DEPARTMENT OF STATE REVENUE

04-20080447REV.LOF

Letter of Findings Number: 08-0447
Sales Tax
For Tax Years 2004-06

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales Tax–Hotel Accommodations.

Authority: Quill Corp. v. North Dakota, 504 U.S. 298 (1992); McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944); 3551 Lafayette Road Corporation v. Indiana Dept. of State Revenue, 644 N.E.2d 199 (Ind. Tax Ct. 1994); Internet Tax Freedom Act, 47 U.S.C. § 151 note (2007); IC 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-4-4; IC § 6-8.1-5-1; 45 IAC 2.2-1-1; Black's Law Dictionary (6th ed. 1990).

Taxpayer protests the assessment of sales tax on fees it charges for hotel reservations.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer should have been collecting sales tax on some amounts of sales it made to its customers. Taxpayer operates an Internet site where its customers can reserve hotel accommodations in Indiana and elsewhere. Taxpayer operates under the "Merchant Model." Under the "Merchant Model" [Taxpayer refers to this model as the "Opaque Model," but the Department will continue to refer to it as the "Merchant Model"] the customer reserves the hotel room via Taxpayer's Internet site and pays Taxpayer for the whole transaction at that time. At the time of the room reservation, Taxpayer displays two amounts to its customers. The first amount includes the cost of the hotel room plus a fee to Taxpayer. The second amount includes estimated taxes on the room plus a fee to Taxpayer. There is no breakdown of what portions of the two amounts constitute room costs, Taxpayer's fees, or estimated taxes. The customer then pays Taxpayer one total which includes both the first amount and the second amount at the time the rooms are reserved on the Internet site. At this time, the hotel bills Taxpayer for the price of the customer's room, including all relevant taxes on the occupation of the room. The hotel then remits sales tax to the Department on the amount the hotel billed Taxpayer for the customer's occupation of the room. Taxpayer did not remit sales tax on the amount of fees which it received from its customers for its services in the reservation process. The Department determined that Taxpayer should have collected and remitted sales tax on the total amount Taxpayer collected from its customers and issued proposed assessments for sales tax on the amount Taxpayer did not remit to the hotels and interest. The Department issued proposed assessments for sales tax and interest on the amounts representing Taxpayer's fees. Taxpayer protests the imposition of sales tax on the amounts representing its fees. An administrative hearing was conducted, and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Hotel Accommodations.

DISCUSSION

Taxpayer protests the imposition of sales tax on certain amounts it collected from its customers who reserved Indiana hotel rooms via Taxpayer's Internet site. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department determined that Taxpayer should have collected and remitted sales tax on amounts it retained as fees when those customers paid Taxpayer directly for the entire cost of the transaction. Taxpayer protests this determination on several grounds. First, Taxpayer states that it does not engage in retail transactions in Indiana and is not therefore subject to collecting Indiana sales or use tax. Second, Taxpayer states that requiring it to collect sales tax on its customers' rental of rooms violates the United States Constitution's Commerce Clause. Third, Taxpayer states that its written agreements with the Indiana-located hotels clearly demonstrate that the hotel is providing the accommodation. Taxpayer believes that this means that the hotel alone is responsible for collecting sales tax on the amount it charges for the accommodations. Fourth, Taxpayer states that the imposition of sales tax on its fees violates the Internet Tax Freedom Act ("ITFA") and is therefore invalid.

IC § 6-2.5-4-4 provides:

(a) A person is a retail merchant making a retail transaction when the person rents or furnishes rooms, lodgings, or other accommodations, such as booths, display spaces, banquet facilities, and cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment to another person:

(1) if those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days; and

(2) if the rooms, lodgings, and accommodations are located in a hotel, motel, inn, tourist camp, tourist

cabin, gymnasium, hall, coliseum, or other place, where rooms, lodgings, or accommodations are regularly furnished for consideration.

(b) Each rental or furnishing by a retail merchant under subsection (a) is a separate unitary transaction regardless of whether consideration is paid to an independent contractor or directly to the retail merchant. (Emphasis added).

Also, IC § 6-2.5-2-1 states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Also of relevance is IC § 6-2.5-1-1(a), which states:

Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

Finally, 45 IAC 2.2-1-1(a) states:

For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Accordingly, IC § 6-2.5-4-4 requires that a person rent or furnish rooms, lodgings, or other accommodations in order to be considered a retail merchant making a retail transaction. In this case, Taxpayer's customers rented the rooms in unitary transactions which included the cost of the rooms and Taxpayer's fees in one price. As explained by 45 IAC 2.2-1-1(a), sales tax applies to the total combined charge irrespective of the fact that services which would not otherwise be taxable are included in the charge.

In Taxpayer's first point of protest, Taxpayer argues that it could not have furnished rooms in Indiana since it did not and does not own any buildings in Indiana. Further, Taxpayer argues that it could not have rented rooms in Indiana since it did not have the right to use the rooms itself, but only to arrange the use of the rooms by its customers. The Indiana Tax Court has discussed the application of IC § 6-2.5-4-4 in 3551 Lafayette Road Corporation v. Indiana Dept. of State Revenue, 644 N.E.2d 199 (Ind. Tax Ct. 1994), in which the court explained:

Under the plain, ordinary, and ususal [sic] meaning of the words in I.C. 6-2.5-4-4, a person is a retail merchant when he or she "rents or furnishes... cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment..." As the court has noted in a related context, "the linchpin of taxability... is 'consideration.' " Maurer, 607 N.E.2d at 988, n. 3. Consequently, the words "rents or furnishes" necessarily imply that consideration must be given for use of the actual space in which the adult entertainment occurs. See Bailey v. State (1904), 163 Ind. 165, 167, 71 N.E. 655, 656. Moreover, since the tax imposed under I.C. 6-2.5-4-4 is on the consideration received for use of the space, "rents or furnishes" must mean "rents or furnishes for consideration," for if the rental or furnishing of the space were gratuitous, there would be nothing to tax under the statute. The court will not construe a statute to have an absurd result. Id. at 201.

"Rent" is defined in Black's Law Dictionary 1297 (6th ed. 1990) as follows:

Consideration paid for use or occupation of property. In a broader sense, it is the compensation or fee paid, usually periodically, for the use of any rental property, land, buildings, equipment, etc.

As previously explained, these were unitary transactions in which Taxpayer's customers paid Taxpayer consideration for use or occupation of property. Taxpayer's customers were unquestionably renting Indiana hotel rooms. The transaction is the rental of the room itself. Since the transaction of renting an Indiana hotel room can only occur in Indiana, the transactions were subject to Indiana sales tax. Since the customers' rentals of the rooms were clearly taxable, and since the transaction by which the customers rented the rooms were unitary transactions as provided by IC § 6-2.5-1-1(a), the total combined charges were subject to Indiana sales tax. Since the total combined charges were paid to Taxpayer, Taxpayer was responsible for the collection and remittance of sales tax on the total combined charges.

In Taxpayer's second point of protest, Taxpayer argues that requiring it to collect sales tax on its customers' rental of rooms is prohibited by the United States Constitution's Commerce Clause. Taxpayer refers to McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944) in support of this position. In McLeod, the United States Supreme Court ruled that Arkansas could not impose sales tax on sales in Arkansas originating in Tennessee, where the transfer of the goods in question took place in Tennessee and the goods were then transported into Arkansas. The Department is unconvinced that this case supports Taxpayer's position. Unlike the circumstances in McLeod, the "goods" in the instant case are transferred in Indiana. Indeed, it would be impossible for a customer to stay at an Indiana hotel outside of Indiana's borders.

Another Supreme Court case dealing with the Commerce Clause is Quill Corp. v. North Dakota, 504 U.S. 298 (1992), in which the Court explains:

While contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to

> arise for the first time today, Bellas Hess is not inconsistent with Complete Auto and our recent cases. Under Complete Auto 's four-part test, we will sustain a tax against a Commerce Clause challenge so long as the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S., at 279, 97 S.Ct., at 1079. Bellas Hess concerns the first of these tests and stands for the proposition that a vendor whose only contacts with the taxing State are by mail or common carrier lacks the "substantial nexus" required by the Commerce Clause.
>
> Id. at 311.

The Court also provided:

> Complete Auto, it is true, renounced Freeman and its progeny as "formalistic." But not all formalism is alike. Spector 's formal distinction between taxes on the "privilege of doing business" and all other taxes served no purpose within our Commerce Clause jurisprudence, but stood "only as a trap for the unwary draftsman." Complete Auto, 430 U.S., at 279, 97 S.Ct. at 1079. In contrast, the bright-line rule of Bellas Hess furthers the ends of the dormant Commerce Clause. Undue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation. Bellas Hess followed the latter approach and created a safe harbor for vendors "whose only connection with customers in the [taxing] State is by common carrier or the United States mail." Under Bellas Hess, such vendors are free from state-imposed duties to collect sales and use taxes.
>
> Id. at 314-5.

Again, the tax here is being applied to an activity with more than substantial nexus with Indiana. The Indiana hotel rooms are occupied in Indiana. Taxpayer already collects those taxes which the hotels would collect from the customers. Unlike the vendors discussed in Quill, Taxpayer's contacts with Indiana are not discrete or remote. Taxpayer specifically entered into arrangements with Indiana-located hotels to arrange accommodations in Indiana for Taxpayer's online customers. Additionally, Taxpayer specifically entered into a category of transactions which were completed only when its customers occupied Indiana hotel rooms.

This leads to the conclusion that the commerce at issue here is not, in fact, interstate in nature. As defined by IC § 6-2.5-4-4(a), renting a hotel room is a retail transaction. Unlike a traditional interstate transaction of tangible personal property, where the goods are located in one state and transported into another state, the transactions in this case took place wholly within Indiana. This situation is similar to tangible personal property which can never enter or leave Indiana. Under IC § 6-2.5-4-4(b), each rental or furnishing by a retail merchant under subsection (a) is a separate unitary transaction regardless of whether consideration is paid to an independent contractor or directly to the retail merchant. While the service of arranging the customers' occupation of the rooms would not ordinarily be subject to sales tax, these transactions were unitary in nature, as provided by IC § 6-2.5-1-1(a) and IC § 6-2.5-4-4(b). Therefore, the entire amount the customers paid Taxpayer are subject to sales tax, as explained by 45 IAC 2.2-1-1(a). The only activities which took place outside Indiana occurred when Taxpayer and its customers reached an agreement to conduct a transaction in Indiana and arranged payment for that transaction. The actual transfer occurred in an Indiana unitary transaction.

Taxpayer's third point of protest is that it is the hotels and not Taxpayer which provide the rooms. Taxpayer states that the contracts it has with the various hotels establish that Taxpayer is strictly an intermediary between the hotels and the ultimate consumers. As previously discussed, the customers pay Taxpayer a single price for the total transaction, including the cost of the hotel room and Taxpayer's fees. This constitutes a unitary transaction under IC § 6-2.5-1-1(a) and IC § 6-2.5-4-4(b). Taxpayer's arrangements with the hotels do not change the fact that the people who stay in the hotel rooms do not pay the hotels. Those customers pay Taxpayer to secure the right to use and occupy the rooms. The customers' payment to Taxpayer in a unitary transaction imposes the duty of collection on Taxpayer under IC § 6-2.5-2-1(b). Taxpayer has made no reference to any statute, regulation, or court case which would allow it to contract away its duty to collect sales tax on the entire amount of the unitary transaction.

In Taxpayer's fourth point of protest, Taxpayer asserts that the State is prohibited from imposing sales tax on this transaction by the Internet Tax Freedom Act, 47 U.S.C. § 151 note (2007). Taxpayer is incorrect. While the Act does prohibit a State from imposing a discriminatory tax on electronic commerce, the Act does not prohibit a state from imposing a tax on a transaction that would be subject to tax regardless of whether or not it is transacted over the Internet. See Internet Tax Freedom Act § 1101(a)(2) & 1105(2), 47 U.S.C. § 151 note (2007) (providing that a tax is discriminatory if an electronic commerce transaction is taxed at a higher rate or is taxed differently than a similar transaction that is accomplished through non-electronic commerce).

Taxpayer states that the imposition of sales tax on its fees discriminates against interstate commerce. In support of this position, Taxpayer states that Indiana does not impose sales tax on the fees Indiana-based travel agents charge their customers. Taxpayer has not provided any evidence in support of this position. The Department's practice in enforcing IC § 6-2.5-1-1(a) and 45 IAC 2.2-1-1(a) is to collect sales tax on unitary transactions. If an Indiana-based travel agent bills its customer a single price for the entire transaction, then the entire price is subject to sales tax. If the Indiana-based travel agent separates its fees from the cost of a hotel

room it reserves for its customer, then the fees are not subject to sales tax.

Taxpayer did provide documentation which it believes supports the position that Indiana does not impose sales tax on out-of-state businesses with similar operations to Taxpayer's, but which do not use electronic commerce to conduct business. The documentation provided shows that an out-of-state business offered trips into Indiana from other states which included accommodations. The documentation provided does list the price of the trips, but does not mention taxes of any kind.

The Department is unconvinced by this documentation. Taxpayer has not shown that the other business is not collecting sales tax on its services. Even if the documentation did show that a particular taxpayer was not complying, that would not prove that the Department approved of such behavior. If the Department becomes aware of any Taxpayer acting as a retail merchant in a unitary transaction, the Department expects sales tax to be collected and remitted on such transactions. The Department, in subjecting these Indiana hotel transactions to Indiana sales tax, is treating Taxpayer like any other travel agent that does not separately state its service fee. Therefore, since Taxpayer is being treated the same as other similarly situated taxpayers offering non-electronic commerce in Indiana, Taxpayer has not been subject to a discriminatory tax.

In conclusion, Taxpayer collects a single price from its customers for Indiana transactions which constitute a retail transaction under IC § 6-2.5-4-4 and are therefore unitary transactions under IC § 6-2.5-1-1(a). McLeod does not support Taxpayer's position, due to differing circumstances. Quill explains that taxes will survive Commerce Clause scrutiny if they pass the four-part test and do not place an undue burden on interstate commerce. The burden here is the same as the burden on an Indiana-based travel agent. The fact that the hotels own the rooms is not determinative due to the fact that the customers pay Taxpayer the entire price for the occupancy of the rooms. The imposition of sales tax here does not violate the ITFA since the same standards are applied to any travel service which does not separately state its fees from the other costs when billing its customers. Taxpayer has not met the burden of proving the proposed assessment wrong, as provided by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

Posted: 02/18/2009 by Legislative Services Agency
An html version of this document.