



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



CITY OF PHOENIX, et al. v. ORBITZ WORLDWIDE INC., et al.
CV-18-0275-PR

PARTIES:

Petitioners/Cross-

Respondents/Defendants: Orbitz Worldwide, Inc.; Orbitz, LLC; Trip Network, Inc.; Internetnetwork Publishing Corp.; Expedia, Inc.; Priceline.com, Inc; Travelweb LLC; Travelocity.com, LP; Hotels.com, LP; and Hotwire, Inc. (collectively, “the OTCs”)

Respondents/Cross-

Petitioners/Plaintiffs: City of Phoenix; City of Apache Junction; City of Chandler; City of Flagstaff; City of Glendale; City of Mesa; City of Nogales; City of Prescott; City of Scottsdale; City of Tempe; and City of Tucson (collectively, “the Cities”)

FACTS:

Tax Provisions at Issue: All of the Cities have adopted the Model City Tax Code (the “MCTC”). Three MCTC provisions are at issue here.

The first is MCTC § 444, which imposes a privilege tax on “the gross income from the business activity upon every *person* engaging or continuing in the business of operating a hotel charging for lodging and/or lodging space furnished to any . . . (a) person.” (Emphasis added.) MCTC § 100 includes “brokers” within the definition of “person” and defines “broker” as “any person engaged or continuing in business who acts for another for a consideration in the conduct of a business activity taxable under this Chapter, and who receives for his principal all or part of the gross income from the taxable activity.”

The second is MCTC § 447, which provides that in addition to any tax liability under MCTC § 444, an additional tax is levied on “the gross income from the business activity of any *hotel* engaging or continuing within the City in the business of charging for lodging and/or lodging space furnished to any transient.” (Emphasis added.) MCTC § 100 defines “hotel” as “any public or private hotel, inn, hostelry, tourist home, house, motel, rooming house, apartment house, trailer, or other lodging place within the City offering lodging, wherein the owner thereof, for compensation, furnishes lodging to any transient . . .”

The third is MCTC § 542(b), which provides that: (a) if a city adopts “a new interpretation or application of any provision” of the MCTC, “or determine[s] that any provision applies to a new or additional category or type of business”; and (b) if “the change in interpretation or application is not due to a change in the law,” then the city “shall not assess any tax, penalty or interest retroactively based on the change in interpretation or application.”

OTCs: The OTCs operate websites that advertise travel services and allow customers to use the Internet to research travel destinations and book hotel room reservations. The OTCs enter contracts with the hotels to list available rooms and negotiate with the hotels to obtain discounted

room rates. Customers reserve rooms by providing an OTC with their personal information, length of stay, and payment information. The OTC then gives the customer the total price, broken down by: (a) the “reservation rate,” consisting of the discounted hotel rate plus the OTC’s service fee; and (b) “taxes and fees,” consisting of the city privilege tax and an additional OTC service fee.

Once a hotel accepts a reservation, the OTC charges the customer’s credit card for the amount owed. The OTC appears as the merchant of record and handles any financial or customer service issues that come up before the customer checks in at the hotel. After a customer checks out, the hotel invoices the OTC for the negotiated room rate and the city tax the hotel owes on that amount. After the OTC remits this amount to the hotel, the hotel forwards the tax due to the city. The OTC does not pay any tax to the city on its service fees, and the city does not receive any tax revenue from the money that the OTC keeps.

The Dispute. In March 2013, each of the Cities issued a notice to the OTCs demanding that they remit privilege taxes owed on their service fees from June 2001 through April 2009. They argued that the OTCs owed taxes under MCTC §§ 444 and 447 for the privilege of engaging in the business of operating hotels or, alternatively, for acting as brokers for hotels.

After an administrative law judge held that those two MCTC provisions did not apply to OTCs, the Cities appealed to the superior court, which overturned the ruling. The court held that although the OTCs did not own or operate hotels, they fell within the definition of “broker” because “the hotel uses [an] OTC as its agent to obtain business.” The court concluded the OTCs as brokers were subject to taxation under MCTC §§ 444 and 447. It also ruled, however, that MCTC § 542(b) barred the Cities from assessing any taxes on the OTCs for tax years before 2013 because the Cities’ assessments constituted a “new interpretation or application” of the MCTC.

The Court of Appeals’ Decision. The Court of Appeals: (a) affirmed the superior court’s ruling that the OTCs could be taxed under MCTC § 444, reasoning that they fell within the definition of “broker” under MCTC § 100 and therefore fell within the definition of “person” set forth in the same section and used in MCTC § 444; (b) reversed the superior court’s ruling that the OTCs’ service fees are taxable under MCTC § 447, reasoning that OTCs did not fall within the definition of “hotel” set forth in MCTC § 100 and used in MCTC § 447; and (c) reversed the superior court’s ruling that the Cities may not assess tax, penalties, and interest for tax years before 2013, reasoning that MCTC § 542(b)(2) barred the assessment of taxes retroactively only if the City’s assessment reflected a “change” in a previously articulated position.

ISSUES:

Did the Court of Appeals err in its rulings:

- (a) affirming partial summary judgment and holding that the OTCs are “brokers” under MCTC § 444 and therefore their service fees are subject to municipal taxation [Petition];
- (b) reversing partial summary judgment and holding that because the OTCs are not “hotels,” they are not subject to taxation under MCTC § 447 [Cross-Petition]; and
- (c) reversing the superior court’s ruling that the Cities may not assess tax, penalties, and interest for tax years before 2013 [Petition]?

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