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

Michael G. Colantuono
MColantuono@chwlaw.us
(530) 432-7359

May 14, 2014

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 94102-4797

Re: ***In re Transit Occupancy Tax Cases (City of San Diego v. Hotels.com et al.)*, California Supreme Court Case No. S218400, 2nd DCA Case No. B243800.**
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 San Diego ("San Diego") seeking review of a published opinion which exempts online resellers of hotel rooms from local hotel bed taxes by adopting an unduly narrow construction of the tax ordinance in issue.

AMICI'S INTEREST IN THIS CASE. The League is an association of 472 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.

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The League urges this Court to grant San Diego's petition for review because the Court of Appeal's opinion ("the Opinion") will have a significant, adverse impact on the nearly three-fourths of California cities which rely on transient occupancy taxes (TOT) — hotel bed taxes, in common parlance — to fund essential services to nearly all Californians. As demonstrated in the Request for Judicial Notice filed with the Petition for Review, most California cities have adopted ordinances that define the hotel bed tax base in identical or substantially identical terms to those of the San Diego ordinance at issue here and those of the ordinances of Anaheim and Santa Monica construed in two earlier unpublished decisions on which the Second District relies here.

San Diego's Ordinances Are Substantially Identical to Most Ordinances in the State. The San Diego ordinance imposes the tax at issue in this case "for the privilege of Occupancy in any Hotel" in the amount of 6 percent "of the Rent charged by the Operator." (San Diego Mun. Code, § 35.0103.)

The same tax base — a percentage of the defined "rent" charged by the "Operator" for the "privilege of Occupancy"[1] by a "Transient" — is stated by the ordinances of nearly all cities and counties in the state. For brevity's sake, we cite here only those of the ten largest cities in California by population and of three other large recipients of bed taxes: West Hollywood, Palm Springs, and Monterey.

All 13 of these ordinances define "operator," "transient" and "rent" in identical or substantially similar terms to San Diego's definitions and all but Bakersfield and Anaheim define "occupancy" as San Diego does.[2] This similarity is not surprising;

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[1] Fresno and Long Beach tax "rent for occupancy" and thus will be affected by at least part of the Opinion's reasoning. Oakland, Bakersfield, and Anaheim use a slightly different formulation — "room rent charged by a hotel" — but the Opinion cites an earlier unpublished decision involving Anaheim to find this language leads to the same result as the Opinion found appropriate here. (Opinion at p. 8.)

[2] The TOT ordinances discussed here are the following: Los Angeles Mun. Code, ch. 2, art. 1.7; San Jose Mun. Code, tit. 4, ch. 4.72; San Francisco Tax & Bus. Regs. Code, art. 7; Fresno Mun. Code, ch. 7, art. 6; Long Beach Mun. Code, vol. 1, tit. 3, ch. 3.64; Sacramento Mun. Code, tit. 3, ch. 3.28; Oakland Mun. Code, tit. 4, ch. 4.24; Bakersfield Mun. Code, tit. 3, ch. 3.40; Anaheim Mun. Code, tit. 2, ch. 2.12; West Hollywood Mun. Code, tit. 3, ch. 3.32; Palm Springs Mun. Code, tit. 3, div. 1, ch. 3.24; and Monterey Mun. Code, ch. 35, art. 3. A complete list of all of the ordinances at issue in this case is found in Exhibit I to the Request for Judicial Notice filed with the Petition.

model ordinances are common in local government finance and allow standardization that is helpful to both the taxer and the taxed. Indeed, Los Angeles, Monterey, Oakland, Sacramento, West Hollywood, and dozens of other cities title their TOT ordinances as the "Uniform Transient Occupancy Tax".

TOT IS A SIGNIFICANT REVENUE SOURCE FOR MANY CALIFORNIA LOCAL GOVERNMENTS. Of the state's 58 counties and 482 cities, 397 — or 73.5 percent — reported bed tax receipts to the Controller in FY 2010–2011.[3] Statewide TOT receipts that year totaled $1,141,223,229 — **$1.141 billion**. Receipts in that year range from just under $210 million in San Francisco ($209,961,963) to just $1 in McFarland. Dependency on bed taxes ranges from zero for those few jurisdictions which report no receipts to these communities which are very dependent on this revenue source:

City	Percentage of FY 2010–2011 general fund revenue
Yountville	68.8%
Mammoth Lakes	57.0%
Calistoga	54.8%
Avalon	53.9%
Solvang	51.8%
Pismo Beach	44.3%
Half Moon Bay	41.7%
Anaheim	39.6%
Bishop	38.5%
Dana Point	35.7%

[3] The information in this section is drawn from annual reports to the State Controller required of local government by statute. It is posted by Michael Coleman, a leading expert on California local government finance at <http://californiacityfinance.com/index.php#OTHERTAX> (last visited May 12, 2014).

Thus, these 10 communities receive from one-third to two-thirds of their discretionary funding from hotel bed taxes.

Of course, the present fiscal stress on California's local governments is not news to this Court. That stress results from recession, reduced employment, reduced travel and tourism, and changes in revenue laws by the Legislature and by case law. The Opinion and the unpublished authorities on which it relies threaten to increase that stress. These revenues are a crucial source of funding for essential local services such as police, fire, streets, libraries, and parks, to name a few. Bankruptcies in Vallejo, Mammoth Lakes, and San Bernardino have been widely reported, as has Half Moon Bay's serious consideration of that option following a ruinous inverse condemnation verdict. Four recently incorporated cities in Riverside County are seriously considering disincorporation, and Jurupa Valley has started the process.

Plainly, the erosion of bed tax receipts by an emerging, untaxed, virtual marketplace as countenanced by the Opinion — and the two unpublished opinions on which it relies — is of serious moment to all Californians. If the law requires this result, this Court ought to say so.

THE OPINION'S REASONING WARRANTS REVIEW. The Opinion's essential authorities are two unpublished decisions involving Santa Monica and Anaheim, cited as law of the case. (Opinion at p. 3 and fn. 4, and p. 7.) Indeed, the Opinion was not designated for publication until San Diego requested it. One panel of the Court of Appeal should not control the outcome of a dispute of great moment for all Californians and the local governments which serve them in this manner.

The dispute here arises as a question of law on undisputed facts (Opinion at p. 6) and therefore is amenable to efficient review. The Opinion fails to analyze the impact of the phrase "for the privilege of Occupancy" on the meaning of "rent charged by the Operator" or to address the fundamental economic relationships among tourists, hotels and online resellers of hotel rooms, which the Opinion labels "online travel companies" or "OTCs."

San Diego's ordinance imposes the TOT on the **guest** (not on anyone else) and defines the tax base as "rent charged" for the "privilege of occupancy." Thus, the focus of the ordinance is on what the guest must pay to gain occupancy, not on what the hotel

receives. Indeed, the guest is the only person who pays rent. The Opinion fails to consider these controlling points. Instead, it misreads "rent charged" to mean "rent received"; it ignores that the only person who pays "rent" is the guest; it ignores that the only "rent" paid by the guest is the retail rent; and it ignores the impact of the phrase "for the privilege of occupancy." A tourist who purchases a hotel stay through an OTC cannot get a room key unless he or she pays the retail room rate quoted by the OTC, plus the OTC's fees and markups. The hotel will not allow a customer to obtain occupancy of a room for any amount less than the OTC's quoted rate, so that rate — the retail rate — is necessarily the "rate charged by the Operator" in exchange for the "privilege of occupancy." Construing only some ordinance language without construing all in context under the rules of in pari materia is not how the fiscal futures of almost 400 public entities should be decided.

San Diego's definition of "rent," like the definition found in many other cities' ordinances, includes a list of services included that definition and a catch-all provision:

> [T]he total consideration charged to a Transient as shown on the guest receipt for the Occupancy of a room, or portion thereof, in a Hotel, or a space in a Recreational Vehicle Park or Campground. 'Rent' includes charges for utility and sewer hookups, equipment, (such as rollaway beds, cribs and television sets, and similar items), and in-room services (such as movies and other services not subject to California taxes), valued in money, whether received or to be received in money, goods, labor, or otherwise. 'Rent' includes all receipts, cash, credits, property, and services of any kind or nature without any deduction therefrom.

(San Diego Mun. Code, § 35.0102.) The second sentence states an inclusive list of services other than mere occupancy fees for which are included within taxable "rent." The third makes clear the similar expansive reach of the definition, stating that taxable "rent" "includes all receipts ... of any kind or nature". Yet, the Opinion at pages 11 and 12 limits the reach of San Diego's ordinance, and thus all those similarly phrased, to the fraction of a tourist's payment for occupancy which an OTC pays a hotel — i.e., the wholesale rate for occupancy of a hotel room, not the retail rate.

If the Court of Appeal is correct, it is no answer to say that cities and counties may simply amend their ordinances to avoid the Opinion's narrowing construction. The

adoption of Proposition 13 in 1979, Proposition 62 in 1986, and Proposition 218 in 1996 have made it very difficult for local governments (not to mention the Legislature) to update tax ordinances. Any amendment that increases the tax paid, even by one taxpayer out of a million, is an "increase" requiring voter approval. (Gov. Code, § 53750, subd. (h) [Prop. 218 Omnibus Implementation Act's definition of "increase"]; Cal. Const., art. XIII C, § 2, subds. (b) and (d) [voter approval requirement for tax "increases"].) Such elections on general taxes may be held only when City Council or Board of Supervisors seats are contested. (Cal. Const., art. XIII C, § 2, subd. (b).) As such elections typically occur only every two years, any change in a tax ordinance requires the cost of an election, a delay of up to two years, and a need to focus the attention of the electorate on such technical details as the distinction between OTCs which choose the "merchant model" from those which choose the "modified merchant model." (Opinion at pp. 15–16.)

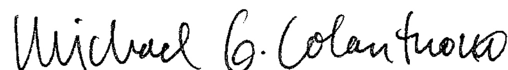
In addition, the Opinion relies on a 1930 decision of this Court for the proposition that tax ordinances are construed against the government and in favor of the taxpayer. (Opinion at pp. 7, 18 [citing *Pioneer Express Co. v. Riley* (1930) 208 Cal. 677, 687].) However, the Opinion overlooks subsequent case law holding that tax ordinances are to be construed as any other legislation. (E.g., *Los Angeles v. Belridge Oil* (1954) 42 Cal.2d 823, 827 [rule construing tax laws against government "does not take precedence over other fundamental rules of statutory construction"]; *Estate of Rath* (1937) 10 Cal.2d 399, 406 [tax laws "are not to be approached with a spirit of hostility and with a purpose of ignoring the intention of the legislature"].) Still later cases question these. (E.g., *Armstrong v. County of San Mateo* (1983) 146 Cal.App.3d 597, 622–623 [collecting cases and describing *Pioneer Express* rule as "by no means hard and fast"].)

Moreover, *Pioneer Express*' common law rule of construction dates from the Great Depression and bears revisiting in light of current technology; Propositions 13, 62, 218, and 26; and the Great Recession. The economy that includes both present-day Silicon Valley and the suffering Central Valley has little in common with that of the Great Depression. Government can no longer legislate nimbly in the face of unrelenting technological and economic change. Yet essential public services still must be funded. San Diego bears significant costs to serve visitors whether the OTC which sold them a hotel room uses the "agency model," the "merchant model" or the "modified merchant model."

The Opinion also finds no consequence in OTCs concealing from taxpayers the amount of tax paid by combining taxes and OTC fees in a single line on receipts, in violation of an express ordinance requirement to the contrary. (Opinion at p. 11, fn. 11.) It thus ignores the policy consequences of misleading the public about the distinction between public revenues and private profits, confounding San Diego's efforts to audit and enforce its tax, and assisting hotels and OTCs in concealing the true nature of their economic relationships from both government and the public it serves. (Opinion at pp. 11, fn. 11; 16, fn. 13.) Moreover, it ignores this Court's own conclusion that the search for the intent of legislation can be informed by the practical consequences of a construction for the implementation of other provisions of law. (*Richmond v. Shasta Community Services Dist.* (2004) 32 Cal.4th 409, 419 [fee for new water connection not a property-related fee under Prop. 218 because agency could not predict who would request new service, triggering the fee, when a notice of proposed fee would be required by Cal. Const., art. XIII D, § 6, subd. (a)].)

CONCLUSION. For all these reasons, the League respectfully urges this Court to grant San Diego's petition for review so this critical decision for nearly three-fourths of California's local governments and nearly all its residents may benefit from this Court's attention. This Court alone can speak authoritatively and facilitate prompt resolution of the many pending cases on these issues. It alone can untangle muddled case law regarding the construction of tax ordinances which alternately holds that such ordinances are construed in favor of taxpayers and that such ordinances are construed as other legislation. The amount at stake — more than $1.141 billion per year in essential funding for local government services — alone justifies this Court's attention.

Sincerely,



Michael G. Colantuono

MGC:rtd

Enclosure: Proof of Service