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Opinion No. 09-19

Hotel Tax on Houseboats Capable of Interstate Travel

QUESTION

May Clay County, upon authorization by private act, impose a hotel/motel tax that applies to rental of a houseboat that might travel to the Kentucky side of Dale Hollow Lake, without violating the Commerce Clause of the United States Constitution?

OPINION

Yes. Even though such houseboats would be capable of interstate travel, the Commerce Clause would not preclude a county hotel/motel tax on the privilege of renting a houseboat as long as the houseboat was rented from a location in Tennessee and was in Tennessee when the period of occupancy began.

ANALYSIS

Whether or not a proposed Clay County hotel/motel tax would be susceptible to constitutional challenge necessarily depends on the reach of that tax as determined from the text of the implementing private act. We recognize that over the last several decades private acts have authorized hotel/motel taxes in sixty-nine Tennessee counties. *See* CTAS *Tennessee County Tax Statistics* (2009).[1] Generally, these existing private acts authorize the county to levy "a privilege tax upon the privilege of occupancy in any hotel of each transient."[2] Having previously addressed this type of privilege tax, the Tennessee Supreme Court has stated that there is "no question but that the operation of hotels and motels is a business which can be and has long been regulated in this state" and that a county hotel/motel tax "is a legitimate exercise of the power of taxation." *L. B. Pete v. Cumberland County*, 621 S.W.2d 731, 733 (Tenn. 1981).

Almost without exception, the various private acts creating the existing Tennessee county hotel/motel taxes establish that the tax is a privilege tax upon the transient occupying the hotel room, the rate of the tax is calculated based upon the rate charged by the operator, and the tax is

[1] Additionally, metropolitan and consolidated forms of local government may establish a hotel/motel tax pursuant to Tenn. Code Ann. §§ 7-4-102, *et seq*., and "home rule" municipalities may levy a hotel/motel tax pursuant to the guidelines established by Tenn. Code Ann. §§ 67-4-1401, *et seq*.

[2] This quote is from the sample "Private Act To Levy Hotel/Motel Tax" provided in the appendix to the CTAS publication *County Revenue Manual*, Seventh Edition (2006).

collected from the transient by the operator at the time of payment.[3] Additionally, the term "hotel" is most often broadly defined. *See, e.g.*, CTAS model "Private Act To Levy Hotel/Motel Tax." As to what constitutes a "hotel" the occupancy of which is subject to tax, this Office has previously opined that Campbell County's hotel/motel tax act includes houseboats under its definition of "hotel." *See* Op. Tenn. Att'y Gen. No. 04-163 (Nov. 10, 2004). However, in that opinion the houseboats at issue were on Norris Lake and interstate travel was not an issue.

In the case of a houseboat capable of interstate travel, it becomes important to focus on the precise privilege that is subject to tax. Imposing the tax on "occupancy" is problematic, since in this setting some or all of that "occupancy" may occur in other states. It would be more consistent with our privilege tax jurisprudence to impose the tax on the "privilege of renting a houseboat," or, more generally, the "privilege of renting a room or space (including a houseboat) for personal occupancy." This would allow the legal analysis to focus on the place where the rental contract is entered as well as where occupancy occurred, which, as illustrated below, is significant when crafting a tax that will withstand Commerce Clause challenge.

The Commerce Clause of the United States Constitution provides, in relevant part, that "Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . ." U.S. Const. art. I, § 8, cl. 3. It has been stated that the "central purpose of the Commerce Clause was to foster the creation of a national economy and to protect the national economy from unjustifiable interference by the states." *ARCO Building Systems, Inc. v. Chumley*, 209 S.W.3d 63, 68 (Tenn. Ct. App. 2006) (*citing Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179-80 (1995); *Nat'l Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753, 760 (1967)). While the text of the Commerce Clause contains only an affirmative grant of authority to the United States Congress to regulate interstate commerce, the Supreme Court has long interpreted it to also include an implied limitation on the power of the states to do the same even when Congress has failed to legislate on the subject. *Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992). This implied limitation on state regulatory power is commonly referred to as the "negative" aspect of the Commerce Clause or the "Dormant Commerce Clause." *Department of Revenue of Ky. v. Davis*, _ U.S. _, 128 S.Ct. 1801, 1808-09 (2008); *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 287 (1997).

It is well established that the Dormant Commerce Clause applies to the states' power to tax. *ARCO*, 209 S.W.3d at 69. Specifically, the clause "prohibits state taxation . . . that discriminates against or unduly burdens interstate commerce and thereby "imped[es] free private trade in the national marketplace." *Gen. Motors Corp*. at 287 (*citing Reeves, Inc. v. Stake*, 447 U.S. 429, 437 (1980)). While the Dormant Commerce Clause was once interpreted so as to render "wholly immune from state taxation" all interstate commerce, *Jefferson Lines*, 514 U.S. at 180 (*citing Robbins v. Shelby County Taxing Dist*., 120 U.S. 489, 497 (1887)), the United States Supreme Court has since "recognized that, with certain restrictions, interstate commerce may be required to pay its fair share of state taxes." *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30-31 (1988). Accordingly, a four-part test was developed to determine whether a state tax would survive a Dormant Commerce Clause challenge. A state tax on activity in interstate commerce is

[3] As described in greater detail below, such hotel/motel tax acts need not follow this exact format to be a valid tax, and in many respects, a hotel/motel tax on "the privilege of renting a room or space for personal occupancy" would better withstand constitutional challenge with regard to houseboats capable of interstate travel.

allowed if: 1) it relates to an activity with "substantial nexus" to 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 taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Since the *Complete Auto Transit* decision over three decades ago, courts have consistently applied this four-part analysis to determine the constitutionality of state taxes challenged under the Dormant Commerce Clause. *ARCO*, 209 S.W.3d at 69.

The inherent mobility of boats, including houseboats, on a lake within the borders of two states renders them capable of moving in interstate commerce, *see U.S. v. Morrison*, 529 U.S. 598, 609 (2000), and therefore state taxation related to this activity may raise valid Commerce Clause concerns. However, a Tennessee hotel/motel tax based on the rental and occupancy of a houseboat is analogous to the Oklahoma sales tax on bus line tickets for travel across state lines, the latter of which was found to be a proper state tax by the United States Supreme Court in *Oklahoma Tax Commission v. Jefferson Lines* because the Oklahoma tax complied with all prongs of the four-part *Complete Auto Transit* test.

The proposed Clay County hotel/motel tax would presumably be charged to the transient at the location where the operator's rental office is located and where the houseboats are moored at the time of initial rental. A tax for the privilege of renting a hotel room/houseboat is similar to a sales tax, like the one in *Jefferson Lines*, and it is well settled that the sale of goods or services has sufficient nexus to the state in which the sale is consummated to be taxed in that state. *Jefferson Lines*, 514 U.S. at 184. Accordingly, as long as the Clay County hotel/houseboat operator has a "physical presence" in Tennessee, *see Quill Corp*, 504 U.S. at 314, there is little question that "substantial nexus" is established and the tax would pass the first prong of the *Complete Auto Transit* test.

The second prong of the *Complete Auto Transit* test requires that a state tax be "fairly apportioned" with the goal that each state may tax only its fair share of an interstate activity. *Jefferson Lines*, 514 U.S. at 184. The courts have determined that fair apportionment requires both "internal consistency" and "external consistency." *See Goldberg v. Sweet*, 488 U.S. 252, 261 (1989). Internal consistency requires that a tax be "structured so that if every state were to impose an identical tax, no multiple taxation would occur." *Goldberg*, 488 U.S. at 261. If structured as a tax on the privilege of renting a houseboat that is occupied at least partially in-state, the proposed tax would be internally consistent, in that every state could pass the same tax—that is a tax on the privilege of renting a houseboat, with the tax collected from the transient in the state where the operator is located at the time of payment and where occupancy begins. Under this framework, no transient would be subject to more than one state's tax.

Additionally, the tax must also be "externally consistent," which requires an examination into "the threat of real multiple taxation" that occurs not through simple duplicative state taxes, but because a state's tax "reaches beyond that portion of value that is fairly attributable to the economic activity within the taxing state." *Jefferson Lines*, 514 U.S. at 185. This examination requires a look at the "in-state business activity which triggers the taxable event and the practical or economic effect of the tax on the interstate activity." *Goldberg*, 488 U.S. at 262. As pointed out above, because a houseboat is mobile, portions of the "occupancy" may occur while the houseboat is in out-of-state waters, and thus the occupancy itself may not be entirely a local

event. However, if the in-state activity that triggers the tax is the sale of the right to occupancy through entering into the rental contract and is accompanied by initial occupancy in-state, then the tax is on a discrete in-state event. Taxes on the "gross charge" for such a contract are acceptable because the sale can be "consummated in only one state." *Jefferson Lines*, 514 U.S. at 187. The U.S. Supreme Court has determined that even a "sale with *partial* delivery [in-state] cannot be duplicated as a taxable event in any other state" and therefore would also pass the external consistency requirement. *Id.* at 190 (emphasis added).

Much like the Illinois excise tax on interstate telephone calls found acceptable in *Goldberg*, the hotel/motel tax "has many of the same characteristics of a sales tax." *Goldberg*, 488 U.S. at 262. In the instance of houseboats rented from Clay County, the exchange of payment leading to the right of occupancy would occur only in Tennessee, and the occupancy itself also occurs at least *partially*, if not fully, in-state. As in *Jefferson Lines*, "no other state can claim to be the site of the same combination." *Jefferson Lines*, 514 U.S. at 190. If the hotel/motel tax legislation were expressly to place the incidence of tax upon the rental of a room or space, including a houseboat, such a tax would fall squarely under the *Jefferson Lines* precedent and would pass the apportionment prong of the *Complete Auto Transit* test.

In short, if the houseboat is rented from and returned to Tennessee, it simply does not matter if a transient takes the houseboat into out-of-state waters during any part of the occupancy period. This simple act alone would not serve as basis for any other state to tax the same activity. *See United Air Lines, Inc. v. Mahin*, 410 U.S. 623, 631 (1973) (state has no nexus to tax an airplane based solely on its flight over the state). Because the proposed hotel/motel tax would reach only those houseboat rentals that originated in Tennessee with actual occupancy occurring at least partially in-state, the tax would be externally consistent and thus also pass the second prong of the *Complete Auto Transit* test.[4]

The proposed tax would also pass the final two prongs of the *Complete Auto Transit* test. The tax would not discriminate against interstate commerce because it would apply equally to those who chose to occupy houseboats exclusively within Tennessee waters as well as those who would venture across the line to Kentucky waters. Lastly, assuming the operator's rental office is located in Tennessee and the houseboats spend time in Tennessee waters, the proposed hotel/motel tax would be "fairly related" to the benefits provided Tennessee. It has been held that interstate commerce may be made to "pay its fair share of state expenses," *Jefferson Lines*, 514 U.S. at 199, and that this includes its fair share of "the cost of providing all governmental services, including those services from which it arguably receives no direct 'benefit.'" *Goldberg*, 488 U.S. at 267. Tennessee, largely through Clay County in this instance, would provide police and fire protection—including water rescue services should they be needed, use of public roads, use of its judicial system, and all the other "usual and usually forgotten advantages conferred by the State's maintenance of a civilized society." *Jefferson Lines*, 514, U.S. at 200. Accordingly,

[4] Under such a regime, if a Tennessee operator rented a houseboat docked in Kentucky waters, requiring the transient to both board and disembark the houseboat out-of-state, actual occupancy of the houseboat might never occur in-state if the transient chose to remain in Kentucky waters for the duration of the occupancy period. Even if payment were received in Tennessee, such facts would likely render the tax inapplicable.

the proposed tax would fairly and reasonably relate to the many benefits conferred by the State, and thus the fourth and final prong of the *Complete Auto Transit* test would be satisfied.

Assuming the houseboats are occupied at least partially within Tennessee and the sale of the right to that occupancy occurs in Tennessee, a Tennessee county hotel/motel tax that reaches such activity would not violate the Dormant Commerce Clause even if the houseboats were taken into out-of-state waters at some point during the rental period. A hotel/motel tax applied under these circumstances would have sufficient nexus with Tennessee, would be fairly apportioned, would not discriminate against interstate commerce, and would be fairly related to the services provided by the State of Tennessee. Accordingly, the tax would not violate the Commerce Clause of the United States Constitution.

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