

Travel Sites Won Big In Tax Fight

By Robert W. Wood

Fighting tax bills is rarely easy, and that is especially true with California tax bills. For one thing, the process can be administratively difficult. For another, California's taxing agencies often display a take-no-prisoners attitude toward settling them. So, you may have to go to court.

If you do, though, you can win big, as a group of online travel companies have proven. The California Supreme Court has now ruled in favor of the group. It included such household names as Hotels.com, Priceline, Expedia, Hotwire, Travelocity, Orbitz and others. The issue in the case concerned the hotel occupancy taxes charged by San Diego.

San Diego, like many other municipalities all over the country, charges a hotel tax. The legal question was whether the tax should be computed by applying the tax rate to the amount the online travel company charges the customer, or the amount the online travel company pays the operator. San Diego argued that the entire amount paid by the customer is subject to tax.

But beyond mere rates, the question was also exactly *who is liable* for the tax. This suit was against the online companies, not against hotels. San Diego sued the companies in an attempt to recover about \$21 million in back taxes. Expedia appears to have had the largest portion of this fight, with about \$16 million of the \$21 million at stake.

Way back in 2010, a hearing officer had ruled that the online companies were hotel operators, and that they were subject to the tax on the spread they collected. After multiple proceedings, the matter eventually reached California's Supreme Court. Examining a San Diego occupancy ordinance, the court had to decide if the online companies could be forced to fork over the \$21 million, or any part of it.

In a unanimous decision, the California Supreme Court ruled that online travel companies are not hotel operators. *See In re Transient Occupancy Tax Cases (City of San Diego v. Hotels.com)*, 225 Cal. App. 4th 56 (2014), review granted 329 P.3d 192 (Cal. 2014). This tax applies only to hotel operators, not to the online businesses. And that meant they simply are not subject to the tax. Even so, the questions of spread and how hotels and consumers pay up can be important.

Hotels contract with online sites to provide rooms at discounted rates. The sites charge a higher rate and require consumers to pay a charge for taxes and fees. Hotels have been paying occupancy taxes based on the amounts they received for their rooms, not the higher price paid by consumers to the online firms.

The travel site makes money too, and marks up the spread between the actual cost of the hotel and what the customer pays. This is America, after all. The travel sites pointed out that the tax ordinance was focused on the rent for the hotel room charged by the operator. The fact that a travel site marks up that rent with its own charges does not mean that every dollar is going to the hotel operator for the room. Still, the City argued that the occupancy tax applied to the whole enchilada.

The Supreme Court said that the ordinance imposed the tax on the operator. The hotel operator alone has the duty to remit the tax and to pay it. This California case is not the only one, and probably won't be the last word on this subject. In fact, The Tax Foundation has reported that over the past decade, state and local

governments in 34 states have filed law suits against travel sites such as Expedia, Hotels.com, Priceline and Travelocity.

The online companies have won in something on the order of 39 cases in 23 states.

But they have lost in ten cases in six states, as well as losing in the District of Columbia. The Tax Foundation seems to take a dim view of all of these suits, noting that the lawyers are really the only winners. The Tax Foundation has even suggested that national legislation might be in order.

Online travel sites do not charge for occupancy tax. But they do appear to charge the customer for a tax recovery fee. Expedia explains it thusly:

"You acknowledge that except as provided below with respect to tax obligations on the amounts we retain for our services, the Expedia Companies do not collect taxes for remittance to applicable taxing authorities. The tax recovery charges on prepaid hotel transactions are a recovery of the estimated taxes (e.g. sales and use, occupancy, room tax, excise tax, value added tax, etc.) that the Expedia Companies pay to the hotel supplier for taxes due on the hotel's rental rate for the room. The hotel suppliers invoice the Expedia Companies for certain charges, including tax amounts. The hotel suppliers are responsible for remitting applicable taxes to the applicable taxing jurisdictions. None of the Expedia Companies act as co-vendors with the supplier with whom we book or reserve our customer's travel arrangements. Taxability and the appropriate tax rate vary greatly by location. The actual tax amounts paid by the Expedia Companies to the hotel suppliers may vary from the tax recovery charge amounts, depending upon the rates, taxability, etc. in effect at the time of the actual use of the hotel by our customers. We retain service fees as additional compensation in servicing your travel reservation. Service fees retained by the Expedia Companies for their services vary based on the amount and type of hotel reservation."

This legal gobbledygook seems significant. It suggests that the online company might estimate *one* amount of tax that might have to pay, so they charge you for that. Of course, it may turn out that not all of this "tax" money *actually* is due or must be paid.

But because of the language you just read, Expedia is saying clearly that this tax overage — if any — is simply more money for Expedia. As the online customer, you don't get it back.

Everyone probably knows that only travel companies mark up the wholesale price for the room. Estimates for the usual size of that markup vary from 8 percent to 22 percent, though there is probably much variation. If someday this is part of the room cost on which tax can be collected, the local governments will be happy. That could even mean the online travel companies are back in the soup. The contracts between the hotels and the online travel sites may require the online companies to reimburse the hotels for any taxes owed. Stay tuned.

Robert W. Wood is a tax lawyer with www.WoodLLP.com, and the author of "*Taxation of Damage Awards & Settlement Payments*" (www.TaxInstitute.com). This is not legal advice.