Case No. B230457

COURT OF APPEAL, STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT – DIVISION 2

In Re Coordinated Proceeding Special Title (Rule 1550(b))
TRANSIENT OCCUPANCY TAX CASES

CITY OF ANAHEIM, et al.
Plaintiffs and Appellants,

vs.

PRICELINE.COM, INCORPORATED, et al.
Defendants and Respondents.

Appeal from the Superior Court of
the State of California for the County of Los Angeles
The Honorable Carolyn B. Kuhl, Department 323
Case Numbers: JCCP4472; 30-2009-00244139; CGC09-48289; CGC09-488292; BC326693; 30-2009-0244176; 30-2009-00244120; 30-2009-00244175; 30-2009-00244232; 30-2009-00244240; 30-2009-00244195; GIC891117

APPLICATION OF THE LEAGUE OF CALIFORNIA CITIES TO FILE *AMICUS* BRIEF IN SUPPORT OF APPELLANTS; PROPOSED BRIEF OF *AMICUS CURIAE*

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Application Of The League Of California Cities To File *Amicus* Brief In Support Of Appellants

To the Honorable Presiding Justice of this Court:

The League of California Cities (hereafter "Applicant" or "League") requests leave to file an *amicus curiae* brief in this case in support of the position of Appellant City of Anaheim.

The issue presented by this case is one that affects a majority of Applicant League's members, approximately 90% of which have adopted ordinances imposing taxes on transient occupancy of lodgings. These cities collectively stand to lose tens of millions of dollars a year if this Court allows online travel companies to evade transient occupancy tax ordinances by excluding a portion of the amount paid by customers from the tax base. With local finances in California under severe stress as a result of the state's general economic malaise and ongoing diversion of funds by the State of California, cities have no choice but to be diligent in enforcing the tax measures they have adopted. Although the details of the transient occupancy tax ordinances adopted by California cities differ, the Court of Appeal's opinion on this issue has the potential to tip the balance in favor or against cities' efforts to enforce their ordinances.

As the leading advocate for the common interests of California cities, Applicant League has appeared as *amicus curiae* before this and

other courts on matters involving issues of common concern to cities in California.

No counsel for any party authored the Proposed Amicus Brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this Brief.

Applicant's counsel is familiar with the issues in this case and the scope of their presentation and believes an explanation of the implications of the trial court's ruling may be helpful to this Court in its consideration of this case.

Dated: February 3, 2012 BEST BEST & KRIEGER LLP

By: */s/Andrew J. Morris*
ANDREW J. MORRIS
Attorneys for *Amicus Curiae*
League of California Cities

Case No. B230457

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[PROPOSED] BRIEF OF *AMICUS CURIAE* LEAGUE OF CALIFORNIA CITIES

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

The fiscal crisis facing local governments in California is unprecedented in the state's history. California's economic woes mirror those of the nation as a whole, except that the effects are more pronounced here. California's unemployment rate is the second-highest in the nation, which has contributed to significant reductions in the sales taxes upon which cities rely for a significant share of their revenue.[1] The broad decline in real estate values has resulted in declines in property tax revenue, the other principal source of revenue for cities in the state.

In light of these economic challenges, California's cities need to be able to fully enforce their tax-generating ordinances -- all of which that have been adopted since 1997 with voter approval. As demonstrated below, both the trial court and Respondents have ignored the logical inconsistency of interpreting Anaheim's ordinance to exclude from the transient occupancy tax base a portion of the amount paid by renters of lodging. This interpretation also creates the very real possibility of widespread manipulation of business models and business relationships in order to improperly evade transient occupancy taxes. The League therefore respectfully supports the City of Anaheim in urging the Court to reverse the trial court's ruling.

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[1] *Local Area Unemployment Statistics,* U.S. Bureau of Labor Statistics, October 2011; *Summary of Retail Sales and Use Tax Collections*, California State Board of Equalization, October 2011.

II. INTERESTS OF AMICUS CURIAE

The League of California Cities is an association of 469 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, which is comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities, and identifies those that are of statewide – or of nationwide – significance. The Committee has identified this case as being of such significance.

III. LEGAL ANALYSIS

A. State Law Demonstrates That Transient Occupancy Taxes Are Intended to be Based on Amounts Paid by Lodgers

The fundamental illogic of Respondents' position is that it is at odds with the intent of transient occupancy tax ordinances statewide, as well as with the intent of the state laws authorizing cities to impose transient occupancy taxes. Respondents believe that transient occupancy taxes in Anaheim and elsewhere should be based on the amounts received by hotels, while state law evinces a clear intention for transient occupancy taxes to be based on the amounts actually paid by transient lodgers.

Prior to the advent of online travel companies, the distinction between basing the tax on the amount paid by the transient lodger and the

amount actually received by the hotel was irrelevant, because the two amounts were one and the same. Travel agents received commissions directly from hotels, but the hotels did not reduce the amount of transient occupancy tax paid to cities as a result of paying these commissions. However, the advent of the "merchant model" used by online travel companies (as examined in Appellants' brief) has created a distinction that did not previously exist, since the amount received by a hotel for a room is not the amount actually paid by the lodger.

Both the transient occupancy tax provisions of the Revenue and Taxation Code and many cities' transient occupancy tax ordinances predate the creation of this distinction. Many transient occupancy tax ordinances in California go back decades, having been adopted under former Government Code § 51030 (adopted by the Legislature in 1963) or under the successor statutes in Revenue and Taxation Code §§ 5280 *et seq*, adopted in 1971. The intent of the ordinances has always been to impose a tax on the amount paid by a transient lodger, consistent with the authority in the law to "levy a tax on the privilege of occupying a room or rooms... in a hotel... or other lodging..." (Cal. Rev. & Tax. § 7280(a).) With this language allowing a tax on the privilege of occupying a room, the Legislature clearly intended the tax calculations to be based on the amount paid, rather than the amount received by the hotel.

The result is that although state law does not specifically address the distinction between the amount a lodger pays and the amount a hotel receives, the law unambiguously dictates that transient occupancy taxes should be based on the amount paid by the lodger. Respondents' position is at odds with this, and should not be endorsed by this Court.

B. The Trial Court's Decision Creates Significant Potential for Abuse

Beyond being inconsistent with the intent of state law, the trial court's decision invites widespread abuse and manipulation by hotel operators. This is a result of the trial court incorrectly concluding that the transient occupancy tax base is the amount actually received by a hotel, rather than the amount paid by a transient lodger. If upheld by this Court, this conclusion will lead hotel operators to skirt local transient occupancy tax ordinances by attempting to minimize the amount subject to taxation without reducing the amount actually paid by a transient lodger.

For example, a hotel operator could arrange for all booking and reservation tasks (even those for bookings made in the lobby of the hotel or reservations made by calling the hotel's phone number) to be performed under contract by an entity other than the owner of the hotel. The contract might specify that the reservation company charge an artificially low rate for rooms, but allow the reservation company to charge additional "service fees" that would raise the price paid by a transient lodger to something approximating a normal hotel room rate. The contract might go on to call

for "franchise" or "license" payments to the hotel that, in practical terms, return most of the "service fee" to the hotel.

To put some numbers to this scenario, assume a hotel room rate of $100 and a municipal transient occupancy tax rate of 10%. With a typical booking, the lodger would pay $110, of which $10 would be remitted to the city. Under a model with reservations contracted out to a third party and "service fees" being charged, a lodger might still pay $110, with $50 going to the hotel as the nominal room rate, $5 going to the city as taxes, and $55 charged as a "service fees." Of the "service fee" amount, $5 could be retained by the reservation company, and $50 paid to the hotel as a "franchise" or "license fee" for the privilege of handling reservations.[2]

The net result is that the hotel receives the same revenue under either approach, but half of the transient occupancy tax revenue that should have been paid to the city is diverted to pay the third-party reservation company. This example may seem absurd, because it recognizes form over substance, allowing amounts paid by the transient lodger to escape taxation simply by calling them something other than payment for a room. But this is the practical effect of the trial court's decision, and this is the position which Respondents are advocating.

[2] The transient lodger would likely not be aware of this distinction, since the reservation company could follow Respondents' practice of refusing to disclose to customers the "service fees" and the actual rate paid for the room.

This example is not far-fetched. There is no reason that a hotel could not install booking kiosks in lobbies, all operated by a third-party company, or use a third-party company to handle all online and telephone bookings. Under the example provided above, there is no financial cost to the hotel in doing so, since the third party is paid entirely with funds which should have been remitted to the city as transient occupancy taxes. Or a hotel might accept somewhat less and give the third-party operator a larger share, while still keeping the transient occupancy tax artificially and improperly low. This latter possibility is precisely what Respondents' model does, and it could easily be scaled up so that all of a hotel's bookings are handled that way.

C. The Fiscal Implications of This Issue Are Significant

California's cities have a tremendous amount at stake concerning whether Respondents and others are allowed to manipulate and evade transient occupancy tax obligations. According to the League of California Cities, 431 of the state's 482 cities have transient occupancy tax ordinances in place. Both the number of cities and the tax rates imposed are rising, as voters across the state are approving new or increased transient occupancy taxes to help pay for essential local services.

One estimate prepared by an expert in municipal finance calculates the cumulative loss to California cities from online travel companies' improper practices at more than $342 million since 1999, or more than

$614 million if penalties and interest on unpaid taxes are included.[3] The estimated loss for 2011 alone exceeds $42 million before penalties and interest, and this figure is likely to rise in future years as Respondents and others increase their share of all hotel bookings. With other revenues declining, and demands for services only increasing, the effect of this loss is magnified.

IV. CONCLUSION

For the reasons set forth above, the League of California Cities supports the City of Anaheim in urging the Court to reverse the trial court's opinion determining that the City of Anaheim's transient occupancy tax ordinance cannot be applied to the full amount of fees charged to transient renters of lodging by online travel companies. California's cities simply need to be able to enforce their transient occupancy tax ordinances in the manner contemplated by state law, in order to keep police and firefighters protecting their communities, keep streets paved and parks open, and help contribute to a high quality of life for all Californians.

Dated: February 3, 2012 BEST BEST & KRIEGER LLP

By: */s/Andrew J. Morris*
ANDREW J. MORRIS
Attorneys for *Amicus Curiae*
League of California Cities

[3] This estimate was prepared by Michael Coleman, Fiscal Policy Advisor to the League of California Cities.

PROOF OF SERVICE

I am employed in the County of Sacramento, State of California. I am over the age of eighteen and not a party to the within action, my business address is 300 South Grand Avenue, 25th Floor, Los Angeles, CA 90071.

On February 3, 2012, I served the foregoing document described as **APPLICATION OF THE LEAGUE OF CALIFORNIA CITIES TO FILE *AMICUS* BRIEF IN SUPPORT OF APPELLANTS; PROPOSED BRIEF OF *AMICUS CURIAE*** on the interested party in this action as follows:

> **[X] By United States mail.** I enclosed the documents in a sealed envelope or package addressed to the persons at the addresses listed below. I placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with this business's practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid.

Clerk, California Supreme Court — 4 copies
350 McAllister Street
San Francisco, CA 94102

Clerk of the Superior Court
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I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on February 3, 2012, at Los Angeles, California.

Sandra Rosales

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