

SEP 13 2012



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MEMORANDUM

Management Services Memo No. 13-010

DATE: SEPTEMBER 12, 2012
TO: MAYOR & COUNCIL
THRU: RICH DLUGAS, CITY MANAGER *RD*
FROM: DAWN LANG, MANAGEMENT SERVICES DIRECTOR *DL*
SUBJECT: FOLLOW-UP ON ITEM #21, ONLINE TRAVEL COMPANIES TAXABILITY

For several years, the City of Chandler and other valley cities have been involved with conducting a joint privilege tax audit of the online travel company industries (OTC) hotel/motel collections. The City of Tempe is the lead on this joint audit and has issued a request for proposal for legal representation from the law firm, Holm Wright Hyde & Hays, PLC.

Currently the City of Chandler imposes a privilege tax of 1.5% on the business activity of hotels. The City imposes an additional tax on the activity of transient lodging, commonly referred to as "bed tax" of 2.9% for a total tax of 4.4%. The OTC industry collects a fee or charge over and above the rate charged by the hotel for occupancy of the room and keeps the remaining amount. It is the contention of the cities that taxes are owed on the difference between what the OTC collects from the customer and what the hotel ultimately collects. This amount is believed to fall under the broker provision of the Municipal Tax Code.

The question was asked at what rate the additional amount the OTC collects would be taxed. This amount would be taxed at the same amount of the transaction being "brokered", 4.4%. It is estimated that Chandler would be owed approximately \$131,000 in unpaid taxes for the audit period and the attorney's fee would be paid from the tax recovery. In addition, taxes would then be collected in the future for this type of transaction.

Should you have any questions, please feel free to call me at x2255.

cc: Lee Grafstrom, Tax Audit Supervisor

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MEMO TO: MAYOR AND COUNCIL

FROM: Eric Anderson, Asst. City Attorney 

THRU: Mary Wade, City Attorney

SUBJECT: Contract for Legal Service with the law firm of Holm Wright Hyde and Hays PLC, for the purposes of collecting unpaid privilege tax from on-line travel companies.

DATE: September 5, 2012

RECOMMENDATION: Staff recommends that the City contract for legal services with the law firm of Holm Wright Hyde & Hays, PLC, to provide legal representation related to collecting the City's portion of statewide, unpaid transaction privilege tax from on-line travel companies.

BACKGROUND/DISCUSSION: The City of Chandler imposes a privilege tax (currently 1.5%) on the business activity of hotels. The City imposes an additional tax on the activity of transient lodging (currently 2.9%). This additional tax is often referred to as the "bed tax." The City of Chandler, as well as other cities and towns, has also adopted language in its tax code that allows the broker for a taxable activity to be liable for the taxes of their principal.

For several years, the City of Chandler and other "non-program" cities (large cities whose tax collection is not administered by the Arizona Department of Revenue) have been involved with conducting a joint privilege tax audit of the online travel company (OTC) industry. This industry (eg. Priceline, Hotels.com, Orbitz, etc.) provides the ability for people to search for and book hotel rooms by assessing OTC websites. The OTC industry charges the user a fee or charge over and above the rate charged by the hotel for occupancy of the room. It is the contention of the cities that taxes are owed on the difference between what the OTC collects from the customer and what the hotel ultimately collects (and would remit taxes on).

The City of Tempe has acted as the lead audit jurisdiction and has issued a request for proposal for legal representation. After a competitive process, Tempe awarded the contract for the requested services to the firm of Holm Wright Hyde & Hays, PLC. The awarded contract provides for cooperative use by other cities. The Tempe contract documents include the Tempe RFP and Vendor Response.

The City Attorney's Office has reviewed the contract awarded by the City of Tempe and have confirmed that the awardee will extend substantially the same terms to the City of Chandler. The law firm has agreed to a professional services contract with the City of Chandler which

incorporates the contract by reference the terms and conditions of the Tempe solicitation. The City Attorney's Office is seeking approval of Council to enter this contract for outside legal services. Due to the expertise possessed by the OTC's attorneys in litigating this issue across the country, it is beneficial to the City at this point to also obtain representation by outside counsel with the necessary expertise in this area of law, as well as familiarity with the industry and similar litigation experience elsewhere to assure that the City effectively presents its position.

FINANCIAL IMPLICATIONS: The City is not required to pay the awardee for providing any legal representation or other legal service unless the City recovers unpaid taxes. The awardee has offered to provide legal services on a contingency basis of 27%. Further, the awardee is not requiring the City to reimburse it for any costs unless unpaid taxes are recovered. Should the City not prevail, no monies are owed to awardee. Based on estimates provided by the joint audit, Chandler is owed approximately \$131,000 in unpaid taxes for the audit period. Should the City prevail, the awardee will recoup their costs and take their percentage fee from the recovery before remitting the remainder to the City. The RFP process used by Tempe established that this arrangement is standard for this type of representation.

PROPOSED MOTION: Move to approve the Contract for Legal Services between the City of Chandler and the law firm of Holm Wright Hyde & Hays, PLC, to provide legal representation related to collecting the City's portion of statewide, unpaid transaction privilege tax from on-line travel companies.

Eric Anderson
Assistant City Attorney

Attachment: Contract for Legal Services

CONTRACT FOR LEGAL SERVICES

This CONTRACT FOR LEGAL SERVICES (the "Contract") is entered into and is effective as of the 6th day of August, 2012, by and between by CITY OF CHANDLER, an Arizona municipal corporation (the "City"), and the law firm of HOLM WRIGHT HYDE & HAYS PLC ("Counsel").

RECITALS

- A. Various cities and towns in Arizona have common issues related to the applicability of the municipal tax code to certain on-line travel services.
- B. On behalf of multiple cities and towns, the City of Tempe, Arizona conducted an RFP process for the purpose of selecting legal representation qualified to assist cities and towns with the issues described above.
- C. Counsel submitted a response to the RFP conducted by the City of Tempe and was selected by the City of Tempe to provide legal representation with regard to the issues described above.
- D. Counsel is able and willing to provide similar legal representation to the City of Chandler and it will be in the best interests of the City of Chandler to have joint representation by Counsel with the City of Tempe and such other municipalities as may retain Counsel.

AGREEMENT

NOW THEREFORE, in consideration of the mutual agreements set forth herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, City and Counsel hereby agree as follows:

- 1. **Scope of Services.**
 - 1.1 Counsel agrees to represent City and provide legal counsel in all matters related to the City's attempts to collect unpaid transaction privilege tax from on-line travel companies.
 - 1.2 Counsel agrees to perform legal services specified in this Contract and as identified and described in the RFP Response which was submitted by Counsel to the City of Tempe ("the RFP Response"), attached as Exhibit A and incorporated by reference.
- 2. **Term of Contract.** Unless terminated as provided below, the term of this Contract shall expire upon the conclusion of any litigation or other proceedings as set forth in the RFP response.
- 3. **Authorized Expenditures for Legal Services and Expenses.** City agrees to pay Counsel for services rendered in accordance with the proposed fee arrangement

set forth in Section Four of the RFP Response, as amended by Counsel's best and final offer, attached as Exhibit B and incorporated by reference.

4. **Lead Attorney.** Counsel shall serve as Lead Attorney to City. However, Counsel may utilize the services of other attorneys or law firms as set forth in the RFP Response providing that the overall fees to the City are not changed.
5. **Subcontracting/Assignment; Experts.** Except as set forth in Section 4 above, services covered by this Contract shall not be assigned or subcontracted, in whole or in part, without the prior written notice and consent of the City Attorney. Technical experts shall not be retained by Counsel at the expense of City without the prior written consent of the City Attorney.
6. **Insurance.** Counsel shall secure and maintain during the life of this Contract a Certificate of Insurance evidencing that Counsel carries Errors and Omission Professional Liability with limits no less than \$1,000,000. Insurance evidenced by this certificate shall not expire, be canceled, or be materially changed without 15 days prior written notice to City.
7. **Independent Contractor.** The services provided by Counsel under this Contract are those of an independent contractor, not an employee.
8. **Termination Under A.R.S. § 38-511.** In accordance with A.R.S. § 38-511, City may cancel any contract or agreement, without penalty or obligation, if any person significantly involved in initiating, negotiating, securing, drafting or creating the contract on behalf of City's departments or creating the Contract on behalf of City's departments or agencies is, at any time while the Contract or any extension of the Contract is in effect, an employee or any other party of the Contract in any capacity or a consultant to any other party of the Contract with respect to the subject matter of this Contract. The cancellation shall be effective when written notice from City is received by all other parties to the Contract, unless the notice specifies a later time.
9. **Common Interests and Conflicts of Interest.** City acknowledges that Counsel is jointly representing City and other municipalities on the matters contemplated by this Contract. To achieve economies of scale and to maximize the effectiveness of City in any adjudication, City authorizes Counsel to seek strategies and positions in such adjudication that advance the common interests of all retained municipalities. However, City also recognizes that from time to time issues may arise in the adjudication concerning which City and other municipalities may have diverse, incompatible or conflicting interests.
 - 9.1 Counsel will fully and timely inform and explain to City the factual and legal basis for each conflict of interest among participating municipalities which Counsel perceives as a result of the performance of its duties under this Contract respecting issues raised in adjudication; and

- 9.2 City will disclose to Counsel perceived or known conflicts of interest among the participating municipalities respecting issues raised in the adjudication.
- 9.3 In the event the participating municipalities, with Counsel's assistance, are unable to resolve a conflict of interest among them, such conflicts shall be dealt with in accordance with the Supreme Court's Rules of Professional Conduct; provided, however, this Contract shall be construed to confer upon City and upon Counsel a direct obligation to negotiate in good faith in an attempt to resolve such concerns in order to allow Counsel to continue to represent the municipalities in situations where the rules would require Counsel to cease representing City.
- 9.4 Counsel will notify City if one of the participating municipalities has withdrawn from the joint representation contemplated herein.

10. Immigration Law Compliance.

- 10.1 Counsel, on its own behalf and on behalf of any subcontractor, warrants, to the extent applicable under A.R.S. § 41-4401, compliance with all federal immigration laws and regulations that relate to their employees as well as compliance with A.R.S. § 23-214(A) which requires registration and participation with the E-Verify Program.
- 10.2 Any breach of warranty under subparagraph 10.1 above is considered a material breach of this Contract and is subject to penalties up to and including termination of this Contract.
- 10.3 City retains the legal right to inspect the papers of Counsel or a subcontractor employee who performs work under this Contract to ensure that Counsel or any subcontractor is compliant with the warranty under subparagraph 10.1 above.
- 10.4 City may conduct random inspections, and, upon request of City, Counsel will provide copies of papers and records of Counsel demonstrating continued compliance with the warranty under subparagraph 10.1 above. Counsel agrees to keep papers and records available for inspection by City during normal business hours and will cooperate with City in exercise of its statutory duties and not deny access to its business premises or applicable papers or records for the purposes of enforcement of this paragraph.
- 10.5 Counsel agrees to incorporate into any subcontracts under this Contract the same obligations imposed upon Counsel and expressly accrue those obligations directly to the benefit of City. Counsel also agrees to require any subcontractor to incorporate into each of its own subcontracts under this Contract the same obligations above and expressly accrue those obligations to the benefit of City.

10.6 Counsel's warranty and obligations under this section to City are continuing throughout the term of this Contract or until such time as City determines, in its sole discretion, that Arizona law has been modified and that compliance with this paragraph is no longer a requirement.

10.7 The "E-Verify Program" above means the employment verification program administered by the United States Department of Homeland Security, the Social Security Administration, or any successor program.

11. **Prohibited Activities.** Counsel, and on behalf of any subcontractors, certifies, to the extent applicable under A.R.S. §§ 35-391 et seq. and 35-393 et seq., that neither has "scrutinized" business operations, as defined in the above statutes, in Sudan or Iran.

HOLM WRIGHT HYDE & HAYS PLC

By: 
Title: Managing Member

**CITY OF CHANDLER,
a municipal corporation**

By: _____
Jay Tibshraeny, Mayor

Attest:

Marla Paddock, City Clerk

Approved As To Form:




Eric C. Anderson, Assistant City Attorney for
Mary Wade, City Attorney