

Taxing Cancellation and Attrition Fees



Q: What exactly is the law on taxation of cancellation and attrition fees — and who is obligated to pay?

A: Not surprisingly, the answer is not always entirely clear and, more often than not, is simply “it depends.”

But, there is some guidance to be had. Whether hotels can tax cancellation fees is a state law issue, so the answer varies depending on which state has jurisdiction. In most cases, that will be the state where the hotel is located. It may not seem obvious why taxes should be paid on canceled rooms. The state would argue that it counts on taxes from the sales of those sleeping rooms: if a room isn’t sold, but there is a payment anyway for the sale of that room from a cancellation or attrition charge, we, the state, are still entitled to our tax revenue. While some states have specifically addressed this issue, many have not.

One of the leading court decisions is in Vermont, whose Supreme Court held in 1985 that cancellation deposits were subject to tax. The court ruled that any fees retained by the taxpayer resort for the cancellation of rented condominium units were fair game for room tax. Other states have taken a more direct, legislative approach to the subject. For example, Maryland amended its tax regulations on room rentals in 2001 (apparently in reaction to industry fallout from high post-9/11 cancellations). In Maryland, taxes apply not only to cancellation fees, but also to all no-show deposits and attrition fees paid to the hotel.

The same is true in Illinois. When a contracting party becomes irrevocably liable to pay for rooms, any guaranteed hotel room charges and early departure fees charged to mitigate losses related to those rooms are subject to taxes, regardless of whether they are called attrition, no-show or cancellation fees. In the District of Columbia, once an organization has the right to occupy the rooms, and is obligated to pay attrition or cancellation fees whether or not the hotel rooms are

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used, those fees are taxable.

The rule in Texas is that if the cancellation charges are equal to the reserved room rate, they are taxable. However, no tax is due on fees that are less than the stated room rate. Oklahoma taxes cancellation charges, regardless of the rate of the room, but maintains that forfeited deposits are not subject to tax. North and South Carolina allow for taxation only when the canceled room in question has not actually been re-rented to a new guest. Therefore, if the hotel can re-rent the room, even if the canceling guest paid the entire room rate as a cancellation fee, the fee is not subject to tax. Of course, many would argue that if a hotel can re-rent the room, no cancellation charge should be imposed in the first place.

In Florida, no tax is applied unless the

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guest retains the right to occupy the room. Florida classifies liquidated damage fees as “penalty charges,” and clearly states that they are not subject to tax. While canceling rooms or failing to fill a room block in a Florida hotel may result in a “penalty,” it generally won’t require a tax on top. But, Florida is one of the few states where such a clear “no-tax” decision results. For most other states, it is not clear. As one can imagine, pressure is increasing on all states to find additional revenue sources. Moreover, some cities, counties and municipalities separately tax cancellation fees. For example, San Francisco City and County apply taxes to all deposits and no-show fees whether or not the room is used.

Several lessons may be learned. First and foremost, be mindful that cancellation fees and attrition charges may be subject to tax. Second, negotiate upfront who pays the tax. Like anything else in a hotel contract, the party responsible for paying the tax on liquidated damages can be negotiated. Third, organizations and hotels should work together to minimize the potential for tax being imposed.

By reviewing existing state and local regulations and case law, creative contract drafters can find ways to minimize the likelihood liquidated damages will be subject to tax. After all, it is in their best interests to do so. None of those tax dollars are likely to benefit them directly. In addition, organizations may start allowing the existence of a tax on cancellation or attrition fees to influence the locations in which they are willing to book meetings.

Finally, organizations should not pay a tax unless absolutely certain that it is due and owing, and that it is going to the state, not to the hotel itself. If in doubt, make two payments: one to the hotel for the amount of the liquidated damages and the second to the taxing body for the amount of the tax. ■

The answers provided here should not be construed as legal advice or a legal opinion. You are urged to consult a lawyer concerning any specific situations or legal questions you may have.