

NY ALJ: Travel Reservation Facilitation Receipts Are Service Receipts

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Overview

An Administrative Law Judge (the "ALJ") from the New York State Division of Tax Appeals recently ruled in favor of Expedia, Inc. ("Expedia"), a Washington-based corporation, holding that Expedia's receipts from its travel reservation facilitation business should be characterized as "services," and therefore should be sourced to where the services are performed (in this case outside of New York), for purposes of apportioning income under Article 9-A of the New York Tax Law.¹ The ALJ also ruled that the advertising receipts of an Expedia affiliate that operated an on-line travel search engine and directory should be classified as service revenue and sourced accordingly. The New York State Department of Taxation and Finance (the "Department") had, on audit, asserted that such revenues constituted "other business receipts", and sourced these receipts to New York using a customer location approach. The Department has the right to appeal this decision within 30 days of the ALJ's ruling. Accordingly, the decision may not be final.²

In this Tax Alert we summarize this ALJ decision.

Background

For tax years beginning prior to 2015, the New York tax law specified that receipts from services were required to be sourced to the location where the services were performed.³ By contrast, "other business receipts" were required to be sourced to where they were earned.⁴ The Department has taken the approach in recent years that the receipts of out-of-state businesses earned through transactions effected through electronic commerce or on-line were other business receipts and sourced to the location of the customer. This approach is based on their view that receipts from an electronic commerce/on-line transaction were earned from a simple, instantaneous and automated transaction, fully executed at the moment of a customer click. As such, the Department's position was that the transactions at issue could not be services as, in their view, the applicable regulation required a human component at the moment of sale.⁵

In this case, Expedia asserted that the travel reservation facilitation receipts during the years at issue were receipts from services, properly sourced outside of New York based on its specific facts. Additionally, Expedia argued that its affiliate's advertising receipts were also service receipts that, likewise, must be sourced outside of New York.

The ALJ's Ruling

Noting that New York's apportionment statute did not expressly define the word "services," the ALJ sought to interpret the intent of the legislature by giving that word its ordinary and usual meaning.⁶ This exercise led to the "inexorable conclusion" that the travel reservation facilitation receipts earned by Expedia were the result of services performed by its employees.⁷ Expedia acted as a travel intermediary, providing information to its customers, compiling summaries from travel service providers and facilitating travel arrangements. Expedia also provided pre- and post-transaction support. All of these activities were part of Expedia's business and occurred whether its customer accessed information from Expedia's database or was involved in a telephone call to a live Expedia representative. (It was not clear from the case what portion of Expedia's business was conducted over the phone as opposed to on-line and to what extent the fact that Expedia interfaced directly with customers as well as on-line

¹ *In re Expedia, Inc.*, New York State Division of Tax Appeals, Administrative Law Judge Unit, DTA Nos. 825025 and 825026 (Feb. 5, 2015), which may be accessed at the following link: <http://www.dta.ny.gov/pdf/determinations/825025.det.pdf>

² Note that ALJ determinations are not considered precedent, nor are they given any force or effect in other proceedings in the Division of Tax Appeals. However, an ALJ's reasoning and analysis may potentially suggest how that ALJ may address similar facts presented by another taxpayer.

³ Former N.Y. Tax Law Sec. 210.3(a)(2)(B), prior to adoption of N.Y. Tax Law Sec. 210-A.10(a), as added by Section 16, Part A, Chapter 59, Laws of 2014, effective Jan. 1, 2015.

⁴ Former N.Y. Tax Law Sec. 210.3(a)(2)(D), prior to adoption of N.Y. Tax Law Sec. 210-A.10(a), as added by Section 16, Part A, Chapter 59, Laws of 2014, effective Jan. 1, 2015.

⁵ See TSB-A-99(16)C, Apr. 7, 1999; TSB-A-00(15)C, Sept. 6, 2000; TSB-A-02(3)C, Apr. 18, 2002; TSB-A-11(1)C, Dec. 28, 2010; TSB-A-11(8)C, July 12, 2011.

⁶ *In re Expedia, Inc.*, at 11.

⁷ *Id.*

was important to the ALJ.) Based on the foregoing, and after concluding that the Department's own regulation does not support a human interaction requirement, the ALJ concluded that the Department's interpretation of what constitutes services appeared to be an impermissible expansion of the statute sourcing service receipts.⁸ Moreover, the ALJ noted that even if a human interaction requirement was an acceptable reading of the tax law, the Department ignored the evidence of human involvement throughout Expedia's process of providing its services, which would arguably satisfy the Department's own strained reading of the regulation to require human involvement.⁹ During the years at issue, Expedia employed approximately 6,600 people. Many of those people were involved in the creation of its software used, negotiation of the agreements with its various travel service providers, compilation of information, programming and operation of its servers, creation and maintenance of the website interface and telephonic and electronic customer service.¹⁰ Having concluded that these receipts were earned from the performance of a service, the ALJ therefore concluded it was proper for Expedia to have sourced them to the location where the underlying services were performed (in this case, outside of New York).¹¹

The ALJ further ruled that Expedia's affiliate's advertising receipts were receipts for services performed for advertising clients under the theory of recognizing the underlying activities of the people procuring and managing the advertisements that were viewed online, similar to the analysis above.¹² Therefore such receipts would be sourced to the location where the work that generated the income was performed (in this case, outside of New York).

Considerations

This ALJ decision applies to pre-2015 tax years.¹³ Taxpayers should take into account the procedural status of this case (i.e., whether it will be appealed) as well as their own specific fact patterns when considering how this case may apply to them in an audit situation or in evaluating potential refund claims. This case should also be monitored by New York-based e-commerce businesses who may have used the Department's prior advisory opinions as support for sourcing certain revenue streams based on customer location.

Contacts

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⁸ *Id.* at 12. The ALJ did not find to be persuasive a series of advisory opinions issued by the Department in support of its position that it had consistently concluded that services performed over the Internet or by electronic transmission should be classified as other business receipts. According to the ALJ, those advisory opinions involved receipts from initial access or subscription fees, distinguishable from Expedia's business model.

⁹ *Id.* at 13.

¹⁰ This comprehensive view of the income producing activity can be contrasted with the Department's more restrictive view as set-forth in TSB-A-92(9)C as relates to travel service companies in the pre-internet era.

¹¹ *Id.* at 15.

¹² *Id.* at 17-18.

¹³ As of January 1, 2015, receipts from services are sourced based on customer location using a hierarchy of methods. Receipts from on-line advertising is also customer based (using a ratio of the number of New York viewers divided by the number of all viewers). The ALJ cited the law change in support of Expedia, stating that the change would not have been necessary if the then-current law was interpreted as the Department suggested.