

How San Diego made online travel companies pay

A conversation with Laura Baughman

BY AMANDA BRONSTAD

The city of San Diego won \$21.2 million in a legal battle over transient occupancy taxes allegedly owed by the online travel booking companies that own Expedia Inc., Orbitz Worldwide Inc., Priceline.com Inc. and Travelocity.com L.P.

San Diego is one of several cities and government entities that have sued online travel companies claiming that the taxes they charge should be based on the retail price of the room — what the consumer pays after mark-ups and fees have been added — not on the wholesale price that hotels charge the companies.

In San Diego's case, an administrative hearing officer in May found that the companies owed \$17 million plus more than \$4 million in penalties. On Aug. 4, the companies filed for a writ of mandamus with the Los Angeles County, Calif., Superior Court.

Laura Baughman, a shareholder at Baron & Budd in Dallas who represents the city of San Diego, talked to The National Law Journal about the hearing officer's decision



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and how governments are faring in similar litigation. Darrel Hieber, a partner in the Los Angeles office of New York's Skadden, Arps, Slate, Meagher & Flom who represents the online travel companies, did not return calls for comment.

The following remarks have been edited for clarity and to conform with NLJ style.

NLJ: What are these cases about?

LB: The allegations are that the online travel companies are collecting taxes on the mark up that they charge on the rent. They're pocketing tax dollars instead of

remitting them to the appropriate municipality, county or state.

Say you booked a room in San Diego at the Hyatt through Expedia. They'll say the room is hypothetically \$200. Then they'll charge you a separate amount for a lump sum of taxes and fees and won't tell you what part of that is a tax and what part of that is a fee.

In order for the travel company to allow you as a traveler to book a room at the Hyatt, they have a contract they've entered into with Hyatt. Usually, the online travel company will mark up the price the hotel is charging the online travel company from 15% to 30%. The online travel companies are claiming that their mark-up isn't really the rent — it's for their service of booking the room. It's excluded or exempt in some way from the transient occupancy tax.

The hotel, after you stay at the Hyatt, will bill Expedia for the \$150 they get plus tax on the \$150, and Expedia keeps the difference. Expedia has charged you for tax on the \$200 but only remitted the tax for the \$150 and kept the difference. The dispute is: Is the mark-up taxed or not?

NLJ: These cases seem to have had mixed rulings. In Texas, for example, a jury gave the city of San Antonio \$20.6 million earlier this year, but a judge threw out a similar claim by the city of Houston. How are cities and other governments faring in these court battles?

LB: On the whole, the municipalities and counties and states around the country are winning. That doesn't mean we've won every time. It means that more often than not, we're getting rulings [that] the online travel companies have to pay tax on the mark-up. Where we haven't won is when the court has had a very, very technical interpretation of a particular ordinance and found that the online travel companies don't fall within a term such as "operator" or "innkeeper."

But what we're seeing is a new trend, and that's evidenced by a Supreme Court ruling from Georgia and a more recent ruling from a trial court in the city of Atlanta and now the ruling in San Diego. What we're finding here is these judges are looking beyond that technical definition and saying, "OK. Even if the online travel company doesn't fall within that technical definition in the ordinances, which were written before the advent of the Internet, they're still collecting a tax. If they're not an operator or an innkeeper, or such a defined term, they are acting as an operator because they are performing those functions." The city of Atlanta called them "third-party collectors." The hearing officer in San Diego called them "agents" of the operators.

NLJ: In the San Diego case, you're dealing with an administrative ruling. How could this ruling affect other cases, if at all?

LB: It's not binding. But it's a well-reasoned, well articulated opinion setting forth why the online travel companies are agents of the hotel operators, and it gets it exactly right. In that sense, it can be cited, it can be brought to the attention of these other judges and used as persuasive reasoning as to why this judge should reach the same conclusion.

NLJ: What exactly did you argue before the administrative hearing officer?

LB: One of the most important arguments we made is [that] it was the legislative intent of the city council that the tax would be on the transients for the privilege of occupancy. It's not a tax on the tax collector or the intermediary. It's a tax on the transient for what he pays on the occupancy. The fact that the hotels contracted with a third party to collect tax on the rent doesn't change the tax base. The tax base is on what the traveler pays for the room, and in San Diego the definition of rent, which is what is taxed, refers to what is on their receipt. The only receipt the traveler gets is the travel company's. It doesn't say \$200 and \$150 goes to the hotel and \$50 goes to us. It says it's \$200 for the room.

NLJ: What do you think convinced the hearing officer to ruling in your favor?

LB: He starts out with that in his opinion. He says it's clear that the legislative purpose and intent was the tax the transient. If you don't require the online travel companies to remit that amount that was already collected, what you've done is left the traveler exposed. You've left the traveler in this odd situation where he doesn't know what tax he's paid or whether he's fulfilled his tax obligation. So the hearing officer said, as a matter of fairness, the online travel company needs to remit the money. Otherwise, the traveler's been deceived.

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