MEMORANDUM OF LAW

DATE: July 19, 1995

TO: Jack Sturak, Assistant City Treasurer

FROM: City Attorney

SUBJECT: Transient Occupancy Tax Exemption for Agents of Federal or California Government

QUESTION PRESENTED

You have asked us whether businesses, which contract with federal or state governments to obtain and pay for hotel/motel rooms that are used by government employees, are exempt from payment of Transient Occupancy Tax due to principles of agency law?

SHORT ANSWER

Generally, such contractors are not exempt and the City may collect Transient Occupancy Tax ("TOT") unless: 1) the contractor and government are so closely connected that they cannot be viewed as separate entities; or, 2) as the Municipal Code is presently worded, the government pays for the room directly. Each case depends on its particular facts. In the two examples you have provided, these requirements are not met.

DISCUSSION

Attached is a Memorandum prepared by Thomas Zeleny, a Senior Legal Intern in our office. That Memorandum explains in depth the origin and status of governmental exemptions from local tax, including TOT.

Federal case law originally exempted the United States from state, and therefore local government (as instrumentalities of the state), taxation. San Diego Municipal Code section 35.0111(a)(4) exempts federal and state governments from TOT when the rents are paid directly by the government. As you indicate, the City has based its exemption on the two Attorney General Opinions that you attached to your memo.

As you also indicate, however, there has been a more recent Attorney General Opinion on this subject, which Mr. Zeleny analyzes. Based on that opinion and the cases it cites, we conclude that contractors who contract with state or federal governments to reserve and pay for hotel/motel rooms used by government employees are not exempt from payment of TOT.

The focus of your question was on an exemption from TOT based on agency principles. You provided two examples of agreements in which the

contractor agrees to arrange for motel or hotel rooms for a governmental agency, pays the motel or hotel directly, and is later reimbursed by the government under the terms of the contract.

In the "Bid Agreement" between Corporate Lodging Consultants, Inc. ("CLC") and Howard Johnson Hotel-Harborview, the agreement is between the contractor and Howard Johnson. There is no mention of an agreement between CLC and the government. Similarly, the other agreement between Convention Marketing Services, Inc. ("CMS") and Howard Johnson Hotel, states that the contractor seeks award of a government contract to provide meals and lodging to government military personnel. These agreements between contractors and Howard Johnson, in which the government is mentioned as the contractor's client or potential client, do not create an agency relationship between the contractors and the government.

In United States v. Boyd, 378 U.S. 39, 44 (1964), the Court upheld the application of a Tennessee use tax to a government contractor, stating: "The contractors remained distinct entities pursuing `private ends' and their actions remained `commercial activities carried on for profit.' (citations omitted). Because of their own commercial status, the contractors had not become `instrumentalities' of the United States." Here CLC and CMS are commercial entities carrying on their activities for a profit. They, and contractors in similar situations, are not agents of the government simply because the government is their client. Therefore, they are not exempt from TOT.

You also directed us to a case that you believed was recently issued by either the California or U.S. Supreme Court regarding sales tax exemptions for defense contractors. The most recent case on that subject is a United States Supreme Court case, United States v. California, 507 U.S. , 113 S. Ct. 1784, 123 L. Ed 2d 528 (1993). That opinion discussed contractors' exemptions from local governmental entities' sales and use taxes, and also discussed governmental immunity from local taxation in general. In that case, the court referred repeatedly to an earlier Supreme Court case, United States v. New Mexico, 455 U.S. 720 (1982), in which a use tax imposed on a government defense contractor was found to be valid. The Court held that imposition of New Mexico's gross receipts and compensating use tax on federal contractors doing business in the state was valid, stating, "Tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." Id. at 735.

The Court in U.S. v. New Mexico, 455 U.S. at 736, addressed tax exemptions relative to agency provisions: "A finding of constitutional tax immunity requires something more than the invocation of traditional agency notions: to resist the State's taxing power, a

private taxpayer must actually `stand in the Government's shoes.'" Id. at 736, quoting City of Detroit v. Murray Corp., 355 U.S. 489, 503 (1958). The corporations in your examples are not agents of the U.S. government, and are therefore not exempt from TOT.

Finally, as Mr. Zeleny points out in his accompanying memorandum, the City's current exemption may be broader than is required. We will be glad to work with you should a narrowing of the exemption be sought.

CONCLUSION

If the government does not contract directly to rent a hotel room, but instead utilizes the services of a contractor to do so, a renter, including contractors, may be charged Transient Occupancy Tax. There are some very specific exceptions, as noted above, which do not apply to the two examples you provided.

JOHN W. WITT, City Attorney
By
Mary Kay Jackson
Deputy City Attorney

MKJ:mb:160.1(x043.2)
Attachment
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