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Hotels.com, Travelocity mired in tax battle

Hotel reservation firms win round in California, others loom

Dallas Business Journal - by [Jeff Bounds](#) Staff writer

A group of online hotel-reservation companies, including Dallas-based hotels.com and Southlake's **Travelocity**, has won an early but key ruling in a dispute with the city of Anaheim, Calif., over the city's contention that the businesses have failed to pay a version of hotel-occupancy taxes.

The California state appellate court said that the companies can go to court to fight a city administrative ruling that they owe \$21.3 million in back taxes without first coughing up the sums they were found to owe.

The Anaheim case is one of about 40 or so city hotel tax matters nationwide causing sleepless nights for hotels.com, Travelocity and other online hotel bookers.

Hotels.com is owned by Bellevue, Wash.-based **Expedia**. Both Expedia and Travelocity, a unit of Southlake's **Sabre Holdings**, are "very big players in travel distribution," said Douglas Quinby, senior director, research, at PhoCusWright, a Sherman, Conn.-based market research firm that follows the travel industry. "Hotels represent a very big piece of that."

Combined, hotels.com and Travelocity had an estimated 15.5 million visitors to their sites in October 2009.

California's state constitution says that taxpayers who want to fight assessments of state taxes must first pay the disputed tax before going to court. But in a Nov. 24 opinion, Judge Carolyn Kuhl ruled that constitutional provision didn't apply in the Anaheim case because it pertains only to tax appeals against the state. In addition, Kuhl said there were no other legal grounds on which Anaheim could impose a "pay first" requirement upon the online hotel-reservations companies.

Kuhl did not rule on the merits of Anaheim's claim against the reservations companies, but did say there were "significant due process concerns" because Anaheim had supposedly imposed its version of a hotel-occupancy tax for a seven-year period without giving the companies notice that they were subject to that tax.

Kuhl's decision was limited to procedural matters, and did not address the merits of Anaheim's case. Still, it's good news for the defendants, said Andrew Weinstein, a spokesman for the Interactive Travel Services Association.

"We believe it is a strategic setback for the plaintiffs' attorneys, who were trying to use the payments as leverage against the online travel companies," Weinstein wrote in an e-mail to the DBJ.

The Washington, D.C.-based trade group is not a party to the suit, but represents the hotel-reservations companies in public policy matters.

Attorneys for Anaheim suggested that an appeal of Kuhl's ruling may be imminent.

"We are studying what the law allows for the opinion to be reviewed," said Steve Wolens, a principal in the Dallas office of the law firm McKool Smith who represents Anaheim in the matter. "We will make a decision on what we're going to do shortly."

Among other hotel occupancy cases brewing nationwide is a San Antonio class-action brought by 173 Texas cities, including Dallas and Fort Worth. Last month, a jury in the San Antonio case handed the Texas cities a \$20 million verdict, ruling that the online hotel booking companies did not pay occupancy taxes.

Millions at stake

The companies, including hotels.com and Travelocity, have denied wrongdoing and have said they plan to appeal the San Antonio verdict.

"The industry is watching (the cases) very closely," said Quinby. It's not clear what potential monetary exposure the online hotel-booking companies have in the combined tax cases, but it could be significant. For instance, Expedia (NASDAQ: EXPE), which owns Dallas-based hotels.com, disclosed the tax-recovery suits to investors in its annual 10-K filing with the Securities and Exchange Commission, signaling that the cases could have an impact on its finances.

In the Anaheim case, hotels.com was ordered to pay \$7.4 million by the city administrative hearing officer, while Expedia was hit with a \$9.8 million ruling. The San Antonio jury, meanwhile, hit hotels.com with damages totaling about \$7.1 million; Expedia's were closer to \$6.1 million and Travelocity's were \$1.3 million.

The crux of the dispute in the Anaheim case is the city's contention that between January 2000 and March 2008, hotels.com, Expedia and other reservation firms collected money for occupancy taxes based on the retail price that consumers paid, but paid taxes only on the wholesale — and lower — prices that hotels paid the reservations companies.

The online reservations companies were supposed to collect the tax and in turn pay it to the government, but instead remitted part of what they collected from the hotels and kept the rest, Wolens says.

The city launched the case in 2007, ostensibly because it took Anaheim's attorneys awhile to figure out the problem involving alleged non-payment of taxes. There has been no accusation of wrongdoing or failure to pay taxes against the hotels with which the reservations companies do business.

Each of the hotel-reservations companies in the Anaheim case filed separate litigation seeking to overturn the administrative hearing officer's decision. In its petition, hotels.com argued that the city ordinance at the heart of the tax dispute limits the tax to "rent" charged by the actual operator of the hotel for a guest room.