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Municipal Hotel Occupancy Tax Litigation Against Online Travel Companies

— by Steven D. Wolens and Gary Cruciani —

In December 2004, the City of Los Angeles filed a class action lawsuit on behalf of itself and other California municipalities against online travel companies (OTCs) for underpayment of hotel occupancy taxes.¹ This ushered in a wave of similar lawsuits, and there are presently more than 25 pending lawsuits filed against OTCs by municipalities for unpaid hotel occupancy taxes—some as individual claims by a single municipality, and others as statewide class actions.² The hotel tax revenues that are allegedly due these municipalities are substantial; for a single large municipality, they can amount to many millions of dollars in unpaid taxes. This article provides an overview of the nature of these hotel tax lawsuits and information to help municipal attorneys determine whether their municipalities may have similar claims for unpaid hotel occupancy taxes.

Traditional vs Online Transactions

Virtually every state has a hotel occupancy tax statute,³ and thousands of cities and counties across the country have enacted municipal hotel occupancy tax ordinances, sometimes referred to as hotel occupancy tax (HOT) ordinances or transient occupancy tax (TOT) ordinances.⁴ Often, these hotel tax revenues are earmarked for use by the local convention and visitors' bureaus. While the ordinances may vary from jurisdiction to jurisdiction, they will invariably specify the tax rate, the items that are subject to being taxed, the persons

responsible for paying the tax, and the persons or entities responsible for collecting and remitting the tax to the municipality.

In the case of a traditional hotel stay where the consumer makes the reservation with and pays the hotel directly, the tax calculation, collection, and remittance process is straightforward. For example, a consumer who rents a room in a hotel in San Antonio, Texas will pay a 9% city tax, 1.75% county tax, and 6% state tax, for a total tax payment of 16.75%. Accordingly, on a room rate of \$100, the hotel will collect an additional \$16.75 in hotel taxes, and will remit \$9.00 in taxes to the City of San Antonio, \$1.75 in taxes to Bexar County, and \$6.00 in taxes to the State of Texas.

An ever-increasing number of hotel transactions, however, are being booked online through the Internet by OTCs such as Expedia, Hotels.com, Hotwire, Travelocity.com, Orbitz, Priceline.com, and others.⁵ This has given rise to an issue regarding "who" is required to collect and remit the hotel occupancy tax and "what amount" is subject to being taxed.

The predominant way in which the OTCs conduct business is through a "merchant model," so named because

the OTC is the "merchant of record" in the credit card transaction between it and the consumer. Under the merchant model, the OTC negotiates a room rate with a hotel at a discounted or "wholesale" price. The OTC "marks up" the wholesale price, and then sells the room to the consumer at the higher "retail" price. It is the OTCs' use of the merchant model that results in reduced tax payments to the states and municipalities. The key fact in the hotel tax lawsuits is that the states and municipalities are paid taxes based only on the wholesale room rate that the OTC pays the hotel, as opposed to the retail room rate that the consumer pays the OTC. The difference between the wholesale room rate and the retail room rate—the "spread" or the "markup"—is pocketed by the OTC without taxes being paid on that amount.

To illustrate, using the prior example of a hotel stay in San Antonio, assume that a consumer stayed at the same hotel in San Antonio, on the same night, at the same advertised room rate of \$100 per night, with the only difference being that the consumer booked his room through an OTC instead of directly with the hotel. Further assume that the hotel offered this room to the OTC at a wholesale rate of \$80, and

