Sandra J. Levin
SLevin@CLLAW.US
(213) 542-5707

Colantuono & Levin, PC
300 S. Grand Avenue, Suite 2700
Los Angeles, CA 90071-3137
Main: (213) 542-5700
FAX: (213) 542-5710
WWW.CLLAW.US

Sandra J. Levin
Of Counsel

January 8, 2013

RECEIVED

JAN - 9 2013

CLERK SUPREME COURT

VIA FEDEX

The Honorable Chief Justice Tani Cantil-Sakauye
and Honorable Associate Justices of the
Supreme Court of the State of California
350 McAllister Street
San Francisco, CA 94102-4783

Re: *In re TRANSIENT OCCUPANCY CASES (City of Anaheim v. Priceline.com, Inc., et al)*, Case No. S207192 ("Opinion").
Letter Brief of the League of California Cities in Support of Petition for Review

To the Honorable Chief Justice and Associate Justices of the Supreme Court:

The League of California Cities ("League") respectfully submits this letter brief in support of the petition for review filed by the City of Anaheim ("Anaheim") in the matter referenced above.

THE LEAGUE OF CALIFORNIA CITIES' INTEREST IN THIS CASE. The League is an association of 467 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, comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to

municipalities, and identifies those cases that have statewide or nationwide significance. The Committee has identified this case as having such significance.

The League is interested in this matter for both financial and policy reasons. The appellate decision here affects a majority of the League's members, approximately 90% of which have adopted ordinances imposing transient occupancy taxes. At a time when cities are under severe economic duress and the ability to provide basic municipal services is dependent on diligently collecting all revenue sources, California cities will lose tens of millions of dollars a year because the decision here sanctions manipulation by online travel companies ("OTCs") of their business models to evade taxes and violate local tax ordinances. Moreover, and perhaps more importantly, the decision ignores pertinent provisions of the local ordinance and in doing so allows private, third parties to usurp the role of the legislative bodies in establishing tax policy and controlling the flow of information to taxpayers.

THIS CASE MERITS REVIEW TO SETTLE IMPORTANT QUESTIONS OF LAW AND SECURE UNIFORMITY OF DECISION. This case merits review to settle important questions of law and to secure uniformity of decision. (Cal. Rules of Court, rule 8.500, subd. (b)(1).) If review is granted, the League intends to request leave to submit an amicus curiae brief in support of Anaheim on the merits.

Local governments around California urgently require resolution of this conflict involving many millions of dollars in general fund revenues statewide and a clear statement of the law on their power to interpret ordinances establishing local taxes in light of technological and economic change and to retain control over tax policy, including required disclosure to taxpayers of the amounts being charged to them. Resolving these important issues now, rather than through repeated lower court litigation, will benefit all the litigants in these and similar cases, the lower courts, and California taxpayers.

THE COURT OVERLOOKED IMPORTANT PROVISIONS OF THE ORDINANCE. The heart of the ordinance ("Ordinance") is a tax on "each transient." Indeed, the section of the Ordinance imposing the tax makes no mention of the operator and clearly and expressly imposes the tax on the

> transient. Anaheim Municipal Code §2.12.010.010 ("each transient is subject to and shall pay a tax in the amount of fifteen percent of the rent"). Of course, the reference to amounts charged "by the operator" — upon which the Appellate Court below so heavily relied — is in the Ordinance; but it is in a subsidiary definition, not the primary section imposing the tax. Moreover, the Ordinance demands that the transient be plainly informed of the amount of the rent and the amount of the tax.
>
> "Each operator shall collect the tax to the same extent and at the same time as the rent is collected from every transient. The amount of the rent and the tax thereon shall be **separately stated from all other amounts** on all receipts and books of record of the hotel, and each transient shall be tendered a receipt for payment from the operator **with rent and tax separately stated** thereon. § 2.12.020.010 (emphasis added).

Thus, the primary provisions of the Ordinance expressly and exclusively pertain to amounts paid **by** the transient and the information provided **to** the transient. Yet, inexplicably, the Court of Appeal overlooked the Ordinance's repeated emphasis on the amount paid **by the transient** and the focus on disclosure **to the transient**, and instead asserted that the "focus" of the Ordinance was on "the amount of consideration charged by the operator." (Opinion at p. 20.) To the contrary, under the plain language of the Ordinance, the focus is on taxing the transient and disclosing rents and taxes to the transient.

Moreover, the court below overlooked that the "merchant model" conceived by the OTCs violates the Ordinance. Under the plain requirements of the Ordinance, both the "rent" and the "tax" must be "separately stated" to each transient. As the Court of Appeal's own recitation of facts reveals, however, neither is provided to the transient under the OTC's practices. The court explains that, under the merchant model, the OTCs present consumer transients "with these line items: the room price, taxes and fees, and the combined total." Yet, the OTCs do not pay taxes on the "room price" charged to the transient and the transient is not told the wholesale amount paid to the hotel (i.e., the amount on which the tax is paid). Nor is a transient told that the line item for "taxes and fees" actually includes an OTC mark-up. See Opinion at p. 3–4. In short, transients are told neither the amount charged by the operator to the OTC (i.e.,

the "rent" according to the court's interpretation) nor the amount of tax paid – and is not even given sufficient information from which to deduce such amounts despite a plain Ordinance demand to the contrary.

Thus, the business practices of the hotels and the OTCs violate both the spirit and the letter of the Ordinance by violating its disclosure requirements.

THE DECISION UNDERMINES TAX POLICY OF LOCAL GOVERNMENTS AND INTERFERES WITH THE RELATIONSHIP BETWEEN TAXING AGENCIES AND TAXPAYERS. By emphasizing language regarding the "operator" to the exclusion of the language regarding the "transient" and ignoring the patent violations of the disclosure provisions of the Ordinance, the court below has improperly infringed on the local agency's authority to make tax policy. As set forth in Anaheim's petition for review, this reading of the Ordinance allows OTCs to violate the disclosure requirements of the Ordinance and to evade taxes. It is simply not the OTCs' — nor the courts' — province to determine whether the disclosure required by the Ordinance may be sacrificed to the OTC's desire to evade taxes and thereby gain an advantage against their competitors in the transient lodging business who use more traditional models. These are policy issues reserved to cities as taxing agencies.

Indeed, as this Court has explained, the California Constitution expressly reserves these rights to charter cities, such as Anaheim. "The taxation power is vital and is granted to charter cities by the Constitution." *The Pines v. City of Santa Monica* (1981) 29 Cal.3d 656, 660; Cal. Const., art. XI, § 5, subd. (a); art. XI, § 12. This Court has further held that "levying taxes to support local expenditures qualifies as a 'municipal affair' within the meaning of the home rule provision of our Constitution" (*Cal. Fed. Sav. & Loan Ass'n v. City of Los Angeles* (1991) 54 Cal. 3d 1, 13) and observed that "the power of taxation is a power appropriate for a municipality to possess" and that such proposition was "too obvious to merit discussion." (*Ex parte Braun* (1903) 141 Cal. 204, 209.) This Court has thus repeatedly held that matters of local taxation are municipal affairs and that even the State cannot "decree the essentials of municipal tax policy." *Cal. Fed. Sav. & Loan Ass'n,* supra, 54 Cal.3d at 14.

Here, the decision to shift the emphasis of the Ordinance and interpret it to sacrifice the disclosure of rates and taxes expressly required by the city unnecessarily intrudes on the tax policies of local agencies and disrupts the fundamental relationship between a taxing agency and its taxpayers.

Furthermore, such disclosure requirements are not unique to Anaheim but rather reflect a common policy determination by cities and a commitment by numerous agencies to fairness and transparency in their relationships with their taxpayers. To cite but a few examples:

- Los Angeles Municipal Code § 21.7.5 ("The amount of tax shall be separately stated from the amount of the rent charged and each transient shall receive a receipt for payment from the operator");
- San Diego Municipal Code § 35.0112 ("The amount of tax charged each Transient shall be separately stated from the amount of Rent charged, and each Transient shall receive a receipt");
- San Jose Municipal Code § 4.72.050 ("The amount of tax shall be separately stated from the amount of the rent charged");
- Sacramento Municipal Code § 3.28.070 ("The amount of tax shall be separately stated from the amount of the rent charged, and each transient shall receive a receipt for payment from the operator").

Such polices are designed to prevent the kind of shell games that the OTCs engaged in here by concealing from their customers the distinction between taxes paid to government and "fees" pocketed by the OTCs in the interest of consumer protection. In addition, they are intended to facilitate enforcement of the tax by leaving a clear audit trail for the City to ensure its tax is properly collected and remitted to the City. The practice countenanced here frustrates both goals.

The extent to which a private third party may undermine these requirements by a carefully crafted business model, and the extent to which the courts may condone such manipulation by elevating some provisions of an ordinance over others, are thus important questions of statewide significance.

Finally, established tax doctrines allow courts to avoid unnecessary intrusion into the local agencies' domains. These rules will allow this Court on

review to reconcile all of the provisions of the tax ordinance and to preserve the role afforded by our Constitution to local legislators to establish tax policy.

As discussed in Anaheim's petition for review, the step transaction doctrine allows the court to view the entire series of steps as a single transaction. Doing so would bring the entire transaction into compliance with all provisions of the tax ordinance because the amount of the hotel charge stated to the transient on line one would, in fact, be the taxable rent, and the amount of tax stated on line two would, in fact, be the amount of tax paid by the transient. Unfortunately, the Court of Appeal rejected this doctrine, stating it was inapplicable because "the hotels and the OTCs have not structured the merchant model transactions for the purpose of avoiding tax liability. Nor do merchant model transactions lie 'outside the plain intent of the statute.'" Opinion at p. 22. The League respectfully disagrees. Quite the contrary, the merchant model transactions are not only designed to evade taxes, but on their face violate the plain intent of the Ordinance to require those in the transient lodging business to plainly disclose to transients the taxable rent and the tax. A business model designed to defeat this disclosure requirement is improper and should not be condoned. It alone is sufficient to justify application of the step transaction doctrine.

Similarly, the court below erred in concluding that the OTCs are not agents of hotels. If OTCs are neither operators nor agents, what is plainly and economically a room rent within the scope of tax becomes something else. Were all taxes so easily avoided by the mere labels devised by those whose service or product is taxed, no government could survive. By focusing its agency analysis exclusively on whether the OTCs were "managing agents" as that term was used in the Ordinance, the appellate court failed to give proper consideration to the broader case law concerning agency and the goals of tax law to provide a level playing field for those in a taxed industry and to ensure a predictable, transparent and rational flow of revenues to fund essential government services. It is not the goal of judicial review of tax legislation to reward the clever; but to serve the social and policy goals stated here. Again, as discussed in the city's Petition for Review, whether or not the OTCs were "managing agents," they were clearly acting as the agents of the hotels in selling the rights to occupy

rooms in the hotel. To use industry parlance, the OTCs" put heads in beds" for their profit and that of the hotel, just as surely as the hotels' own direct marketing efforts do.

The Court of Appeal nonetheless found, and the OTCs continue to urge, that agency cases should be ignored because "if the transient pays money in addition to what is charged by the hotel, that additional amount is not taxed." Opinion at p. 20; Answer to Petition for Review at p. 5. However, that argument ignores that the "additional amounts" are required to be segregated and separately stated, and they were not. What matters is not the cleverness or opaqueness of the labels chosen by the brick and mortar hoteliers and their on-line marketing agents, but the economic substance of the transaction. Transients rent rooms and the consideration they pay for the privilege of occupancy is intended to be taxed, without respect to the labels the tax collector may devise to fatten its bottom line at the expense of the public fisc. The proper question here is not whether the OTCs' charges are taxable under the Ordinance in isolation, but whether they become taxable when bundled with other taxable transactions and not segregated. The issue is economic substance, not self-serving labels chosen by those with an enormous incentive to evade tax.

Indeed, the OTCs' argument ignores fundamental law and policy that one may not benefit by obscuring the distinction between taxable and non-taxable transactions. A taxpayer seeking to exclude amounts from taxation bears both the burden of proof and the burden of production to establish the proper amount of tax that was due. See, e.g., 18 Cal. Code of Regs., § 5541 ("[e]xcept as otherwise specifically provided by law, the burden of proof is on the taxpayer as to all issues of fact"); *Flying Tiger Line v. State Board of Equalization*, (1958) 157 Cal.App.2d 85, 99 (burden of proof is on the taxpayer); *People v. Schwartz*, (1947) 31 Cal.2d 59, 64 (same); *Hall v. Franchise Tax Board*, (1966) 244 Cal.App.2d 843, 848 (same). This is because the taxpayer is typically in possession of the information necessary to prove these things while the government is not. Here, a taxpayer transient could never carry the burden of proving that some portion of the payment he or she made was non-taxable, because the taxpayer was never given a breakdown of the charges as the Ordinance requires!

Nor do taxpayers realize any benefit by the decision in this case. Instead, the OTCs seek to be rewarded — by a determination that a portion of the amounts paid by the transients for the privilege of occupying a hotel room should be excluded from the definition of rent and pocketed by OTCs – for violating the Ordinance's requirement that rents and taxes be plainly disclosed. This incentive is fundamental to all third-party taxes (i.e., those collected not by government but by the purveyor of the taxed good or service) and tax law has long since found a solution. When a tax collector fails to segregate non-taxable from taxable charges the bundled charge is taxable to the taxpayer. *McDonnell Douglas Corp. v. General Telephone Company of California,* (1979) 594 F.2d 720, 723 (telephone tax collector owes no duty to segregate taxable from non-taxable service charges but failure to do so renders the whole taxable). Under such "bundling" rules, bundling taxable and non-taxable charges renders them all taxable. This promotes good record keeping, disclosure to consumers, and promotes audit and enforcement of the tax. These long-standing and fundamental tax policies do not allow those who obscure the information to benefit from their own lack of transparency. If this is the rule where separately stating charges is not required, it applies all the more strongly here given the express requirement of the Ordinance that room rents and taxes be distinguished and disclosed.

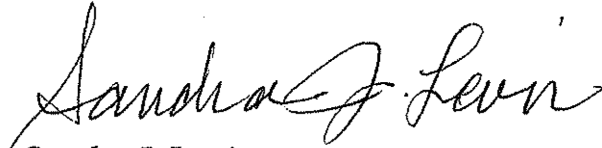
Indeed, transients are harmed by this practice —they lose the benefit of the public services that proper collection of the tax would fund. Who would visit Disneyland if there were no streets to carry them there, police to protect them there, and fire fighters to serve them there? Yet this is the world the OTCs seek – in which hotels and their agents can conspire to determine how much of what is fundamentally room rent they will consent to submit to tax and how much they will pocket.

In sum, the Opinion's almost exclusive focus on the definition of "rent" — and its reference to "consideration charged by an operator" – fails to harmonize these terms with more fundamental provisions of the Ordinance and long-standing common law and statutory tax rules. The instant case is not just about specific code interpretation; it is about who has the authority to weigh competing provisions of local tax code, whether the courts will impose consequences for

violation of transparency requirements and whether private, third parties may usurp the role of the legislative body in determining tax policy. These are important questions to cities.

CONCLUSION. For all these reasons, the League respectfully urges this Court to grant Anaheim's petition for review.

Sincerely,



Sandra J. Levin

Attachment: Proof of Service

CERTIFICATE OF SERVICE U.S. MAIL

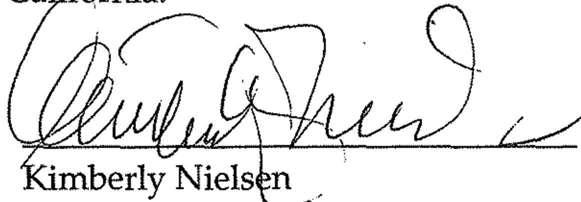
I, the undersigned, declare under penalty of perjury that I am a citizen of the United States; I am over the age of 18 years of age and not a party to the above entitled action. My business address is 300 South Grand Avenue, Suite 2700, Los Angeles, California 90071.

I caused to be served copies of the following document(s): **LETTER BRIEF OF THE LEAGUE OF CALIFORNIA CITIES IN SUPPORT OF PETITION FOR REVIEW** by placing true and correct copies of said document(s) in a sealed envelope addressed as follows:

SEE ATTACHED SERVICE LIST

I further declare that the envelope was mailed with postage thereon fully prepaid. I am readily familiar with the business practice for collection and processing of correspondence for mailing; and that the correspondence shall be deposited with U.S. Postal Service this same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business.

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed this 7th day of January, 2013 at Los Angeles, California.



Kimberly Nielsen

SERVICE LIST

Darrel J. Heiber, Esq.
Stacy R. Horth-Neubert, Esq.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
300 S. Grand Avenue, Suite 3400
Los Angeles, CA 90071-3144
Telephone: (213) 687-5000
Facsimile: (213) 687-5600

Counsel for Respondents: PRICELINE.COM, INC. AND TRAVELWEB, LLC

Brian D. Hershman, Esq.
James P. Karen, Esq.
JONES DAY
555 S. Flower Street, Fiftieth Floor
Los Angeles, CA 90071-2300
Telephone: (213) 489-3939
Facsimile: (213) 243-2539

Counsel for Respondents: EXPEDIA, INC., HOTWIRE, INC. AND HOTELS.COM, L.P.

William B. Grenner, Esq.
Nathaniel S. Currall, Esq.
K&L GATES LLP
1900 Main Street, Suite 600
Irvine, CA 92614-7319
Telephone: (949) 253-0900
Facsimile: (949) 253-0902

Co-Counsel for Respondents: TRAVELOCITY.COM, L.P. AND SITE59.COM, INC.

Brian S. Stagner, Esq.
Chad Arnette, Esq.
KELLY HART & HALLMAN, LLP
201 Main Street, Suite 2500
Fort Worth, TX 76102
Telephone: (817) 878-3567
Facsimile: (817) 878-9280

Co-Counsel for Respondents: TRAVELOCITY.COM, L.P. AND SITE59.COM, LLC

Matthew Oster, Esq.
Jeffrey Rossman, Esq.
McDERMOTT, WILL & EMERY LLP
227 West Monroe, Suite 4400
Chicago, IL 60610
Telephone: (312) 372-2000
Facsimile: (312) 984-7700

Counsel for Respondents: ORBITZ, LLC, TRIP NETWORK, INC. (d/b/a CHEAPTICKETS), AND INTERNETWORK PUBLISHING CORP. (d/b/a LODGING.COM)

Cristina L. Talley, Esq.
Moses W. Johnson, Esq.
CITY OF ANAHEIM
200 S. Anaheim Blvd,, Suite 356
Anaheim, CA 92805
Telephone: (714) 765-5169
Facsimile: (714) 765-5123

Co-counsel for Appellants: CITY OF ANAHEIM, A CALIFORNIA CHARTER CITY, AND MICHAEL H. MILLER, IN HIS OFFICIAL CAPACITY AS HEARING OFFICER FOR THE CITY OF ANAHEIM

Laura Baughman, Esq.
Thomas M. Sims, Esq.
Kevin McHargue, Esq.
BARON & BUDD, P.C.
3102 Oak Lawn Avenue, Suite 1100
Dallas, TX 75219
Telephone: (214) 521-3605
Facsimile: (214) 520-1181

Co-counsel for Appellants: CITY OF ANAHEIM, A CALIFORNIA CHARTER CITY, AND MICHAEL H. MILLER, IN HIS OFFICIAL CAPACITY AS HEARING OFFICER FOR THE CITY OF ANAHEIM

Steven D. Wolens, Esq.
Gary Cruciani, Esq.
McKOOL SMITH
300 Crescent Court, Suite 1500
Dallas, TX 75201
Telephone: (214) 978-4000
Facsimile: (214) 978-4044

Co-counsel for Appellants: CITY OF ANAHEIM, A CALIFORNIA CHARTER CITY, AND MICHAEL H. MILLER, IN HIS OFFICIAL CAPACITY AS HEARING OFFICER FOR THE CITY OF ANAHEIM

Supreme Court of California
350 McAlister Street
San Francisco, CA 94102-4797
(Original + 13 copies)

Clerk of the Court of Appeal
Second Appellate District
North Tower, Floor 2
300 South Spring Street
Los Angeles, CA 90013-1213

Judge Carolyn B. Kuhl
Dept. 1
Los Angeles Superior Court
Stanley Mosk Courthouse
111 Hill Street
Los Angeles, CA 90012

Judge Elihu M. Berle
Dept. 323
Los Angeles Superior Court
Central Civil West
600 S. Commonwealth Avenue
Los Angeles, CA 90005