A POSITION STATEMENT OF THE CITY OF PALM DESERT REGARDING COLLECTION OF CITY TRANSIENT OCCUPANCY (HOTEL) TAX (“TOT”) ON ONLINE HOTEL BOOKING TRANSACTIONS

Background:

Over the last several years, there has been a great deal of litigation between California cities and online travel companies (“OTC’s”) over how much of an online hotel booking transaction is subject to local TOT. Under the typical “merchant model”, there are three financial parts of an online booking transaction that may be subject to TOT, depending upon the wording of a city’s ordinance.

- The “wholesale” price the OTC pays a hotel for the right to market a room online;

- Any retail markup for the room above the “wholesale” price that the OTC is required to charge the customer/guest under a “rate parity” or similar agreement with the hotel. These agreements generally require the OTC to offer a room for a certain minimum retail price online which matches what the hotel would charge if the customer/guest booked the room directly with the hotel; and

- Any discretionary markup that the OTC adds to the retail price for a room beyond what the hotel requires it to charge the customer/guest under a “rate parity” or similar agreement.

In most cases, OTC’s have collected and remitted TOT to California cities based only upon a percentage of the “wholesale” room price (Part 1), but not on any of the retail markup charged to the customer/guest (Parts 2 & 3). On the other hand, California cities have contended that TOT should apply to the entire price (wholesale and retail markup) since that is what is ultimately charged to the customer/guest for occupancy in a hotel room. As a result, California cities argued that the OTC’s have not been collecting and remitting the full measure of TOT due from these online transactions.

Recently, the California Supreme Court provided important guidance on this issue in In re Transient Occupancy Tax Cases (attached). In this case, the City of San Diego (and a number of other similarly situated cities) had ordinances which imposed TOT on “rent charged by an operator” for occupancy in a hotel room. The Supreme Court held that OTC’s were not “operators” under the San Diego ordinance, but hotels were. Therefore, to the extent a hotel controls the wholesale price and retail markup charged to the customer/guest for the room, that is TOT-taxable “rent charged by an operator”. However, to the extent the OTC (and not a hotel) controls the retail markup, that is not TOT-taxable “rent charged by an operator”. Therefore, cities with San Diego-type ordinances may only apply their TOT to the first two parts of the “merchant model” transaction, but not the third.

The City of Palm Desert’s TOT Clearly Applies to the “Wholesale” Price and Hotel-Required Retail Markup in Online Hotel Booking Transactions (Parts 1 & 2).
The City of Palm Desert Municipal Code imposes a 11% TOT “of the rent charged by the operator or otherwise payable by the transient.” (P.D.M.C. §3.28.030) As noted above, the California Supreme Court has held that the “wholesale” price and any retail markup controlled by the hotel are TOT-taxable “rent charged by an operator”. Therefore, the “wholesale” price and any hotel-required retail markup in an online hotel booking transaction, whether required by “rate parity” or other agreement between the hotel and OTC, is TOT-taxable in Palm Desert.

_The City of Palm Desert’s TOT Also Applies to OTC Discretionary Retail Markup in Online Hotel Booking Transactions._

In the Supreme Court case, the San Diego-type ordinance imposed TOT only on “rent charged by an operator”. It taxed no other form of payment for booking a hotel room. Therefore, after determining what an “operator” is, the Supreme Court held that these types of ordinances only tax the “wholesale” price and hotel-required retail markup, because “operators” charge these. OTC discretionary retail markup is non-taxable.

It is noted that the Supreme Court’s decision specifically turned on interpretation of a San Diego-type ordinance. California cities with the same type of ordinance will likewise be prohibited from applying their TOT to OTC discretionary retail markup. However, to the extent a city has a validly adopted TOT ordinance which taxes more broadly, the limitations of the Supreme Court’s decision do not apply.

That is precisely the situation in Palm Desert. The City's Municipal Code imposes an 11% TOT “of the rent charged by the operator or otherwise payable by the transient.” (P.D.M.C. §3.28.030) This added language is a critical distinction from the San Diego-type ordinance. Palm Desert's ordinance necessarily taxes the entire value of the online hotel booking transaction because the final retail price (with all markups) is “otherwise payable by the transient”, even if it is not entirely “charged by the operator”. Ultimately, whatever the customer/guest pays the OTC for a hotel room is TOT-taxable in Palm Desert.

_Conclusion/Determination._

Therefore, the City of Palm Desert hereby determines that the City’s Transient Occupancy Tax applies to the entire retail price charged by an OTC to a customer/guest in an online hotel booking transaction, regardless of the source of any retail markup (hotel-required or discretionary). The City finds that this determination is consistent with the Palm Desert Municipal Code and the California Supreme Court’s ruling in _In re Transient Occupancy Tax Cases._

Further questions or comments may be directed to Janet Moore - Director of Finance at the City of Palm Desert, at (760) 346-0611 ext. 327.