

JOINT INFORMATIONAL HEARING OF THE ASSEMBLY LOCAL GOVERNMENT
COMMITTEE AND THE REVENUE AND TAXATION COMMITTEE

**TRANSIENT OCCUPANCY TAXES AND THE
HOME-SHARING PHENOMENON**

MARCH 18, 2015, 1:30 PM, ROOM 4202

HEARING GOAL

The goal of this hearing is to educate members on the application and collection of Transient Occupancy Taxes (TOTs) at the local level. This hearing will also examine how the emerging trend of home-sharing and other short-term vacation rental websites is impacting cities and counties.

1) BACKGROUND ON TRANSIENT OCCUPANCY TAXES

TOTs are levied on occupants for the privilege of occupying a room or rooms in a hotel, motel, inn, or other specified lodging. TOTs were originally designed to compensate local governments for the increased public service costs incurred by serving tourists. In general, TOTs are collected by the operators of hotels or motels, or their agents, and remitted to the city or county imposing the TOT.

More than 400 cities and 55 counties impose a TOT. Rates vary from 3.5% to 15%, with a statewide average of around 10%. On average, TOTs provide about 7% of city general purpose revenues. Some cities, however, are very dependent upon TOT revenue.

Counties and General Law Cities. Counties and general law cities derive their authority to impose a TOT pursuant to Revenue and Taxation Code Section 7280, which provides that "*The legislative body of any city, county, or city and county may levy a tax on the privilege of occupying a room or rooms, or other living space, in a hotel, inn, tourist home or house, motel, or other lodging unless the occupancy is for a period of more than 30 days.*" Counties may impose a TOT in unincorporated areas. There are a number of exemptions listed in Section

7280, including owners of timeshare properties and owners of membership camping contracts. Not all cities and counties in California allow short-term rentals. In fact, several jurisdictions have an outright ban on short-term rentals.

Charter Cities. Charter cities derive their powers of taxation from the California Constitution, article XI, section 5, which says that "*It shall be competent in any city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect to municipal affairs, subject only to restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws. City charters adopted pursuant to this Constitution shall supersede any existing charter, and with respect to municipal affairs, shall supersede all laws inconsistent therewith.*"

TOT Ordinances. Each jurisdiction that imposes a TOT does so through an ordinance that spells out who the tax applies to along with the percentage of the tax and how it is calculated, defines applicable terms and how the tax is collected, remitted and reported, and provides other similar details that are then implemented by the Tax Administrator or Tax Collector.

Voter Approval. TOTs may be imposed as general taxes or special taxes. Most TOTs are imposed as general taxes, meaning that the tax is imposed for general governmental purposes, and is required to be submitted to the electorate and approved by a majority of the electorate voting in the election. For a TOT imposed for special purposes, including taxes imposed for a specific purpose (tourism, or beach maintenance and cleanup, for example), such a tax must be submitted to the electorate and approved by a 2/3 vote of the electorate voting in the election.

In general, if a city or county wants to impose a TOT, or extend or increase an existing TOT, it must go to the ballot and get the appropriate level (majority or 2/3) of voter approval.

2) HOME-SHARING AND OTHER SHORT-TERM AND VACATION RENTAL WEBSITES

In the past few years, home-sharing and other online short-term vacation rental businesses such as Airbnb, Vacation Rentals by Owner (VRBO), and HomeAway, among numerous others, have become popular for those seeking travel accommodations. VRBO, HomeAway, and Airbnb allow owners or property managers to list rooms, houses, or apartments for rent through their websites. While the concept of listing available accommodations is similar, each of these businesses has a different platform and may attract different segments of the travel or business industry. Some are more focused on urban markets and provide budget-friendly options, while others are aimed at vacation rentals or second homes in tourist areas. Still others cater toward family-friendly accommodations.

Airbnb. Airbnb allows guests to pay through its website when booking a listing. The host then receives payment through Airbnb 24 hours after the guest checks in. Airbnb makes money by

taking a percentage of each transaction, collecting fees from both the host and the guest. Pursuant to the Terms on Airbnb's website, as a host "You understand and acknowledge that appropriate governmental agencies, departments or authorities (the "Tax Authority") where your Accommodation is located may require Taxes to be collected by Hosts from Guests on the amount paid for the right to use and/or occupancy of accommodations, and to be remitted to the respective Tax Authority." The Terms also note that "In certain jurisdictions, Airbnb may decide in its sole discretion to facilitate collection and remittance of Occupancy Taxes from Guests on behalf of and in-lieu of Hosts, if such tax jurisdiction asserts Airbnb or Hosts have a tax collection and remittance obligation." Airbnb also notes that "In particular, hosts should understand how the laws work in their respective cities. Some cities have laws that restrict their ability to host paying guests for short periods. These laws are often part of a city's zoning or administrative codes. In many cities, hosts must register, get a permit, or obtain a license before listing a property or accepting guests. Certain types of short-term bookings may be prohibited altogether. Local governments vary greatly in how they enforce these laws. Penalties may include fines or other enforcement. Hosts should review local laws before listing a space on Airbnb."

Airbnb includes the following information about two cities in California, San Francisco and San Jose, on its website:

San Francisco, CA USA

Guests who book Airbnb listings that are located in San Francisco, CA will pay the following taxes as part of their reservation:

- San Francisco Transient Occupancy Tax: 14% of the listing price including any cleaning fee for reservations 29 nights and shorter. 14% is the tax rate imposed by the City and County of San Francisco (the tax jurisdictions are one and the same). For detailed information, visit SFTreasurer.org.

San Jose, CA USA

Starting February 1, 2015, guests who book Airbnb listings that are located in San Jose, CA will pay the following taxes as part of their reservation:

- San Jose Transient Occupancy Tax: 10% of the listing price including any cleaning fee for reservations 30 nights and shorter. For detailed information, visit SanJoseCa.gov.

VRBO and HomeAway. Both VRBO and HomeAway charge a fee (either an annual subscription or a per-booking fee) to advertise the location of the rental; however, neither collects payment from the renter directly. VRBO's website says that they are "a self-service website that enables you to directly contact vacation rental owners and property managers

without dependence on a middleman." A disclaimer on HomeAway's website says that "[HomeAway] is not a party to any rental or other agreement between users." HomeAway additionally notes that "Users agree that they are responsible for, and agree to abide by, all laws, rules and regulations applicable to their use of the Site" and that "Members further agree that they are responsible for and agree to abide by all laws, rules and regulations applicable to the listing of their rental property and the conduct of their rental business, including, but not limited to, any and all laws, rules, regulations or other requirements, zoning ordinances, safety compliance and compliance with all anti-discrimination and fair housing laws, as applicable."

3) LEGAL ISSUES

HomeAway Inc. v. City & County of San Francisco. HomeAway, Inc. and HomeAway.com (collectively, "HomeAway") brought suit against the City and County of San Francisco ("City") challenging the enactment of Ordinance No. 218-14 ("Ordinance"). (*HomeAway Inc. v. City & County of San Francisco*, 2015 U.S. Dist. LEXIS 9912.¹) Specifically, HomeAway challenged a provision of the Ordinance potentially making HomeAway responsible for TOT for rental properties advertised on their online platforms.

Under the dormant Commerce Clause, HomeAway challenged the validity of the Ordinance on two grounds. First, HomeAway argued that the Ordinance impermissibly impedes interstate commerce because it discriminates against out-of-state property owners by allowing only San Francisco permanent residents to rent their units. Second, HomeAway argued that the Ordinance impedes interstate commerce because the Ordinance's tax collection requirement favors an "agency" business model over its own "advertising venue" model.

Regarding the first challenge, the District Court held that HomeAway lacked sufficient standing to bring a claim on behalf of the relevant third parties. Regarding HomeAway's second claim, the District Court dismissed this claim on the grounds that HomeAway again lacked standing because they could not establish any causal connection between the injury and the conduct in question. Thus, the District Court granted the City's motion to dismiss the suit.

In re Transient Occupancy Tax Cases, 225 Cal.App.4th 56 (2014). On a related but separate issue, this case arose from the City of San Diego's ("City's") efforts to impose its TOT on online travel companies ("OTCs"). OTCs provide comparative information about airlines, hotels, and rental car companies on their websites. In facilitating hotel room sales, these companies employ several room-sale models, including the "merchant model" whereby OTCs contract with hotels

¹ The Ordinance permits short-term rentals of units only where a permanent resident occupies the unit for at least 275 days out of the calendar year. A "permanent resident" is defined as a person who occupies the unit for at least 60 consecutive days with intent to establish the unit as his or her primary residence.

for the right to advertise and rent rooms to the general public. Specifically, the OTC will pay a hotel a "wholesale" price for a room, and charge its customer a higher "retail" price for the same room. In May 2010, the City's hearing officer ruled that the OTCs owed TOT on their service charges and markups. The OTCs challenged this decision by petitioning for a writ of mandate, which the superior court granted. On review, the Court of Appeal affirmed the trial court's ruling, holding that the City's TOT ordinance did not reveal an intent to impose a tax on the service fees and markups charged by the OTCs.

The City currently alleges that, in affirming the trial court's decision, the Court of Appeal inappropriately failed to focus on the total consideration paid by a transient for occupancy. The Supreme Court of California has granted review and the final interpretation of San Diego's TOT ordinance will be resolved by that Court.

3) OTHER LOCAL GOVERNMENT ISSUES

As these types of home-sharing and short-term vacation rental websites become increasingly popular, some local governments in California are experiencing a variety of resulting issues that are not addressed in their local ordinances and municipal codes. Several local agencies have banned short-term rentals in their jurisdictions, but are aware of listings on websites in violation of their policy, and are struggling with how to deal with these listings. Rentals can also violate a city's zoning ordinance, and can constitute an unpermitted activity. Cities and counties are familiar with the hotels, motels, and B & Bs operating in their jurisdictions, and as such, there are certain statewide and local regulations that apply to the traditional lodging accommodations that may not apply to listings on VRBO and Airbnb.

There are also safety and noise issues to consider, as well as whether hosts or those people who post listings on these types of websites must apply for, receive, and pay business license taxes for the privilege of conducting business within the city or county.