



City of Anaheim
PLANNING & BUILDING DEPARTMENT
Business License Division

January 23, 2017

Re: California Supreme Court Ruling on Transient Occupancy Tax

Dear Hotel/STR Operator,

On December 12, 2016, the California Supreme Court in *In re Transient Occupancy Tax Cases*, issued a ruling that may significantly impact your hotel's payment of transient occupancy taxes ("TOT") to the City of Anaheim ("City" or "Anaheim").

The opinion may be reviewed by visiting

<http://www.courts.ca.gov/opinions/documents/S218400.PDF> link.

In that case, the City of San Diego issued tax assessments against various online travel companies ("OTCs") for alleged underpayment of TOT to San Diego under its TOT ordinance. The assessments related to the OTCs' "merchant model," in which the OTCs contract with hotels to advertise and rent rooms to the general public, and the OTC is the merchant of record in the credit card transaction with the customer. In explaining the operation of the merchant model, the Supreme Court stated:

The price the hotel charges the OTC for the room is the "wholesale" price; rate parity provisions^[1] in most master contracts between OTCs and hotels bar the OTC from selling a room for a rent lower than what the hotel quotes its customers directly. The OTC offers the rooms to the public at retail prices. Its charge to the customer includes a "tax recovery charge," which represents the OTC's estimate of what the hotel will owe in transient occupancy tax based on the wholesale price of the room as charged by the hotel to the OTC.... The hotel then bills the OTC for the wholesale price of the room plus transient occupancy tax the hotel will have to pay based on the room's wholesale price. The OTC remits the charged amount to the hotel, which in turn remits the tax to San Diego; the OTC retains its markup and service fees. Opinion, p. 3.

As an example of a merchant-model transaction as described above, assume the hotel charges the OTC a "wholesale" price of \$80 and sets the minimum floor rate of \$100. The OTC adds a \$20 "markup" and charges the customer a "retail" price of \$100. Using this example, the OTC would charge the customer a "tax recovery charge" equal to 15% (the Anaheim TOT rate) multiplied by the \$80 wholesale price, which equals \$12. Thus, the OTC bills the customer \$100 for the room plus \$12 in taxes for a total price of \$112. The OTC retains its \$20 "mark up" and remits the \$80 wholesale

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^[1] The Supreme Court described "rate parity" provisions as meaning "any provisions in hotel-OTC contracts that set the 'floor' room rate the OTCs must quote and charge customers." Opinion, p.3, fn.3.

price plus the \$12 in taxes to the hotel. In turn, the hotel remits \$12 in taxes to the City. San Diego contended that (1) its TOT should be based upon the \$100 retail rate the customer paid the OTC for the room and not the \$80 wholesale rate that the hotel charged the OTC, and (2) the OTCs were obligated to remit the TOT on the \$100. On the first issue, the Supreme Court held that TOT should be based on the \$100 retail amount. On the second issue, the Supreme Court held that it was the hotel operator, not the OTC, that was liable for TOT on the retail amount. The Supreme Court's holding was as follows:

*The question before us is whether the San Diego transient occupancy tax is payable on the amount retained by the OTCs above the amount remitted to the hotels as the agreed wholesale cost of the room rental. We conclude that under the San Diego ordinance, in a "merchant model" transaction of the sort at issue here, **the operator of a hotel is liable** for tax on the wholesale cost plus any additional amount for room rental the operator requires the OTC to charge the visitor under what have been termed "rate parity" provisions of hotel-OTC contracts but, as San Diego effectively conceded, OTCs are not operators within the meaning of the ordinance. We shall affirm the judgment of the Court of Appeal. Opinion, pp. 1-2.*

The San Diego ordinance imposed its TOT on the rent "charged by the Operator" and this was the key language in dispute. In interpreting the rent "charged by the operator" language, the Supreme Court stated "**it is the wholesale room rate plus the hotel-determined markup,** exclusive of any discretionary markup set by the OTC, **that is 'charged by the Operator' and subject to the tax.**"

Anaheim's TOT ordinance, like San Diego's, imposes a TOT on the rent "charged by an operator." Thus, it is clear that the Supreme Court's opinion regarding the amount subject to tax under the San Diego ordinance applies equally to the amount subject to tax under the Anaheim ordinance.

The Supreme Court opinion establishes that for those California cities – such as San Diego and Anaheim – whose ordinances impose a TOT on rent "charged by the operator," the hotel operator must remit TOT on "the wholesale room rate *plus the hotel-determined markup.*" In the example addressed above, TOT must be remitted by the hotel on the \$100 retail rate and not just the \$80 wholesale rate. **The problem is that in OTC merchant-model transactions, the hotel has only been remitting TOT to Anaheim on the wholesale room rate, resulting in underpayment of TOT.**

We would like to begin discussions with you in order to ensure that (1) the City is made whole for the past TOT underpayments resulting from remittances to the City on the wholesale rate as opposed to the retail rate, and (2) on a going-forward basis the City is paid on the retail rate and not the wholesale rate for merchant-model transactions as described in the Supreme Court's opinion. This will impact not only TOT but ATID for those hotels that are required to remit ATID. We are modifying our TOT, STR and ATID forms to include a separate line item for these OTC transactions to be noted when TOT and ATID are remitted. These revised forms will be available online by January 31, 2017.

We understand that many hotels have indemnification agreements with OTCs in which the OTCs have agreed to indemnify the hotels for any TOT liability that results from TOT being remitted on the wholesale amounts if it is determined that TOT is due on the retail amounts, as the California Supreme Court has now held. Thus, to the extent that you have indemnity agreements with any of the OTCs, they may ultimately be obligated to pay the TOT on their margins (as San Diego originally claimed).

The City of Anaheim prides itself on fostering a positive business environment and working cooperatively with its businesses to resolve issues when they arise. To this end, we would like to discuss with you options and issues for resolving these TOT underpayments. Please contact me at your earliest possible convenience so we may arrange a meeting or phone conference. My contact information is provided below.

Sincerely,



Sandra Sagert
License Collector
City of Anaheim



Moses W. Johnson, IV
Assistant City Attorney
City of Anaheim