settlement-deal](http://articles.orlandosentinel.com/2011-11-02/business/os-tdt-hotel-tax-20111102_1_tax-collections-expedia-settlement-deal); Tom Gilroy, *Expedia, Duluth, Minnesota, Agree to \$60,000 Hotel, Sales Tax Settlement*, TAX MGMT. WKLY. ST. TAX REP., July 20, 2012; Tom Gilroy, *Online Travel Companies, South Carolina Municipalities to Settle Hotel Tax Lawsuits*, TAX MGMT. WKLY. ST. TAX REP., Oct. 22, 2010; Tom Gilroy, *OTCs, Georgia Jurisdictions OK Partial Hotel Occupancy Class Action Settlement*, BNA TAX MGMT. WKLY. ST. TAX REP., Mar. 23, 2012. For a chart depicting the procedural posture of each case on this issue as of June 13, 2011, see Reagan, *supra* note 144. For a list of “Online Travel Company Litigation By State,” see Henschman, *supra* note 99.

<sup>189</sup> In response, OTCs “have sued to stop other governments in the U.S. from imposing the higher levy.” See, e.g., Michael DeMasi, *Priceline, Expedia Could Face Higher Occupancy Room Taxes in Saratoga Springs*, THE BUS. REV. (Sept. 24, 2012, 2:58 PM), <http://www.bizjournals.com/albany/news/2012/09/24/priceline-expedia-could-face-higher.html?page=all>; Tom Gilroy, *D.C. Law Requiring Online Travel Firms to Pay Hotel Tax on Full Price Takes Effect*, TAX MGMT. WKLY. ST. TAX REP., Apr. 22, 2011. New Hampshire has published a Technical Information Release, claiming that taxes must be calculated based on the higher, retail rate of the room paid by the occupant. See *New Hampshire DOR Provides Guidelines for Hotel Operators Using Online Booking Companies*, ST. TAX TODAY, Jan. 10, 2008, available at 2008 STT 7-14. Bills “have also been introduced in a number of states in recent years, including such bills in 2011 legislative sessions as Raised Bill 6624 in Connecticut, Senate Bill 1577 and House Bill 1454 in Texas, Senate Bill 296 in

passed one example of such legislation in 2010 in response to “court decisions that local occupancy tax statutes did not cover the OTCs’ ‘facilitation’ fee.”<sup>190</sup> Several OTCs filed suit seeking to block such amendments:

The lawsuit takes aim at North Carolina’s Department of Revenue, which in late December 2010 issued a notice on the amendments to modernize sales tax on accommodation rentals, and made it clear that the basis for calculating accommodation taxes includes “charges designated as facilitation fees and any other charges necessary to complete the accommodation rental.”<sup>191</sup>

When considering *all* of the avenues affecting the Expedia tax question—court rulings, settlement agreements, and legislative responses—it is not improbable that the tides may turn in favor of states and municipalities in the not-so-distant future.

### C. *The Best Tax Approach*

Regardless of which entity is currently prevailing (OTCs or governments), one must still consider which approach is *better*—assessing hotel taxes on the higher, retail room rate or instead, the lower, wholesale rate. As courts continue to wrestle with this issue, it is at least clear that a resolution is needed. And, like Groupon, fast. In the meantime, those courts with current OTC cases should mirror the Groupon regulatory majority imposing a lower tax base. When two modern trends such as Groupon and Expedia pose the same legal question, the solution should apply equally across both tax-generating bodies. As a result, undecided OTC cases should fall in line behind those courts comprising a “majority” and *require that OTCs remit hotel taxes based only on the lower, wholesale room rate.*<sup>192</sup>

#### 1. Statutory Interpretation

Similar to Groupon, where statutory interpretation supports the contention that the lower tax base should prevail, such analysis in the OTC context produces the same conclusion. Where the definition of “sales price” within the Groupon arena argued for a lower tax base, similarly, in the OTC realm, the statutory definition of “hotel opera-

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Utah, and Senate Bill 972 in Virginia.” Michael Mazerov, *CBPP Calls for Closure of Online Hotel Tax ‘Loophole,’* ST. TAX TODAY, Apr. 13, 2011, available at 2011 STT 71-1.

<sup>190</sup> Gilroy, *supra* note 9.

<sup>191</sup> *Id.*

<sup>192</sup> See Mazerov, *supra* note 189. For the opposing position that OTCs should remit hotel taxes based on the higher, retail rate, see Mak, *supra* note 103.

tor” supports the same. The Tax Foundation reported that of the seventy lawsuits filed as of May 2012, twenty-six cases rendered an opinion on the merits.<sup>193</sup> Of the fifteen cases where courts considered “whether [OTCs] are hotel ‘operators’ for purposes of hotel occupancy statutes,” twelve held for OTCs, finding that they are *not* hotel operators<sup>194</sup> within the meaning of the applicable statute.<sup>195</sup> One rationale for this finding, set forth by the Superior Court of Los Angeles County, California, states that “[o]ne cannot logically conclude . . . that because a hotel operator is required to furnish a receipt specifying the amount of taxes, therefore any entity that furnishes a receipt of some sort to the consumer must be an operator.”<sup>196</sup>

Similarly, of the twelve cases where courts considered “the scope of the hotel occupancy tax and what activities it is meant to tax,” nine cases held for OTCs, finding that “OTC services are beyond the scope of the hotel occupancy tax.”<sup>197</sup> One rationale, set forth by the Missouri

<sup>193</sup> Henchman, *supra* note 8, at 6.

<sup>194</sup> For an example of “hotel operator,” see *Louisville/Jefferson Cnty. Metro Gov’t v. Hotels.com, L.P.*, 590 F.3d 381, 383 (6th Cir. 2009) (considering the “Kentucky Enabling Acts[,] [which] authorize[s] counties to impose a transient room tax 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.’”) (citing KY. REV. STAT. ANN. § 91A.390(1) (LexisNexis 2013) and subsequently, interpreting the language of this statute).

<sup>195</sup> Henchman, *supra* note 8, at 6 (citing *Pitt Cnty. v. Hotels.com, L.P.*, 553 F.3d 308 (4th Cir. 2009); *Louisville/Jefferson Cnty. Metro Gov’t v. Hotels.com, L.P.*, 590 F.3d 381 (6th Cir. 2009); *City of Birmingham v. Orbitz, Inc.*, No. CV 09-3607 JSV, 2011 WL 9753765 (Ala. Cir. Ct. Mar. 24, 2011); *Priceline.com, Inc. v. City of Anaheim*, No. JCCP 4472, 2010 WL 8721517 (Cal. Super. Ct. L.A. County Feb. 1, 2010); *Orange Cnty. v. Expedia, Inc.*, No. 48-2006-CA-2104-O (Fla. Cir. Ct. Jan. 20, 2011); *Expedia, Inc. v. City of Columbus*, 681 S.E.2d 122 (Ga. 2009); *St. Louis Cnty. v. Prestige Travel, Inc.*, No. SC 91228, 2011 Mo. LEXIS 198 (Mo. June 28, 2011); *City of Findlay v. Hotels.com, L.P.*, 441 F. Supp. 2d 855 (N.D. Ohio 2006); *City of Phila. v. City of Phila. Tax Rev. Bd.*, No. 216 C.D. 2011, 2012 Pa. Commw. LEXIS 47 (Pa. Cmmw. Ct., Feb. 2, 2012); *City of Goodlettsville v. Priceline.com, Inc.*, No. 3:08-cv-00561, 2012 U.S. Dist. LEXIS 21195 (M.D. Tenn. Feb. 21, 2012); *City of Hous. v. Hotels.com, L.P.*, No. 14-10-00349-CV, 2011 Tex. App. LEXIS 8448 (Tex. App. Oct 25, 2011); *City of Orange v. Hotels.com, L.P.*, No. 1:06-CV-413, 2007 WL 2787985 (E.D. Tex. Sept. 21, 2007)).

<sup>196</sup> *Id.* at 6 (citing *City of Anaheim*, at 23).

<sup>197</sup> *Id.* at 8 (citing *City of Birmingham v. Orbitz, Inc.*, No. CV-09 3607 JSV, 2011 WL 9753765 (Ala. Cir. Ct. Mar. 24, 2011); *City of Santa Monica v. Expedia, Inc.*, No. SC108568 (Cal. Super. Ct. L.A. County Mar. 16, 2011); *Orange Cnty. v. Expedia, Inc.*, No. 48-2006-CA-2104-O (Fla. Cir. Ct. Jan. 20, 2011); *St. Louis Cnty. v. Prestige Travel, Inc.*, No. SC 91228, 2011 Mo. LEXIS 198 (Mo. June 28, 2011); *City of Gallup v. Hotels.com*, No. CV 07-644 JC/RPL (D.N.M. Mar. 1, 2010); *City of Phila. v. City of Phila. Tax Rev. Bd.*, No. 00764, 2011 WL 6961120 (Pa. Commw. Ct. Feb. 2, 2012); *City of*

Supreme Court, states that “‘the money [the OTC] retains is compensation for facilitating a reservation, not providing a sleeping room,’ outside the scope of a tax on amounts paid by hotel guests.”<sup>198</sup> Based on such statutory analysis here as well as the considerations of “hotel operator,” one can rightfully conclude that the taxable value should be the *lower* amount—the “wholesale” room rate paid by Expedia to the participating hotel.

## 2. Economic Considerations

Like Groupon, alongside statutory interpretations supporting a lower tax base, economic considerations are also pertinent. Where the economic arguments within Groupon focused solely on the *consumer*, here, the solution is based, more or less, on reasonableness. In arguing that the assessment of hotel taxes should not include the OTC service fees, one commentator stated, “Occupancy taxes are based on the rate the hotel sets and receives, . . . not the profits, fees or commissions of its partners. . . . The facilitation fees are *no more part of the hotel rate than the taxi that takes the guest from the airport or the tip they give the bellhop.*”<sup>199</sup>

When considering the *fairness* of taxing the OTC service fees, one may ask: why not tax *all* service fees, not just those of online companies?<sup>200</sup> In addressing this question, one author posited, “because officials want to extract more revenue from out-of-state travelers and out-of-state businesses, the result is an effort to tax only services provided by out-of-state and Internet businesses.”<sup>201</sup> Considering the fairness of this tax approach, the author argues convincingly that if OTCs are required to remit hotel taxes based on their service fees, then *all* service fees should be taxed:

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Hous. v. Hotels. com, L.P., No. 14-10-00349-CV, 2011 Tex. App. LEXIS 8448 (Tex. App. Oct. 25, 2011); City of Orange v. Hotels.com, No. 1:06-CV-413, 2007 WL 2787985 (E.D. Tex. Sep. 21, 2007)).

<sup>198</sup> *Id.* at 8 (citing *St. Louis Cnty.*, at 6).

<sup>199</sup> Jones, *supra* note 6 (emphasis added). It is noted that regarding the taxi and bellhop examples, such payments are related to, yet distinct from, the cost of the hotel room (what is being taxed); whereas, here, a consumer is paying only for the hotel room, not for the OTC’s placement service. However, in some form, the consumer actually *is* paying for the OTC’s placement service (in a round-about-way), as the percentage of the consumer’s purchase price that the OTC does *not* remit to the state, the OTC *retains* as its service fee. See the example of an OTC transaction accompanying *supra* note 150.

<sup>200</sup> See generally Henchman, *supra* note 8.

<sup>201</sup> *Id.* at 5.



There is no principled basis for only taxing those services provided by Internet businesses. If state and local officials believe that [OTCs] should pay sales or excise tax based on the services they provide, the payment should only occur as part of a general taxation of all services. . . . By singling out only services provided by Internet-based travel companies, state and local governments are demonstrating that their true motivation is gouging revenue from out-of-staters, not *fairness*.<sup>202</sup>

Regarding OTCs' customers, as noted previously, consumers have been less of the focus in the Expedia context than in Groupon—where the primary inquiry there concerned whether and how much sales tax Groupon *customers* should remit to merchants upon redemption of the voucher, the Expedia inquiry asks how much hotel taxes *OTCs* are required to remit to hotels. However, if courts in various states require OTCs to remit hotel taxes based on the *higher*, retail room rate, OTCs can pay their requisite damages and simply refuse to continue listing that particular city or state's hotels on its websites.<sup>203</sup> This will, of course, disadvantage those hotel chains, but it will also harm consumers who are unable to reserve hotels for that area with the convenience of OTCs. "The municipalities that bring these lawsuits are likely doing a disservice to persons, whether residents or out-of-towners, who would like to stay in a hotel."<sup>204</sup> State and city officials must "wonder whether they won the battle but will end up losing the war."<sup>205</sup>

As one commentator noted, regardless of the *solution*, this *approach* to finding it is inefficient and cumbersome: "Whatever the solution, it should be a well thought-out, comprehensive approach, and not this case-by-case approach that is draining resources from the companies, the localities, and the courts."<sup>206</sup>

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<sup>202</sup> *Id.* at 11 (emphasis added). It is noted that the government could argue that it is not taxing OTCs' facilitation or service fees, but rather, is merely taxing the value of the hotel room as paid by the customer. However, as noted above, in some sense, encompassed within the value of the hotel room *is* the service fee, as, what the OTC does not remit of the consumer's payment, it retains as such a fee. See the example of an OTC transaction accompanying *supra* note 150.

<sup>203</sup> See, e.g., Natalie Ragus, *Expedia Ditches Arcadia Market Due to Hotel Tax*, ARCADIAPATCH (July 12, 2012), <http://arcadia.patch.com/articles/expedia-ditches-arcadia-market-due-to-hotel-tax>.

<sup>204</sup> Weissman, *supra* note 168.

<sup>205</sup> *Id.* For additional coverage on this topic, see, for example, James A. Amdur, *Obligation of Online Travel Companies to Collect and Remit Hotel Occupancy Taxes*, 61 A.L.R. 6TH 387 (2011); Kerra J. Melvin, *Technology, Travel Companies & Taxation: Should Expedia Be Required to Collect and Remit State Occupancy Taxes on Profits from Facilitating Hotel Room Rentals?*, 8 WASH. J.L. TECH. & ARTS 43 (2012).

<sup>206</sup> Weissman, *supra* note 168.

## IV. CONCLUSION

The Groupon and Expedia business models are at the forefront because they present an opportunity for cities, municipalities and states to *raise revenue*<sup>207</sup>—by Groupon, in the form of sales tax and by OTCs, in the form of hotel tax. The resulting difficulty has been deciding *how* to obtain such revenue, and namely, how to do so *fairly*. As one analyst said of the Expedia inquiry, it is immaterial whether Expedia or other OTCs qualify as a “hotel operator,” as many opinions do in fact consider—instead, “[i]f states or localities want to raise more revenue, they could just raise the rate rather than argue about which price to apply it to.”<sup>208</sup>

While increasing the tax rates *is* a possible alternative to increasing revenue (yet, still leaves the issue of determining the proper tax base), the point is this: there are other solutions to consider rather than the case-by-case, state-by-state approach being taken among those decision-makers of the Groupon and Expedia tax inquiries. Really, “given the fractured nature of state and local governments, it might require some sort of federal intervention. Although that is probably not a popular idea, the one thing that seems clear is that *ultimately the status quo is going to have to change*.”<sup>209</sup> Whatever and however the change, in an area where two modern trends pose the same tax issue, at the *least*, the proper solution—a lower tax base—should be applied equally across both sectors—not only for consistency’s sake, but for taxpayers’ sake.

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<sup>207</sup> See *id.* (setting forth this consideration in the context of OTCs). Though, of opinion, the thought applies equally to the Groupon consideration as well.

<sup>208</sup> *Id.*

<sup>209</sup> *Id.* (emphasis added) (setting forth this consideration in the context of OTCs). Though, of opinion, the thought applies equally to the Groupon consideration as well.