

TRANSIENT OCCUPANCY TAX LITIGATION UPDATE

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On December 30, 2004 the City of Los Angeles initiated a class action against 15 Online Travel Companies (“OTC”), alleging the defendants collect Transient Occupancy Tax (“TOT”) on the retail price of a room but remit the tax to the cities based on the room’s wholesale price. The City of Los Angeles (the “City”) initiated this action on behalf of all cities in California that have a TOT and in which defendants are selling hotel rooms.

For the better part of 2 1/2 years, the defendants, who were sued collectively, fought to have the claim dismissed, alleging the City of Los Angeles' decision to name all 15 defendants in one action violated the rules of joinder. The defendants’ misjoinder claims were ultimately overruled in March of 2007, and the court ordered all defendants to bring any additional challenges to the pleadings for hearing on June 11, 2007. The defendants' demurrers alleged, among other claims, that the City's failure to exhaust its administrative remedies prevented the filing of a civil action. Defendants also alleged the matter could not proceed as a class action because the TOT ordinances varied between cities.

On July 27, 2007 Judge Carolyn Kuhl issued a ruling staying the pending civil action and ruling that the public entities needed to exhaust their administrative remedy before proceeding with their civil claims. The court's decision provides the cities with clear direction regarding how they must proceed.

The City of Los Angeles contends the OTCs' obligation is to collect the TOT on the price the "transient" (i.e.: customer) pays for the privilege of occupancy. Defendants contend the obligation to pay is based on the amount the OTC pays the hotel for the room charge (the "wholesale rate"). An individual hotel is unaware of the "retail price" charged by the OTC; it only knows the amount it bills the OTC. When the hotel bills the OTC for the room, the TOT is added on based on the rate the OTC pays the hotel. Accordingly, the hotel receives the TOT funds from the OTC, unaware of the amount the OTC charged.

The City contends the transient is charged by the OTC an amount for fees and costs which, in every case, exceeds 100% of the TOT at the retail rate the transient is charged for the room. Examples are included in the power point presentation accompanying this article. Since it is the transient's obligation to pay the TOT, and since the tax is based on the privilege of occupancy, the City contends the tax paid by the transient must be based on the full the price the OTC charges for the room.

The OTCs, however, contend the tax is only imposed on the "operator," and, since the OTCs are not "operators," they have no legal obligation to collect and remit the tax at the rate paid by the transient. The fallacy of this argument is, we believe, that the OTCs collect tax when they sell the room, and all remit that tax back to the hotels. Since the OTCs will be unable to argue that they do not collect tax, in some amount, the City believes the defendants will be held to the burden of collecting the proper amount of tax. Needless to say, this is not a decision the administrative bodies of the individual cities will be able to determine.

We believe the administrative remedies will simply be a vehicle to establish among other things the amount of TOT revenue due to the cities. The OTCs will either cooperate with the cities' request to produce online sales, tax and revenue, or the cities will be forced to estimate the amount of TOT revenue due and require the OTCs to show cause why the amount assessed is not the proper amount.

Ultimately, we believe, this matter will return to the court system for a judicial determination of the OTCs' obligation to collect and remit the TOT on retail, not on wholesale, as they are presently doing.

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

**LOS ANGELES
SUPERIOR COURT**

TRANSIENT OCCUPANCY TAX CASES

Included Actions:

*City of Los Angeles, California v.
Hotels.com, L.P.,*
Los Angeles Superior Court,
Case No. BC 326693

*City of San Diego, California v.
Hotels.com, L.P.,*
San Diego Superior Court,
Case No. GIC 861117

Judicial Council Coordination Proceeding
No. 4472

OPINION AND ORDER ON
DEFENDANTS': (1) DEMURRER TO
PLAINTIFF CITY OF LOS ANGELES'
THIRD AMENDED COMPLAINT; AND
(2) MOTION TO STRIKE CLASS
ALLEGATIONS FROM THIRD
AMENDED COMPLAINT

On June 11, 2007, Defendants'¹ Demurrer to Plaintiff City of Los Angeles' Third Amended Complaint and Motion to Strike the Class Allegations from Plaintiff's Third Amended Complaint came on hearing before this court. This court has considered all of the briefs, objections and arguments presented on behalf of Plaintiff and Defendants. For the reasons stated in the following Opinion and Order, Defendants' Demurrer to Plaintiff City of Los Angeles' Third Amended Complaint is sustained with leave to amend. The case is stayed until such time as the City notifies the court that it has exhausted available

¹ The fifteen Defendants are: Priceline.com Inc.; Travelweb LLC; Lowestfare.com Inc.; Expedia, Inc.; Hotwire, Inc.; Travelnow.com; Hotels.com, L.P.; Hotels.com GP, LLC; Travelocity.com, L.P.; Travelocity.com, Inc.; Site59.com, Inc.; Orbitz, Inc.; Orbitz, LLC; Trip Network, Inc. (d/b/a Cheaptickets.com); and Internetwork Publishing Corp. (d/b/a lodging.com).

administrative remedies with respect to the taxes sought by way of this lawsuit. At that time, the court will set a date by which an amended complaint may be filed.

Defendants' Motion to Strike Class Allegations from Plaintiff's Third Amended Complaint therefore is moot.

I. FACTUAL AND PROCEDURAL SUMMARY

In 1963, the California State Legislature enacted a statute permitting California cities and counties to levy a tax on a hotel guest (or "transient") for the privilege of occupying a hotel room in the city or county. (See Cal. Rev. & Tax Code section 7280(a).²) In 1964, Plaintiff City of Los Angeles exercised this right conferred by the Legislature and enacted a transient occupancy tax ordinance. (See Los Angeles Municipal Code ("Municipal Code") §§ 21.7.1 – 21.7.13.³)

In this action, Plaintiff City of Los Angeles ("City") alleges that the fifteen defendants (eleven online travel companies (or "OTC Defendants") and four of those companies' corporate parents or subsidiaries ("non-OTC Defendants")) owe back occupancy taxes to the City. The City asserts that the OTC Defendants act as agents to hotels conducting business in the City. (See Third Amended Complaint (TAC), ¶¶25, 28.)

² Section 7280 provides in relevant part: "(a) The legislative body of any city, county, or city and county may levy a tax on the privilege of occupying a room or rooms, or other living space, in a hotel, inn, tourist home or house, motel, or other lodging unless the occupancy is for a period of more than 30 days. . . ."

³ Specifically, Section 21.7.3 [Tax Imposed] of the Municipal Code provides in relevant part: For the privilege of occupancy in any hotel, each transient is subject to and shall pay a tax in the amount of four percent (4%) of the rent charged by the operator on or after August 1, 1964, to and including October 31, 1967" This Section then outlines tax percentages that incrementally increase for different time periods. The Section continues by stating that "[s]aid tax constitutes a debt owed by the transient to the City which is extinguished by the payment to the operator or to the City. The transient shall pay the tax to the operator of the hotel at the time the rent is paid. . . ."

(2) none of the seven causes of action states facts sufficient to state a claim (*id.* §430.10(e)); and (3) each of the seven causes of action is uncertain (*id.* §430.10(f)).

In the alternative, Defendants move to strike the class allegations of the Third Amended Complaint pursuant to Code of Civil Procedure sections 435 and 436 on the grounds that common questions do not predominate over individual issues, class treatment would not provide substantial benefits to the litigants and to the courts, and the proposed class is not ascertainable.

II. LEGAL ANALYSIS

Code of Civil Procedure section 430.10 provides in relevant part that “[t]he party against whom a complaint or cross-complaint has been filed may object, by demurrer or answer as provided in Section 430.30, to the pleading on any one or more of the following grounds: (a) The court has no jurisdiction of the subject of the cause of action alleged in the pleading”

Upon reviewing the Third Amended Complaint and the applicable provisions of the Los Angeles Municipal Code, this court has determined that it lacks subject matter jurisdiction over this matter. Plaintiff must exhaust the administrative remedies provided in the Municipal Code before turning to this court for relief.

The City’s Municipal Code, in section 21.16, provides that if the City of Los Angeles’ Director of Finance (“Director”) “determines that any tax is due or may be due to the City of Los Angeles under the provisions under this chapter, he may make and give notice of an assessment of such tax.” (Municipal Code §21.16(a).) The notice of assessment is to “set forth the amount of any tax known by the [Director] to be due or estimated by the [Director], after full consideration of all information within his