REPORT:
AIRBNB'S TAX AGREEMENTS ARE OBSOLETE
Supreme Court Decision Means State And Local Governments Should Tax Airbnb Like Every Other Online U.S. Business

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EXECUTIVE SUMMARY

Through Airbnb's voluntary tax agreements with states and local agencies across the country, tax agencies granted Airbnb and its lodging operators more favorable treatment than other lodging operators and taxpayers generally, thus facilitating Airbnb's growth in market share. The vast majority of Airbnb's voluntary tax agreements are negotiated behind closed doors without any public input, no public disclosures and no avenue, including FOIA, to find out what is in the deals.[1] Taxpayers have no idea if Airbnb is paying the correct amount of taxes. Even the tax agencies that have agreed to restrict their audits of the company cannot properly verify the accuracy of Airbnb's payments.

However, the U.S. Supreme Court's *Wayfair v. South Dakota* decision[2] last year now removes any doubt that Airbnb constitutionally has a sufficient connection to states to be mandatorily required to collect lodging and sales taxes.

Airbnb no longer qualifies—if it ever did—for privileged treatment by tax agencies as a "voluntary collector." This treatment gives Airbnb an advantage in the marketplace by creating a tax and regulatory haven for Airbnb lodging operators. Post-*Wayfair,* Airbnb's "voluntary agreements" are now a relic of a past legal premise that no longer exists.

State laws and tax agency rules and practices should treat Airbnb equally as compared to other businesses by moving the company out of these agreements and into mandatory collection status as they implement the *Wayfair* decision. This fact that Airbnb and comparable sellers are engaging in local commerce but are likely receiving favorable treatment over interstate sellers in the wake of the *Wayfair* decision, opens the possibility of serious, new legal challenges to states and localities.

Further, as the states terminate the Airbnb agreements, they should also ensure that all vestiges of the unjustified tax and regulatory haven created for local lodging operators are eliminated.

The problems caused by these agreements can all be remedied by proper action by state and local governments in the wake of the *Wayfair* decision. One common course of action under consideration post-*Wayfair* is to require electronic marketplaces to collect taxes on sales into a state. Thus, state and local governments can confidently terminate these agreements and secure proper tax collection by requiring Airbnb—as an electronic marketplace that facilitates local commerce within a state — to collect state and local sales or lodging taxes in a proper way.

Further, states can require electronic marketplace to provide, for income tax compliance purposes, 1099 reports of earnings exceeding $600 by in-state sellers, including owners of lodging facilities. Also, to facilitate appropriate local property taxation and regulation of lodging facilities, states should establish a registry of local operators to be coordinated with the operation of the marketplaces within the state.

[1] Only a handful of varying Airbnb agreements are public, offering the only basis for analyzing what they contain.
[2] On June 21, 2018, The United States Supreme Court ruled in the South Dakota v. Wayfair case that states can mandate that businesses without a physical presence in a state with more than 200 transactions or $100,000 in-state sales collect and remit sales taxes on transactions in the state. This decision overturned the Court's 1992 decision in Quill v. North Dakota and 1967 decision in National Bellas Hess.

Fatal Flaws In Airbnb's Voluntary Tax Agreements Before Wayfair decision

Before exploring the legal risks the Airbnb agreements pose to post-*Wayfair* laws, it is necessary to understand critical past mistakes made by states and localities in their processes of decision-making regarding Airbnb. These original mistakes that the jurisdictions signing Airbnb agreements made were two-fold:

1. Evidence exists that Airbnb had a physical presence with the states and localities where it operated and thus was subject to being required to collect lodging and sales taxes by state and local laws even before the *Wayfair* decision, and
2. The jurisdictions appear to have forgotten that, even if Airbnb and other lodging platforms operate across state and national boundaries, they are facilitating lodging transactions entirely within local commerce and not interstate commerce.

The first error is important because states, in particular, should understand that there never was a justification for treating Airbnb differently from all other taxpayers. Thus, the separate and unusually preferential terms granted to Airbnb were never justified and should not be continued in a post-*Wayfair* world. The second error is important because if the Airbnb agreements are left in place even as new laws are enacted to implement *Wayfair*, the perpetuation of this second mistake provides the foundation for legal challenges to the new post-*Wayfair* laws on equal protection and commerce clause grounds.

First, as to the question of whether states and localities could have required Airbnb to collect sales or lodging taxes before *Wayfair*, there is evidence Airbnb maintained an in-state physical presence in at least two ways. The first was by providing services to local lodging operators through local photography paid by Airbnb to take pictures of rental properties for use in the operators' listings on the Airbnb website.[3] Secondly, through their electronic platform services, they acted as an agent of the local lodging operators and their facilities. There may have been other features of Airbnb's operations in particular states—office, employees, other contractors—that constituted additional elements of physical presence. States should have conducted jointly a "nexus audit" of Airbnb prior to completing any agreements with the company.[4] At the very least, agencies should have, as is standard practice in agreements of this type, required Airbnb to make full, binding disclosures of the extent of their business activities subject to verification through audits. Instead, state and local tax agencies accepted representations from Airbnb that were insufficient and inconsistent with publicly available information and, worse yet, abandoned their authority to audit Airbnb. Thus, they erroneously accepted Airbnb as an interstate seller that could not be required to collect sales or lodging taxes.

> "Post-*Wayfair*, there should be no doubt whatsoever that Airbnb can be required to play by the same rules as all other taxpayers and collect sales or lodging taxes within the states and localities where it operates."

Secondly, it is important to understand that the lodging business is inherently local commerce because lodging is supplied locally by a business operating a local facility and is enjoyed locally by a consumer present in the locality. The fact that an out-of-state owner may own the lodging property, or a non-resident traveled into the

[3] These photography services are not an incidental matter. Especially given the absence of addresses from Airbnb, the photographs of the rental properties are a critical element in attracting bookings. Airbnb did not leave these photos to chance, so provided professional services to local operators to produce marketing success and more revenue for both itself and its operators at the expense of competing lodging sources.
[4] A large majority of states participate in the National Nexus Program of the Multistate Tax Commission and could have provided a single, joint nexus audit of Airbnb to determine its taxable status with these states prior to any agreements being signed. States have used that service in comparable cases in the past where new business models have occurred that require examination before states decided what tax treatment was appropriate. The same action should have taken in this instance.

state or locality to occupy the lodging, or an out-of-state service provider may have supported the transaction in some manner does not negate the fact that lodging is local commerce. That makes the transaction and the local lodging operator fully subject to state and local laws. Because lodging is both supplied locally by an in-state operator and consumed locally, it can be distinguished from a remote interstate sale where an out-of-state seller supplies a good or service from outside the state that is consumed inside the state.

Because lodging transactions are local commerce, it is important that they not be treated more favorably than interstate transactions. Otherwise, those engaged in the interstate transactions will have a heightened potential to challenge state or local taxes based on alleged discrimination against interstate commerce in favor of local commerce. There is significant legal risk for states and localities because there are clearly provisions in the Airbnb agreements that treat local lodging operators and lodging platforms more favorably than out-of-state sellers and the electronic marketplaces those sellers use.

Lack of auditing ability of Airbnb's tax agreements poses greatest legal risk

The provisions in the Airbnb agreements that pose the greatest legal risk to post-*Wayfair* implementing legislation are those that apply to audits. Specifically, these are the provisions that limit auditors to auditing only returns and schedules prepared by Airbnb and to anonymous data concerning transactions with lodging operators. These provisions effectively prevent auditors from auditing Airbnb's books and records even though tax administrative laws typically require their maintenance by the taxpayer and availability to the tax agency for audit purposes**.** Like drug-resistant bacteria that are toxic and even lethal to the health of people, Airbnb's "audit-resistant" provisions are toxic to the equity and integrity of the tax system.

> "Airbnb's 'audit-resistant' provisions are toxic to the equity and integrity of the tax system."

Post Wayfair: Airbnb's VCAs face higher risk of constitutional challenges

Some electronic marketplace providers subject to new tax collection and payment under *Wayfair* implementation legislation may find it useful for any variety of reasons to sue to demand equal treatment with Airbnb under the audit or other provisions of the agreements not otherwise available to them. The parties suing would likely allege unconstitutionality of the higher requirements under the marketplace provider legislation on both equal protection and commerce clause grounds. The commerce clause challenge would be based on a claim that marketplace providers of goods and services in interstate commerce are discriminated against as compared to Airbnb with its more favorable treatment as a marketplace provider of lodging services that operate in local commerce.

As long as disparities exist between the tax treatment of marketplace providers generally and the treatment of Airbnb as a specific marketplace provider, this legal risk will continue to exist. The disparities arise because there are two different "bodies of law" now emerging on the tax treatment of marketplace providers.[5] One body of law—clearly legitimate and transparent—consists of the new marketplace provider statutes being enacted through open discussions in state legislatures in the wake of *Wayfair*. The second body of "law"—opaque and of questionable legitimacy—consists of contracts signed and mostly sealed in secrecy between lodging marketplace providers and tax agencies. The only way to eliminate this legal risk is to terminate the lodging agreements and fold the lodging marketplaces into the new laws that apply equally to the full range of electronic marketplaces.

[5] Quotation marks are placed around "bodies of law" in this sentence and around "law" in the second sentence following this one because one to the "bodies of law" may not ultimately be legal. That body consists of the Airbnb agreements and their growing progeny with other lodging marketplace providers. The petition challenging the State of Florida agreements in Appendix B provides a look at some of the reasons these "laws" by contract are likely illegal.

The problems created by these lodging agreements will only grow over time. The "no-books and records/anonymous data" provisions will likely become a magnet for tax abuse. What happens when a new lodging marketplace provider begins consolidating the booking of transactions for traditional hotels and motels and secures an "Airbnb agreement" and proceeds to electronically skim off a portion of lodging tax collections for itself? Under the agreements, auditors would not be able to access the information necessary to detect the abuse.

The problems don't stop there. Attempts by taxpayers to withhold records in corporate audits is a common problem faced by auditors. Why wouldn't a corporate tax manager sitting on top of records of extensive profit-shifting activities or use tax undervaluation refuse audit requests on equal protection and commerce clause grounds—claiming they are being denied the benefits granted by that same tax agency to Airbnb under the "no access to books and records/anonymous data" provisions? This author is a veteran of a large quantity of disputes—often intense—with corporations over records access, and this potential claim is stronger than most of the arguments used in such conflicts. The claim doesn't have to actually prevail in court to be successful in pushing the request of records past a statute of limitations deadline. It is a strong enough basis to exhaust the audit and legal resources of tax agencies and prevent an audit assessment that a corporation knows it cannot otherwise overcome. Once the argument works for one corporation or a large combination of limited liability companies in frustrating an audit, word will spread in business circles. The argument will be refined into a high art by talented corporate tax attorneys who will with great pleasure wrap themselves in the U.S. Constitution in arguing for their corporation's absolute right to withhold records of its tax avoidance from what were—before the Airbnb agreements—routine audit requests.

Will state and localities squander opportunities to level playing field And avoid legal challenges?

There are no indications that states and localities have cancelled or are preparing to cancel agreements with Airbnb. To the contrary, a number of states and localities have been signing new agreements other lodging platforms such as HomeAway, Trip Advisor, misterb&b, onefinestay and perhaps others—some before the *Wayfair* decision and some after.

HomeAway has been especially active in securing agreements, including eight agreements with states and over 25 separate local governments after the *Wayfair* decision. Whether these agreements with additional lodging platforms are patterned and contain the same problematic provisions as the Airbnb agreements is not known.

> "The implementation of the Wayfair decision gives tax agencies an opportunity to expunge the mistake of the agreements with lodging tax providers, and they should seize that opportunity."

The fact that none of these agreements have been released publicly is not a good sign, because it suggests that there is something to hide within them. Because none of these "additional platform" agreements are available, this report has only reviewed the legal risks that the Airbnb agreements might pose to the implementation of the *Wayfair* decision. However, the fact that states and localities are choosing to continue to enter separate agreements for the electronic lodging marketplaces and are not folding them into the electronic marketplace legislation being developed for goods and services does raise red flags.

Separate and different terms adopted for lodging marketplaces can ultimately conflict with and undermine the more general laws for electronic marketplaces as will be seen in the analysis of the legal risks created by the Airbnb agreements in a post-*Wayfair* world.

States and Localities should restore equity, integrity and transparency to avoid future legal challenges

This report points clearly toward a few critical recommendations of actions that state and local governments should undertake concerning tax and regulatory policy toward short-term rentals. The most important developments that affect these recommendations are the U.S. Supreme Court decision in *South Dakota v. Wayfair* and the subsequent implementation efforts by states that center on enacting legislation requiring marketplace providers of goods and services to collect sales taxes for states and localities.

Although Airbnb and other lodging marketplace providers arguably were subject to the jurisdiction of the states before *Wayfair,* that decision removed all doubt on that subject. Further, the movement toward general marketplace provider legislation removes any basis a separate set of rules for lodging marketplaces, especially since those rules have been developed through the questionable means of secret, executive agreements between lodging marketplaces and tax agencies.

Recommendations to states and localities: Cancel VCA agreements and pass general market place provider legislation

States and local governments should begin the process of terminating existing executive agreements in coordination with state adoption of general marketplace provider legislation. Lodging marketplaces should operate according to the same rules as all other marketplaces. Further, governments should cease signing any new agreements with lodging marketplaces.

The passage of general marketplace provider legislation to implement the *Wayfair* decision is an opportunity to bring to a close the unfortunate episode of "laws" being written illegitimately through secret executive contracts. Those contracts undermine equitable taxation and local regulation and provide unjustified favoritism for the companies signing the agreements. Their short history should be expunged as soon as possible.