

# ITSA-City of Los Angeles-Questions and Answers Document

## Los Angeles Lawsuit:

**Q: What is your response to the lawsuit filed by the City of Los Angeles against online travel companies to recover hotel occupancy taxes?**

*The City Attorney's lawsuit against online travel companies is unfounded and reflects a fundamental misunderstanding of how hotel rooms are made available for booking through online travel companies. The services provided by online travel companies are not subject to the City's occupancy tax. The weakness of the City's position is underscored by its simultaneous attempt to expand the hotel occupancy tax by amending its ordinance without obtaining voter approval as required by Proposition 218.*

**Q: Which online travel companies are involved in the lawsuit?**

*A: The lawsuit names nearly every major online travel company that facilitates hotel room bookings including Orbitz, Expedia, Travelocity and Priceline, and certain of their respective affiliates.*

**Q: What are the potential implications for L.A.?**

*A: Attempting to levy this type of tax against online travel companies would likely have a chilling effect on the availability of these specially negotiated-rate hotel rooms. The City of Los Angeles' attempt to expand its hotel occupancy tax to the services of online travel companies may set a dangerous precedent that could lead to other Internet-based taxes at a time when the Congress is working to protect Internet commerce from just such discriminatory taxes.*

*More importantly, increasing the cost to consumers for hotel rooms is not smart tourism or e-commerce policy. What the City of Los Angeles is attempting to do will make the price consumers pay for hotel rooms online more expensive, potentially resulting in fewer sales and decreased tourism for the city of Los Angeles. Alternatively it could mean more heads in beds in places like Santa Monica, Beverly Hills, Burbank, Glendale, and fewer in L.A. A recent article in Forbes Online recognizes just such a result*

[http://www.forbes.com/ebusiness/2005/03/02/cz\\_ic\\_0302beltway.html?partner=yahoo&referrer=](http://www.forbes.com/ebusiness/2005/03/02/cz_ic_0302beltway.html?partner=yahoo&referrer=)

*Furthermore, the ITSA position is shared by a number of local L.A. civic organizations who believe that higher taxes will likely result in less travel to L.A. Fewer travelers mean less overall tax revenue for L.A. Click here to see their letters opposing the City's taxation efforts.*

<http://www.interactivetravel.org/media/pressRelease.cfm?prid=48>

*It is also important not to overlook the positive impact that online travel companies have had on tourism in L.A. specifically. In 2004 alone, the four main online travel companies (Expedia, Orbitz, Priceline, and Travelocity), were responsible for multiple millions of dollars in hotel bookings in terms of incremental "heads in beds" in the City (and on which hotel operators would have remitted the appropriate amount of occupancy taxes).*

*Finally, given that the City Attorney has engaged an outside plaintiffs class action law firm to handle this litigation, the City will have to pay over a large portion of any recovery to the class action attorneys. It seems odd that what should be a simple tax assessment case at best needs to be turned over to outside counsel and treated as a class action.*

**Q: Is there any proof that higher taxes will lead to fewer room sales for L.A. or other cities?**

*A: The Hotel Association of New York City and the New York State Hospitality and Tourism Association conducted an economic impact analysis in the mid '90s and concluded that raising hotel occupancy taxes is not good tourism policy. The study revealed that any anticipated revenue gains associated with a 5% increase in hotel occupancy taxes were offset by losses in other tax revenue that was largely caused by travel and tourism business going elsewhere (i.e. resulting from fewer overall room sales in the state, less convention and trade show business, fewer customers for business that depend on travel and tourism, etc...). The increased occupancy tax resulted in a total loss of \$498.4 million in revenue for the state and local governments during 1993 through 1996. This revenue loss eventually contributed to the repeal of the additional occupancy tax.*

*Other studies have also shown that even small price increases of this nature have detrimental effects on local tourism. For example, a January 2004 study by the American Hotel and Lodging Association ("2003 Impact of Room Tax Increases on the Lodging Industry") notes that "Econometric analysis reveals that on average a 2.0% increase on the combined tax on hotel and motel rooms will cause about a 2.4% reduction in room sales and associated visitor spending per year."*

**"Taxes & Fees":**

**Q: Many of the websites refer to Taxes, Tax Reimbursements or Tax Recovery Charges and Fees. Can you please explain?**

*A: The amount the online travel companies make for facilitating the room booking is not subject to the City's "occupancy" tax. Hotel operators are obligated to collect and pay local occupancy taxes based on the rent they receive for the actual occupancy of the room. Online travel companies submit to each hotel operator an amount that includes rent for the room plus an amount equal to the occupancy tax the hotel must pay to the taxing authorities. This is the "tax recovery charge." The online travel companies are also compensated by consumers for facilitating a sale between hotels and travelers. This compensation is not subject to tax by the local "occupancy" tax ordinances. Further, the members of ITSA disclose on their web sites that "taxes and fees" means a tax recovery charge and a service fee for the online travel company. There is no attempt to pretend that the "taxes & fees" amount is comprised only of tax recovery charges. Consumers are provided the information they need to decide whether the deal offered by the online travel company is a compelling value or not.*

**Q: Are hotel occupancy taxes paid on the full amount the consumer pays?**

*A: Not in the negotiated rate model, because hotel occupancy taxes are not due on the amount the online travel companies receive for their intermediary services – only on the hotel rent. In this case, the rent is the "net rate" of the hotel room that is negotiated with the online travel company.*

**Q: Isn't your system like wholesale/retail? Consumers pay taxes on retail, not wholesale -- why not here?**

*A: A retailer buys a product, owns it and then resells it. That is not what is happening here. Online travel companies are facilitating a transaction. By attempting to portray the sale of "net rate" hotel rooms as a typical retail transaction, the L.A. lawsuit demonstrates a fundamental*

*misunderstanding of how hotel rooms are offered via online travel companies: In most cases, online travel companies do not purchase blocks of hotel rooms and resell them to consumers at a mark-up—so there is no “wholesale” transaction. Rather, the online travel companies act as intermediaries, facilitating the sale of hotel rooms to customers. When a consumer reserves a hotel room through a travel Web site, the online travel company is facilitating the transaction between the consumer and hotel. The online travel company does not “own” the hotel room being purchased, or operate a hotel or take possession of or control the hotel’s room inventory.*

**Q: Are you willing to disclose to consumers the specific amount of your fees?**

*A: No, because doing so would be in nobody’s best interests. Like many businesses, the terms and economics of the online travel companies’ supplier contracts and business models are confidential. No third party is any more entitled to know those terms than they are to know all of the components of what goes into the price of goods at Wal-Mart, or what goes into the price of a haircut. None of the online travel companies know the terms offered by hotels to their competitors, nor should they. That is the essence of competition. Moreover, the contracts between the hotels and the online travel companies contain confidentiality clauses that require both parties to keep hotel “net rates” or “negotiated rates” confidential. This prevents the disclosure of confidential business information such as discounting and marketing strategies. Disclosing the individually negotiated rates could result in hotels refusing to provide those rates any longer, leading to higher prices for consumers.*

**Q: Why aren’t “taxes and fees” broken out separately?**

*A: Because doing so would permit third parties to reverse engineer a travel company’s specially negotiated supplier rates. And, safeguarding the confidentiality of these net rates is critical to the continued willingness of hotels to negotiate such rates.*

**Q: Do consumers know what they are paying for?**

*A: Yes. When consumers book a negotiated-rate hotel room through an online travel company, customers see clearly the total amount they will pay before they book the room. This amount includes what the online travel company will earn for the services provided. Consumers are interested in the total amount they will have to pay for the room. That way they can comparison shop. If they are not happy with the price offered, they have many options including other Web sites, toll-free numbers, the hotel directly, and so forth. As noted above, breaking out taxes and fees as separate numbers would allow interested parties to reverse engineer into the negotiated rate. If that occurs, there would be a breach of the confidentiality clauses and a reduced willingness on the part of suppliers to offer great travel deals and thus hurt consumers.*

**Q: How does opacity help consumers?**

*A: Opacity enables hotels to negotiate special net rates with online travel companies and incrementally sell otherwise “perishable” rooms without affecting the hotels’ own retail pricing structure. It is this opacity that makes it possible for consumers to find hotel bargains on the Web. As noted above, if online travel companies were to separately list taxes and fees, it would allow competitors to reverse engineer into the negotiated rates. Hotels would lose the incentive to negotiate deals that are in the consumers’ best interest, leading to higher room prices and fewer bookings.*

**Q: Wouldn't more transparency encourage competition among the hotels and the online sites?**

*A: We believe that one of the biggest benefits online travel companies have brought to consumers is price transparency. However, what is important to consumers is transparency about total price, and the ability to easily compare prices. Transparency about the individual components of what makes up the total price is not the norm in other industries, why should online travel companies be treated differently? For example, you know that a digital camera costs \$200 at your local camera store. What you don't know, nor expect to know, are all of the individual components that make up the \$200, including shipping costs, employee costs, profit, etc. It's the same thing for online travel companies. Moreover, opacity within the individual elements of the cost of a trip can be an important way to keep prices down. Suppliers in many cases will offer great deals on their hotels or as part of a vacation package when they have assurances that their pricing will not be separately disclosed or backed into. Separately disclosing fees and negotiated hotel room rates would then have the exact opposite effect, as hotels would lose the incentive to negotiate deals that are in the consumers' best interest, leading to higher room prices and fewer sales.*

**Q: How much are taxes on the sale of hotel rooms?**

*A: The types and amount of tax on hotel rooms depends on the jurisdiction. For example, the occupancy tax rate that is set in Los Angeles may be different from that in Chicago. The common denominator, however, is that the hotel occupancy tax is based on the rent charged by the hotel operator. The online travel companies that are part of ITSA are not hotel operators and their service fees are not subject to hotel occupancy taxes.*

**Q: Could imposing additional taxes on your fees affect room bookings and other travel plans?**

*A: Typically, when a merchant incurs additional costs in providing a service, all or most of those costs are ultimately passed on to the consumer. Simple economics says that as prices rise, demand goes down. Travelers are price sensitive and even small changes in price affect buying decisions. It may be the difference between decisions where to travel, how long to travel, where to stay or whether to travel at all. In L.A., for example, consumers can stay in neighboring cities, like Beverly Hills, Glendale, Burbank, etc. and not pay the higher taxes.*

*The Hotel Association of New York City and the New York State Hospitality and Tourism Association conducted a study in the mid '90s and concluded that raising hotel occupancy taxes is not good tourism policy. The study reported that the 5% additional tax loses more in other tax revenue than it collects by diverting business to other cities. In the case of New York City, the increased tax resulted in a total loss of \$498.4 million in revenue for the state and local governments during 1993 through 1996. The loss of revenue eventually contributed to the repeal of the additional occupancy tax.*

**General/Online Travel:**

**Q: Do online travel companies purchase rooms from hotels at a cheaper rate?**

*A: In most cases, online travel companies do not purchase rooms from hotels, but they do negotiate the amount that a hotel is willing to accept for the booking of a hotel room via an online travel site. Online travel companies provide a valuable service to consumers who book*

*hotel rooms online, by allowing them to conveniently shop and compare dozens of hotel options, by providing 24/7 customer service, by providing the ability to add other trip related features like air, car, ski rental, scuba lessons, show tickets, and so forth. Because a large number of hotel rooms are booked online, online travel companies are often able to negotiate attractive, discounted hotel rates. The consumer benefits from whatever lower rates online travel companies negotiate and the services they provide; the hotel benefits by reaching the millions of consumers who shop for their travel needs online; and cities benefit from the heads in beds these bookings provide along with the economic multiplier associated with the hotel stay.*

**Q: How do hotels benefit from distributing through online travel companies?**

*A: Online travel companies act as an intermediary, spending millions of their own dollars on technology, functionality, advertising, and other services to attract hosts of new customers that it would be prohibitive or very difficult for hotels to reach directly. The low distribution costs associated with an online transaction also make this an attractive distribution channel. ITSA members also have a proven record in driving incremental sales and putting heads in beds that would otherwise remain vacant. Online travel companies specialize in marketing travel and are constantly innovating – providing travel services and useful tools and services that facilitate the sale of travel online.*

**Q: How do consumers benefit from using online travel companies?**

*A: Convenience, price, selection, and service come immediately to mind. The success of online travel sales speaks for itself in terms of the value provided to consumers. With respect to booking hotel rooms, a significant advantage to consumers is that they can see offerings from multiple hotels, giving them the freedom to choose the room that best meets their price considerations and needs. Moreover, online travel companies are constantly seeking to negotiate even lower rates for their customers. The combined purchasing power of all of these consumers makes great deals possible.*

**Q: What would happen if local jurisdictions changed their laws to apply the hotel occupancy tax to your service fees?**

*A: Any change that effectively increases the cost of selling a hotel room ultimately will be passed on to consumers who may be considering a hotel stay in that jurisdiction. Studies have shown that even small price increases of this nature have had detrimental effects on local tourism. For example, a study by the American Hotel and Lodging Association notes that “Econometric analysis reveals that on average a 2.0% increase on the combined tax on hotel and motel rooms will cause about a 2.4% reduction in room sales and associated visitor spending per year.” This will spill over into every sector of the economy. Travel and tourism is already one of the most heavily taxed industries and increasing those taxes will negatively impact tourism dollars going to the City of L.A. Further, while many view such hotel occupancy taxes as taxes on “out-of-staters”, a good number of local L.A. citizens stay in L.A. hotels, and many L.A. businesses have their out of town employees and clients stay at L.A. hotels, so this is not simply a matter of “taxing the other guy.”*

**Q: Are online travel companies paying their fair share of taxes?**

*A: Yes, online travel companies do pay their fair share of taxes. Their revenue relating to hotel bookings is subject to income tax and other taxes. Hotel occupancy taxes, however, are not*

*applicable to the services provide by online travel companies. Instead, they apply to hotel operators for the rent they charge to stay at their hotel. With regard to the City of L.A. matter, the City is trying to impose an additional tax – and ignoring the law that requires the voters to decide if new taxes are appropriate.*