

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 04-04**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether cancellation fees for hotel rooms and banquets, forfeited deposits, and early departure fees are subject to Tennessee sales taxes.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

The facts presented by the Taxpayer may be summarized as follows:

The Taxpayer is a hotel primarily engaged in the business of renting or leasing transient accommodations for consideration. When a room is reserved on specific day for an individual guest or group and the individual or group fails to occupy the room or departs earlier than the agreed departure date, the Taxpayer charges a fee to compensate the hotel for revenue that may be lost because it is unable to rent the rooms that were

reserved for the individual or group. For catered events, also known as banquets, the hotel charges a fee when the banquet is canceled after a specified date to compensate the hotel revenue lost because there is not time to schedule another banquet function.

Transient room cancellation fees, food and beverage cancellation fees, forfeited deposits, and early departure fees are described below.

Transient Room Cancellation Fees

The Taxpayer will contract to reserve a large block of transient and/or public rooms for groups and organizations hosting a large event. Reservations for large group events are usually made well in advance of the expected arrival date. Specific transient and/or public rooms are not assigned at the time of the original reservation, but are prepared for and scheduled by the hotel closer to the event date. Individuals from the group generally make their own reservations and the hotel assigns the reservation under the group's contract.

If the group cancels its room block reservation entirely, the Taxpayer charges a cancellation fee, the amount of which depends on how far in advance of the arrival date the cancellation occurs. The cancellation fee compensates the hotel for revenues that may be lost because it is unable to rent the rooms that were reserved for the group. Once cancelled, the rooms are returned to the Taxpayer's available rooms inventory and never become available for the group's use or possession. If possible, such rooms are rented to new prospective hotel guests.

The cancellation fee is initially based either on a fixed fee or on the total number of contracted rooms and room nights multiplied by the contracted group room rate, which is less than the standard night's room rate. The cancellation fee may be adjusted if the hotel is able to rent the previously reserved rooms to new prospective guests. The fee may be structured based on the date the group cancels the event. Typically, the amount that a group pays upon cancellation is the result of a negotiated lump-sum settlement that is less than the originally stated contract amount.

For example, a group plans to hold their annual conference at the hotel's convention center. They contract with the hotel to reserve 80 transient rooms for June 20 through June 24. The contract contains a \$25,000 cancellation fee if the group cancels its reservation after May 1. On June 1, the group cancels the event. The hotel charges a \$25,000 cancellation fee and places the previously reserved rooms back into its available rooms inventory.

Food and Beverage Cancellation Fees

For catered events, also known as banquets, the hotel charges a cancellation fee when the banquet is canceled after a specified date.

Food and beverage cancellation fees are similar to room cancellation fees and are sometimes included under the same contract. When a short cancellation notice is given, the hotel may lose money because there is not time to schedule another banquet function. If a prospective customer fails to cancel a banquet event before the date specified in the contract, a food and beverage cancellation fee is charged. In such a

case, the food and beverages are never prepared or furnished to the prospective customer.

For example, a group plans to hold an awards banquet and dinner buffet at the Taxpayer's hotel on July 25. The contract states that cancellation must be made within 14 days of the scheduled event to avoid a food and beverage cancellation fee being charged. The group cancels the banquet on July 12. The hotel charges the group a cancellation fee for failing to cancel within 14 days of the scheduled event.

Forfeited Deposits

Forfeited deposits arise when the hotel requires the payment of a deposit at the time a room reservation is made. This deposit is applied to the rental charge for the room. The Taxpayer's reservation policy states that deposits will be refunded only if cancellation is made within a specified time period prior to the arrival date. Guests forfeit their deposits if they fail to cancel a room reservation within the specified time prior to their scheduled arrival date or if they fail to show up to occupy the room that has been reserved for them. Once a deposit is forfeited, the room is placed back into the Taxpayer's inventory of available rooms and is furnished to the first new prospective guest available.

For example, a prospective guest makes a room reservation and is scheduled to arrive August 10 and to depart on August 16. A credit card is used to secure the room and the hotel charges the prospective guest's credit card with a lump sum amount equal to one night's room and tax. The Taxpayer's reservation policy states that deposits will be refunded only if cancellation is made prior to 48 hours of the reserved arrival date. The prospective guest cancels his reservation on August 9 and forfeits his deposit.

Early Departure Fees

The Taxpayer charges an early departure fee when a guest checks out earlier than the scheduled departure date. Once the guest checks out early and is charged an early departure fee, the hotel discontinues furnishing the room to the guest and it becomes available for rental to any other prospective guest arriving at the hotel. The early departure fee is charged because the hotel may lose revenue if it is not able to rent the room to another guest. An early departure fee usually amounts to \$50 to \$100, which is less than the standard room rate.

For example, a guest makes a reservation to arrive on August 10 and depart on August 16. Upon arrival and check in, the guest initials the registration card indicating that he will check out on August 16 and is informed that an early departure will result in a fee being charged. On August 14, the guest checks out. The hotel charges him an early departure fee of \$50 for checking out two days earlier than the scheduled departure date.

QUESTIONS PRESENTED

1. Are cancellation fees for transient rooms and public rooms subject to Tennessee sales tax?
2. Are cancellation fees for food and beverages subject to Tennessee sales tax?

3. Are forfeited deposits subject to Tennessee sales tax?
4. Are fees for early departures subject to Tennessee sales tax?

RULINGS

1. No.
2. No.
3. Yes.
4. Yes.

ANALYSIS

T.C.A. § 67-6-202 levies a sales tax for the exercise of the privilege of engaging in the business of selling tangible personal property at retail in this state.

In addition, T.C.A. § 67-6-102(25)(F) makes the following provisions with regard to the taxation of certain services:

- (F) “Retail sale,” “sale at retail” and “retail sales price” include the following services:
 - (i) The sale, rental or charges for any rooms, lodgings, or accommodations furnished to transients by any hotel, inn, tourist court, tourist camp, tourist cabin, motel, or any place in which rooms, lodgings or accommodations are furnished to transients for a consideration. The tax does not apply, however, to rooms, lodgings or accommodations supplied to the same person for a period of ninety (90) continuous days or more.

T.C.A. § 67-6-202 clearly taxes the sale of tangible personal property at retail.

T.C.A. § 67-6-102(25)(F) also makes it clear that charges for rooms, lodgings, or accommodations furnished to transients for consideration by a hotel are subject to Tennessee sales tax unless furnished to the same person for 90 days or more.

Each factual situation must be examined in the light of the applicable statutes.

Cancellation Fees for Transient Rooms and Public Rooms

In this set of facts, the rooms reserved are never made available to anyone for occupancy for a consideration. Thus, they are not “. . . furnished to transients by any hotel . . . for a consideration” and the tax does not apply.

The cancellation fee is not subject to the Tennessee sales tax on services because it is not for “. . . rooms . . . furnished to transients . . . for a consideration” as is required by T.C.A. § 67-6-102(25)(F).

Food and Beverage Cancellation Fees

Food and beverages are tangible personal property. However, under the facts given, the food and beverages are never sold at retail to anyone. Therefore, the sales tax levied by T.C.A. § 67-6-202 does not apply.

The cancellation fee is not subject to the Tennessee sales tax because it is not consideration for the retail sale of food and beverages or for the retail sale of any other tangible personal property.

Forfeited Deposits

Regardless of how the Taxpayer characterizes the charge made to the guest reserving the room, the substance of the transaction is that the guest has paid consideration for a hotel room plus tax for one night. The guest is entitled to occupy the room. The fact that he does not show up to occupy the room or that he cancels the reservation after the specified time period is immaterial. Likewise, the fact that the room may later be furnished to another guest for consideration in another separate transaction is not relevant. The fact remains that a room has been furnished to this guest for consideration charged to the guest.

Under T.C.A. § 67-6-102(25)(F), the sales tax applies whenever a room has been furnished for consideration for a period of less than 90 days.

The Taxpayer cites Letter Ruling 02-01 for the proposition that a forfeited deposit is not subject to Tennessee sales tax. However, Letter Ruling 02-01 can be easily distinguished and has no application to the forfeited deposits described in this Letter Ruling.

In Letter Ruling 02-01, the customer was required to make a deposit when ordering a product that must be custom fabricated and that had no value to anyone other than the customer. If the customer later canceled the order or failed to take delivery after fabrication was complete, he forfeited the deposit and the fabricator disposed of the product after salvaging any materials possible.

The facts given in Letter Ruling 02-01 involve the sale of tangible personal property. T.C.A. § 67-6-102(27)(A) defines a "sale" to mean the ". . . transfer of title or possession, or both . . . of tangible personal property for consideration." Under the facts given in Letter Ruling 02-01, neither title nor possession of the fabricated product was ever transferred to the customer. Thus, no "sale" occurred and no Tennessee sales tax applied.

Unlike the facts in Letter Ruling 02-01, the facts given in this Letter Ruling involve the service of furnishing rooms for consideration for a period of less than 90 days, rather than the sale of tangible personal property. Under the facts given in this Letter Ruling, a "retail sale" has occurred under T.C.A. § 67-6-102(25)(F) because the customer was furnished a room for consideration. Again, the fact that the customer does not show up to occupy the room, or that he cancels the reservation after the specified time period, is immaterial. The room has been furnished for consideration charged to the guest and the sales tax applies.

Early Departure Fees

In this set of facts, the hotel guest departed early and thus failed to occupy the room furnished to him. As a result, he was charged a fee that the Taxpayer characterizes as an early departure fee. However, the substance of the transaction is that the guest has paid a reduced amount of consideration for the room that he was furnished but failed to occupy. Thus, a "retail sale" did occur under T.C.A. § 67-6-102(25)(F) and the sales tax applies. The fact that the guest departed early, thus canceling his reservation, or the fact that the room may have later been furnished to another guest for consideration in another separate transaction is immaterial.

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APPROVED: Loren L. Chumley, Commissioner

DATE: 2/9/04