Collection of Transient Occupancy Taxes from On-Line Booking Services

Background

A growing portion of hotel bookings are being conducted through on-line booking services such as Hotels.Com, Expedia.com and Travelocity.com. A 2005 study found that "nearly 20 percent of all US hotel rooms are now booked on line and the number is expected to grow."[1] In this so-called "merchant model," internet intermediaries purchase rooms from hoteliers at rates far below rack rates, and then, in turn, impose significant markups (25 to 40 percent above the net rate paid to the hotels). Guests who book such rooms online are charged the local TOT based on the marked-up rate they pay. But the on-line company only remits to the hotelier only the discounted wholesale room rate and only the TOT collected on that lower rate.

Hotels pass on to the city the TOT they receive from the online booking company. But these amounts are based on the wholesale rate charged to the booking company, not the full rate charged to the room occupant. The city gets shortchanged for the TOT on the online company's markup, even though the online company collects the TOT on this full rate.

For example, you book a room through an online company at a hotel in Los Angeles for one night at a rate of $200. Los Angeles' TOT is 14%, so the online agency charges you $28 for TOT. The online agency remits to the hotel $150 and 14% on this lower amount = $21. The hotel remits the $21 to the city, only having been paid $150 for the room and $21 for the tax. The online company pockets its $50 markup PLUS the $7 TOT difference.

In "Los Angeles v. Hotels.com, Inc. et al," the city charges that sixteen named online booking agencies violated the Uniform Transient Occupancy Tax Ordinance of the City of Los Angeles, and similar ordinances of other California cities with respect to the charges to and remittance of amounts to cover taxes under such ordinances, and that such violations also constitute acts of unfair competition under California Business and Professions Codes Section 17200, et seq. The named defendants in the suit are:

1. Hotels.com L.P.
2. Hotel.com GP, LLC
3. Hotwire, Inc.
4. Cheaptickets, Inc.
5. Cendant Travel Distribution Services Group, Inc.
6. Expedia, Inc.
7. Internetwork Publishing Corp. (d/b/a Lodging.com)
8. Lowestfare.com
9. Maupintour Holding LLC
10. Orbitz, Inc.
11. Orbitz, LLC
12. Site59.com LLC
13. Travelocity.com, Inc.
14. Travelocity.com LP
15. Travelweb, LLC

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[1] Internet Travel Companies – Taxing the Middleman," by John A. Swain, *State Tax Notes*, February 14, 2005.

16. Travelnow.com, Inc.

The City is being represented by Paul Kiesel of Kiesel, Boucher, & Larson LLP, of Beverly Hills. A copy of the complaint is available at http://www.kbla.com/files/LA%20city.pdf

Similar lawsuits have been filed by the cities of San Antonio, Chicago, San Diego, Philadelphia, Atlanta and others. In addition, a class action consumer fraud lawsuit has been filed on behalf of travelers who have booked hotels with such companies ("Bush et al v Cheaptickets, Inc. et al"). Sabrina S. Kim and Jeff S. Westerman of Milberg Weiss Bershad and Schulman, LLP of Los Angeles are representing the plaintiffs.

The loss is substantial to cities which rely on TOT as a significant source of revenue. We estimate that TOT losses to California cities are nearly $100 million (roughly 5% to 10%+ of a city's TOT revenue) and that past losses statewide through FY06-07 exceed $500 million.

Legal Issues

Attorneys are pursuing litigation on behalf of several California cities including the City of Los Angeles. The courts recently stayed the city's request the case be granted class action status, ruling that the cities must first exhaust their administrative remedies prior to pursuing recovery through the courts. Further specific advice and direction is being prepared. For more information contact Patrick Whitnell at pwhitnell@cacities.org or Paul Kiesel at Kiesel@kbla.com.

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