How they are going to make you pay TOT on revenues your hotel never received

20 December 2009

In early November, we warned the readers of the Hotel Law Blog that the multi-year fight over “lost” transient occupancy taxes (TOT) that has been raging between local governmental entities (state, city, and county) and the various online travel companies (OTCs), such as Travelocity, Orbitz, Hotels.com, Priceline.com, and Expedia, was reaching the point where it was going to start impacting hotels financially. Unfortunately, we are there NOW, and things don’t look good for the lodging industry!

Two important developments have just occurred recently, which hotel owners and operators need to watch carefully because they will be spreading rapidly.

First, at least one city has amended its TOT ordinance to expressly make hotels liable for the collection and payment of the TOT on the entire amount that a guest ultimately pays an OTC for the use of a guest room.

Second, some cities are amending their TOT ordinances so that it will make it more difficult and expensive for hotels to challenge TOT assessments.

The biggest tax threat to the industry in a long time

As we explained in the blog post Occupancy tax update on internet hotel booking: More lawsuits against Expedia and online travel companies (OTCs) over “lost” bed taxes — Why hotels should care about the transient occupancy tax (TOT) battle, billions of dollars of hotel rooms have been sold through the OTCs, and no TOT has been paid on the marked up portion of the room rates which the OTCs keep when they resell the rooms to hotel guests. More than 200 local governments have brought lawsuits against OTCs in an effort to recover this “lost” TOT. Some cities have announced that if they don’t win against the OTCs, they will take aggressive action to collect these lost bed taxes from the hotels themselves. On their part, the OTCs have said that if they lose the fight, they may come back against the hotels.

Here’s what has taken place since we ran that story on November 1, 2009:

**First Bad News:** In the City of South San Francisco, hotels will bear the burden of the TOT wars

On November 3, 2009, voters in the City of South San Francisco approved a measure that expressly makes hotels responsible for the collection and payment of the TOT applicable to the entire amount that a guest ultimately pays for the use of a guest room. (The ballot measure also increased the city’s TOT rate to 10% and made the TOT applicable to parking charged to guests by hotels.)

How will this impact hotels? Here’s an example: Assume that a hotel sells room nights to Expedia (or any other OTC) for $50 per night. Expedia pays the hotel $50 for the room night, plus the applicable 10% TOT of $5, for a total of $55.

Assume further that the OTC then sells the room to the guest for $80. Until the City of South San Francisco amended its
ordinance, it would have had to try to collect the extra $3 in TOT from Expedia. (As readers of the Hotel Law Blog know, cities all over the country have been trying for years to get that extra TOT from the OTCs.) But because the City of South San Francisco has amended its ordinance, it can now make the hotel pay the entire $8 TOT, which includes the $5 it received from Expedia plus the extra $3 out of its own pocket–unless, of course, the hotel can get Expedia to reimburse the $3 to it. Good luck!!!

On December 4, 2009, the City of South San Francisco sent a letter to all of its hotels explaining how this new TOT wrinkle will work:

“As clarified by the voters, the TOT ordinance requires hotel and motel operators to collect the full TOT rate on the final price paid for a room by or on behalf of the occupant, even when the reservation is made or the room paid for using a third-party internet sales operation (such as Expedia, Hotwire, or Hotels.com). That means that the hotel or motel operator is ultimately responsible to make sure that the third party collects the TOT on the final amount paid by a customer to occupy the room; the [hotel] operator must also obtain the TOT collected by the third party [OTC] and remit it to the City. The hotel operator is liable “for any amount that he or she fails to collect or remit; and must remit to the City the entire amount of tax due.” In the event that there is a difference between hat the third party pays the hotel or motel operator to be able to book a room, and what that third party ends up charging the customer, that difference is subject to tax.” (Emphasis added.)

By taking this step, the City of South San Francisco doesn’t have to engage in a lengthy and complex fight with the OTCs; it simply assesses the hotels for the entire TOT, and leaves it up to the hotels to decide whether to pay it out of their own pockets or seek reimbursement from the OTC.

There is little doubt that governmental entities all over–in California and elsewhere–are going to be attempting similar legislative actions to make hotels responsible for collecting TOT even though the hotels have no idea how much the OTCs ultimately charge for a given room and don’t have any ready means to collect it from the guest.

It is interesting to note that once the hotels in South San Francisco received notice of this change, there has been enough of an uproar that the city is now trying to ameliorate the impact of its amended ordinance. On December 8, the city sent a new letter to its hotels, explaining that it “encourages hotel operators to review their contracts and operating agreements with third party internet sites, and make sure those internet sites are collecting and remitting the full 10% TOT on the final price for each room paid by internet customers. The City does not intend to alter its current audit or enforcement, but it does expect full compliance with the clarified terms of the TOT.” (Emphasis added.) It appears that this is a sop to the lodging industry and an effort to buy time to sort out the details of how to make sure that the city gets the additional TOT revenue.

**Second Bad News: “Pay first” ordinances will make it harder for hotels to fight back**

A number of cities in California have levied TOT assessments against the OTCs amounting to tens of millions of dollars. The prevailing assumption until recently was that the OTCs had to pay the amount assessed as a condition to challenging it administratively or in court.

But on November 24, 2009 the California court of Appeal ruled in City of Anaheim v. Superior Court (Priceline.com, Inc.), that Anaheim couldn’t require the OTCs to “pay first” in order to challenge the assessment it had levied. The court pointed
out, however, that Anaheim could impose a pay first requirement merely by inserting such a provision in its TOT ordinance.

Some cities have already amended their TOT ordinances to insert a pay first obligation (e.g., West Hollywood), and it is expected that other California cities will do the same shortly. It is likely that similar efforts will be made in other jurisdictions throughout the country, depending on applicable state and local tax law considerations.

It is important to note in this regard that imposing a “pay first” obligation in a TOT ordinance will apply to any hotel that challenges a TOT assessment—whether related to an OTC transaction or otherwise—forever in the future. This will make it more difficult and expensive for hotels to challenge TOT assessments.

What’s ahead for hotels?

We feel certain that cities everywhere, not just in California, will be taking similar steps to enable them to collect OTC-related TOT in faster and easier ways by inserting hotels into the process. This means that OTCs are almost certainly going to get heavily involved in state and local politics in order to cut their losses and either avoid this extra TOT burden altogether or shift as much of it as possible onto the lodging industry. As we continue to preach, it is imperative that lodging operators establish mechanisms to monitor state and local legislative activities to catch developments of this kind before they become finalized.

Orbitz has sponsored a bill, Senate Bill 2 in California’s Sixth Extraordinary Session, to allow OTCs to challenge TOT assessments without having first to pay the amount arguably owing. It is quite possible that similar bills will be introduced in Sacramento, as well as in other states.

All of this makes it very clear that lodging operators are now in the bulls eye of this fight and need to take proactive steps to avoid what could be extraordinary financial liability. For our suggestions what hoteliers can do, go to: Hotel Occupancy Tax Alert: online travel company suits over transient occupancy taxes raise – 5 things every hotel owner and operator needs to know.

Hotel owners and operators need to consult their hotel lawyers, analyze their exposure and get prepared to fight one of the biggest tax threats to face the hotel industry in a long time.

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer, signing off. We’ve done more than $87 billion of hotel transactions and have developed innovative solutions to unlock value from troubled hotel transactions. Who’s your hotel lawyer?
Jim Abrams is a senior member of the JMBM Global Hospitality Group® and the former President and CEO of the California Hotel & Lodging Association. Jim has served the hospitality industry for 40 years and specializes in lodging and hospitality law and in representing and advising trade associations and other non-profit entities. Jim has significant experience in government affairs at the national level, the state level – including the California Legislature and scores of state agencies – and with local governments and agencies. He has authored successful ballot measures and scores of bills for his clients. For more information, contact Jim at jabrams@jmbm.com or 415.398.8080.

Our Perspective. We represent hotel lenders, owners and investors. We have helped our clients find business and legal solutions for more than $87 billion of hotel transactions, involving more than 3,900 properties all over the world. For more information, please contact Jim Butler at jbutler@jmbm.com or 310.201.3526.

Jim Butler is a founding partner of JMBM and Chairman of its Global Hospitality Group®. Jim is one of the top hospitality attorneys in the world. GOOGLE “hotel lawyer” and you will see why.

JMBM’s troubled asset team has handled more than 1,000 receiverships and many complex insolvency issues. But Jim and his team are more than “just” great hotel lawyers. They are also hospitality consultants and business advisors. For example, they have developed some unique proprietary approaches to unlock value in underwater hotels that can benefit lenders, borrowers and investors. (GOOGLE “JMBM SAVE program”.)

Whether it is a troubled investment or new transaction, JMBM’s Global Hospitality Group® creates legal and business solutions for hotel owners and lenders. They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them.