

### NOTATIONS

TO: County Commission

FROM: Michael Cristalli  
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DATE: February 25, 2020

SUBJECT: Client Proposal – Online Travel Companies and their Failure to Pay the Hotel Occupancy Tax as Required by Nevada Law.

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### **I. Introduction**

This memorandum reviews litigation that has occurred across the nation against online travel companies (“OTCs”) for failing to pay municipal hotel room taxes. Generally, under an OTC merchant business model, an OTC negotiates with a hotel for a block of rooms at a discounted “wholesale” room rate. The OTC then provides the rooms to individual consumers at a marked up “retail” rate, which includes the wholesale rate, the hotel occupancy tax applied to the wholesale rate, and a service fee. When a consumer books a hotel room online, the consumer pays the hotel tax to the OTC upon booking. The OTC then forwards the tax, which is the amount based off of the wholesale rate, to the hotels. The OTCs, however, keep the difference between the retail rate and the wholesale rate as a service charge. The litigation centers on whether the OTCs should be paying the hotel room tax on the full amount, including the amount OTCs keep as their service fees.

This memorandum reviews Nevada’s hotel tax scheme and the merits of potential litigation against OTCs for failing to pay the hotel occupancy tax for the full amount received from a consumer.

#### **a. Overview of Litigation**

Over the past decade, there have been cases brought by state and local governments seeking to apply hotel occupancy taxes to OTCs in about 34 states.<sup>1</sup> Thirty-nine cases in 23 states found that OTC services are not taxable under hotel occupancy taxes.<sup>2</sup> However, appeals

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<sup>1</sup> See Litigation Ongoing Against Online Travel Companies for Hotel Occupancy Taxes, Joseph Henchman, Tax Foundation Special Report No. 260, Feb. 2016.

<sup>2</sup> See, e.g., Alachua County v. Expedia, 175 So.3d 730 (Fla. 2015); Leon County v. Expedia, 128 So.3d 81 (Fla. Dist. Ct. App. 2013), rev. denied 2015 WL 7889296 (Fla. Dec. 3, 2015); Expedia v. Broward County, 135 So.3d 415 (Fla. Dist. Ct. App. 2014), rev. denied 2015 WL 8477751 (Fla. Dec. 9, 2015); In the Matter of Travelocity v. Dir. of Taxation, 346 P.3d 157 (Haw. 2015); Montana Dept. of Revenue v. Priceline, 354 P.3d 631 (Mont. 2015); Expedia v. City and County of Denver, 2014 WL 2980979 (Colo. App. Jul. 3, 2014), appeal granted

were filed in at least 5 of these cases. Recently, the Supreme Court of Arizona held that OTCs were engaged in the business of operating a hotel so as to be subject to the ordinance imposing tax on the gross income from business activity on every person engaged in the business of operating a hotel, that markups on hotel room rental rates and service fees OTCs collected from customers were part of taxable gross income contemplated by the ordinance imposing tax, and that OTCs qualified as persons subject to tax liability under the ordinance imposing tax on persons engaging in business of operating a hotel.<sup>3</sup>

It appears that at least ten cases in six states and Washington D.C. held that OTC services are taxable under hotel occupancy taxes. In seven of these cases, the dispositive factor was that there was a statute requiring the tax imposed a hotel tax on amounts paid by the consumer, whether to the hotel or to others. For example, the Supreme Court of Wyoming held that the Wyoming Legislature intended to tax the entire amount an OTC customer pays for the right to occupy a hotel room in Wyoming.<sup>4</sup>

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2015 WL 5215961 (Colo. Sep. 8, 2015); *City of Fargo v. Expedia*, No. 09-2013-CV-00620 (N.D. Cass Co. Cir. Ct. Aug. 8, 2015); *In re Transient Occupancy Tax Cases (City of San Diego v. Hotels.com)*, 225 Cal.App.4th 56 (2014), review granted 329 P.3d 192 (Cal. 2014); *Wake County v. Hotels.com*, 762 S.E.2d 477 (N.C. App. 2014), appeal denied 762 S.E.2d 608 (N.C. 2014); *Dare County (NC) v. Hotels.com*, Dare County Superior Court No. 07 CVS 56 (consolidated into Wake County); *Buncombe County v. Hotels.com*, Buncombe County Superior Court No. 07 CVS 585 (consolidated into Wake County); *Mecklenburg County v. Hotels.com*, General Ct. of Justice Superior Division No. 08 CVS 741 (consolidated into Wake County); *City of Phoenix v. Expedia*, No. TX2014-00471 (Ariz. Tax Ct. May 28, 2014) (appeal pending); *Orbitz v. Wisconsin Dept. of Revenue*, 2014 WL 2573222 (Wis. Tax. App. May 14, 2014); *City of Rome (GA) v. Hotels.com*, 549 Fed. Appx. 896 (11th Cir. 2013); *City of Branson (MO) v. Hotels.com*, 396 S.W.3d 378 (Mo. Ct. App. 2013); *City of Los Angeles v. Hotels.com*, No. BC326693 (Cal. Super. Ct. Apr. 18, 2013) (appeal pending); *Expedia v. City and County of San Francisco*, No. CGC 13 535278 (Cal. Sup. Ct. Feb. 6, 2013) (appeal pending); *City of Birmingham v. Orbitz*, 93 So.3d 932 (Ala. 2012); *City of Bowling Green (KY) v. Hotels.com*, 357 S.W.3d 531 (Ky. App. 2011), review denied (Ky. Feb. 17, 2012); *City of Duluth v. Expedia*, Minnesota District Court No. 69DU-CV-11-1217; *City of Columbus (OH) v. Hotels.com*, 693 F.3d 642 (6th Cir. 2012); *City of Philadelphia v. City of Philadelphia Tax Review Board*, 37 A.3d 15 (Pa. Cmmw. Ct. 2012); *City of Goodlettsville (TN) v. Priceline*, No. 3:05-cv-00561 (M.D. Tenn. Feb. 21, 2012); *City of Santa Monica v. Expedia*, 2012 WL 5360882 (Cal. App. 2nd Nov. 1, 2012), rev. denied Jan. 23, 2013; *Expedia v. City of Anaheim*, 2012 WL 5360907 (Cal. App. 2nd Nov. 1, 2012), rev. denied Jan. 23, 2013; *Orange County (FL) v. Expedia*, 2011 WL 7657975 (Fla. Cir. Ct. Jan. 20, 2011); *County of Genesee v. Hotels.com*, Circuit Court for the County of Ingham No. 09-265-CZ (settled 2011; all parties stipulated OTCs not subject to hotel taxes); *St. Louis County v. Prestige Travel*, 344 S.W.3d 708 (Mo. 2011); *Expedia v. City of New York Dept of Finance*, No. 6174 650761/09 (N.Y. Ct. App. Nov. 29, 2011); *State (of Oklahoma) v. Priceline*, No. CJ-2010-8952 (Dist. Okla. Cty. Mar. 22, 2011); *City of Houston v. Hotels.com*, 357 S.W.3d 706 (Tex. App. 14th Dist. 2011); *Marshall v. Priceline*, 2010 WL 1068197 (De. Sup. Ct. New Castle Co. Mar. 8, 2010); *City of Gallup v. Hotels.com*, No. CV 07-644 JC/RLP (D.N.M. Mar. 1, 2010); *Louisville/Jefferson County Metro Gov't v. Hotels.com*, 590 F.3d 381 (6th Cir. 2009); *Pitt County (NC) v. Hotels.com*, 553 F.3d 308 (4th Cir. 2009); *City of Madison v. Expedia*, No. 2007-cv-4488 (Wis. Dane Co. Cir. Ct. Jul. 24, 2008); *City of Orange (TX) v. Hotels.com*, 2007 WL 2787985 (E.D. Tex. Sep. 21, 2007); *City of Findlay v. Hotels.com*, 441 F.Supp.2d 855 (N.D. Ohio 2006).

<sup>3</sup> See *City of Phoenix v. Orbitz Worldwide Inc.*, 247 Ariz. 234, 448 P.3d 275 (2019).

<sup>4</sup> See *Travelocity.com LP v. Wyoming Dep't of Revenue*, 2014 WY 43, ¶ 104, 329 P.3d 131, 153 (Wyo. 2014).

The litigation and its outcome, therefore, varies by state. A state’s respective underlying statutory scheme regarding its hotel occupancy tax is a main factor to analyze in assessing the merits of litigation in Nevada.

**b. Overview of Nevada’s Combined Transient Lodging Tax**

The transient lodging tax, established by the Nevada legislature, is imposed on the gross rental receipts of all transient lodging establishments throughout Nevada. Under state law, the incorporated cities are responsible for collection and administration of the tax within the city boundaries. Nevada Revised Statutes (NRS) Chapters 244 and 244A pertain to county administration and collection of the tax. The administration of the combined transient lodging tax within unincorporated Clark County is governed by Chapter 4.08 of the Clark County Code, as required by state law.

The “combined” transient lodging tax rate in unincorporated Clark County ranges between 10.5% and 13.38% depending on the type of transient lodging establishment (resort or non-resort), distance of the transient lodging establishment from the Las Vegas Convention Center, and whether the transient lodging establishment is located inside or outside the Primary Gaming Corridor and the Stadium District. Recipients of the tax collected within unincorporated Clark County include the Las Vegas Convention and Visitors Authority, the Clark County School District, local transportation districts, the Nevada Department of Tourism, the state of Nevada general fund (to be redirected to the State Supplemental School Fund after June 2011), and the Clark County General Fund.

The below chart is depicted from the General Information Guide for Transient Lodging Establishments by the Clark County General Department of Business License.<sup>5</sup> The chart is excerpted from Clark County Code Section 4.08.010 and was modified to reflect the current tax rates in unincorporated Clark County and to provide reference to the individual sections of state law establishing the individual components of the tax.

Recipient of Tax:	Code Section/Title of Transient Lodging Tax Section						Combined Transient Lodging Tax Rate
	Las Vegas Convention & Visitors Authority	State Tourism/ School District Fund	Local Transportation District	County General Fund	State Education	Stadium District	
Clark County Code Section:	4.08.015	4.08.020	4.08.025	4.08.030	4.08.031	4.08.033	
Related Nevada Revised Statute:	244A.619	244.3352	244.3351	244.335	244.33691	SB1 - 30th Special Session	
Resort Hotel in SD & PGC	5.5%	2%	1%	1%	3%	.88%	13.38%
Resort Hotel in SD, outside PGC	5.5%	2%	1%	1%	3%	.5%	13%
Resort Hotel, outside SD & PGC	5.5%	2%	1%	1%	3%	0%	12.5%
Other Transient Lodging within 35 mi. of LVCC, in SD & PGC	4.5%	2%	1%	2%	3%	.88%	13.38%
Other Transient Lodging within 35 mi. of LVCC, in SD, outside PGC	4.5%	2%	1%	2%	3%	.5%	13%
Other Transient Lodging within 35 mi. of LVCC, outside SD & PGC	4.5%	2%	1%	2%	3%	0%	12.5%
Other Transient lodging more than 35 miles from LVCC	2.5%	2%	1%	2%	3%	0%	10.5%

<sup>5</sup> See General Information Guide for Transient Lodging Establishments by the Clark County General Department of Business License, Section 4.08.010.

Clark County General Department

According to the Las Vegas Convention and Visitors Authority, room tax collections in Clark County rose by 7.9 percent to reach a record-total of \$795.9 million in fiscal year 2018. Of these collections, roughly 37 percent went toward tourism promotion, while 35 percent supported public education and 28 percent funded other uses including stadium construction and transportation.<sup>6</sup> The tourism industry in Nevada is subject to industry specific taxes, including gaming taxes and fees, the transient lodging tax, which is at issue here, and the live entertainment tax. The transient lodging tax, however, generated the most revenue of the major industry-specific taxes in fiscal year 2018. The \$795.9 million in recorded revenue in Southern Nevada was 90.6 percent of the state-wide total of \$878.9 million.

Room taxes in Clark County contributed significantly to education, generating \$102.1 million for the Clark County School District and another \$177.9 million for public schools throughout the state. In total, \$279.9 million in Southern Nevada room tax revenues were dedicated for education. Transient lodging taxes that were attributable to visitors generated \$267.0 million in revenue for education statewide. Most of that total, \$169.8 million, was derived from a 3 percent room tax rate that helps fund the state's Distributive School Account. Another \$97.2 million in room taxes is distributed to CCSD's Bond Fund for school construction. Overall, visitors to southern Nevada accounted for more than \$1.0 billion in tax revenues dedicated to statewide education-related purposes in fiscal year 2017. This equates to an annual tax savings of \$350 for every resident in the state and \$958 for every household. Of the total education-related revenue generated by southern Nevada's tourism industry, 75.5 percent of the total, or \$791.8 million remained in Clark County, equating to \$359 in tax savings for every southern Nevada resident and \$1,013 per household.

In fiscal year 2018, \$224.8 million was spread among various local uses, including \$48.6 million distributed to the Las Vegas Stadium Authority and \$66.4 million for transportation in Clark County.

The transient lodging tax generates the most revenue for the state. The tax benefits Nevada residents by funding education and ultimately saving residents' tax dollars. Further, it funds projects, such as the stadium and transportation initiatives, which improves the lives of Nevada residents by making the state a more desirable place to live and visit, thereby improving the economy. As such, litigation resulting in more revenue for the state will garner media attention as well as will align the firm with key individuals and entities in Nevada.

## **II. Comparison of Nevada's Transient Lodging Tax to Other State Ordinances Already Litigated.**

This section provides a more in-depth review of the already litigated cases. Each of these cases was decided based on the language of the particular ordinance or statute at issue. Therefore, this section also provides key portions of Clark County's Combined Transient Lodging Tax Ordinance to allow for comparison between other state's ordinances and the rulings based on those ordinances.

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<sup>6</sup> See The Industry's Contribution to Major Public Revenues, Las Vegas Convention and Visitors Authority, June 2019.

**a. Key Portions of the Combined Transient Lodging Tax.**

Clark County's Combined Transient Lodging Tax Ordinance, § 4.08.010, states as follows:

- (a) All transient lodging taxes set forth in Sections 4.08.015 through 4.08.033 of this chapter shall be collected from every operator in Clark County and shall henceforth be collectively known as the "combined transient lodging tax."
- (b) The tax, when due, constitutes a debt owed by the operator to the county which is extinguished only by payment thereof to the Clark County department of business license.
- (c) The combined transient lodging tax imposed may be collected from the paying transient guests and may be shown as an addition to the rent charged by the transient lodging establishment. The operator is liable to Clark County for the tax whether or not it is actually collected from the paying transient guest.

*An "operator" is defined as the person who is the proprietor of a transient lodging establishment, whether in the capacity of owner, lessee, sublessee, mortgagee, licensee, or any other capacity. Where the operator performs his or her functions through a managing agent of any type or character other than an employee, the managing agent shall also be deemed an operator for the purposes of this chapter and shall have the same duties and liabilities as his or her principal. See Clark County Code of Ordinances § 4.08.005(12).*

"Rent" is defined as follows:

- (a) Means the amount charged for a sleeping room/space in a transient lodging establishment, valued in money, whether received in money or otherwise, and including the following, regardless of whether separately stated:
  - (i) Charges that would normally be part of an all inclusive room rate, such as, but not limited to, payment processing fees, check-in fees, accommodation fees, facility fees, access fees, charges for additional guests, late check-out fees, and utility surcharges;
  - (ii) Charges applicable to cleaning and readying such room/space for occupancy including, but not limited to linen fees, cleaning fees, and non-refundable deposits;
  - (iii) Charges for rental of furnishings and appliances including, but not limited to, cribs, rollaways, refrigerators, televisions, microwaves, and in-room safes;
  - (iv) Room charges applicable to pets including, but not limited to, non-refundable pet cleaning fees/deposits;
  - (v) Charges associated with attrition, cancellation, late arrival, or failure to occupy a room, including, but not limited to, attrition fees, cancellation fees, late arrival fees, early departure fees, and no-show fees;

- (vi) Reimbursements received for use of a sleeping room/space under incentive programs, such as, but not limited to, frequent guest programs or rewards programs;
- (vii) The value of a sleeping room/space included as a component of a package, pursuant to Section 4.08.035;
- (viii) Any charges for services, amenities, accommodations, or use, not otherwise specified above, that are mandatory in nature and charged in connection with rental of a sleeping/room space.

See Clark County Code of Ordinances § 4.08.005(17).

**b. Discussion of Sample of Court Rulings.**

In *In re Transient Occupancy Tax Cases*, the Supreme Court of California affirmed the lower court's decision that tax was not payable on amounts retained by travel companies above the amounts remitted to hotels.<sup>7</sup> San Diego abandoned its argument and effectively conceded that OTCs were not considered "operators" within the meaning of the San Diego ordinance. The Supreme Court denied its argument that the OTCs are liable for assessment of room tax because they are agents of the hotels for purposes of charging and collecting the tax. The Court stated "[t]hat the OTCs act as hotels' agents or intermediaries for the limited purpose of charging and collecting the rent, however, does not subject the OTCs to assessment as an operator or make any undifferentiated portion of the charge representing the amount unilaterally set by the OTCs 'Rent charged by the Operator.'" In regard to San Diego's contractual theories of liability, the Court concluded that even if the hotels contractually allocate responsibility to pay the room tax to OTCs, it "cannot expand the reach of the ordinance and, in particular, do not subject an entity other than an operator to assessment of the tax and penalties."

Contrastingly, in *City of Phoenix v. Orbitz Worldwide Inc.*, the Supreme Court of Arizona held that OTCs were engaged in the business of operating a hotel so as to be subject to ordinance imposing tax on gross income from business activity on every person engaged in business of operating a hotel.<sup>8</sup> Arizona's ordinance imposes a tax on "the gross income from the business activity upon every person engaging in or continuing in the business of operating a hotel charging for lodging." In part, the Court found that the OTCs facilitate all aspects of the transaction from the time a customer makes a credit card payment to the time of physical check in and receive compensation in the form of service fees and markups on the room rental rates for providing their services. "It would be illogical to conclude that the OTCs—which advertise available rooms, solicit potential customers, collect customers' information, process payments, confirm reservations, provide customer service, and facilitate reservation modifications and cancellations—are not actively engaged in 'the business of operating a hotel.'"

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<sup>7</sup> *In re Transient Occupancy Tax Cases*, 2 Cal. 5th 131, 384 P.3d 1236 (2016).

<sup>8</sup> *City of Phoenix v. Orbitz Worldwide Inc.*, 247 Ariz. 234, 448 P.3d 275 (2019).

*Compare, e.g., City & County of Denver v. Expedia, Inc.*, 405 P.3d 1128, 1138 (Colo. 2017) (city ordinance taxed privilege of purchasing lodging and OTCs' markups are inseparable from selling price of lodging), *and Travelocity.com, L.P. v. Wyo. Dep't of Revenue*, 329 P.3d 131, 143, 145 (Wyo. 2014) (OTCs qualify as "vendors," taxable under city's ordinance, and their markups are part of the "sales price" subject to city's tax on hotel lodging), *with State v. Priceline.com, Inc.*, 206 A.3d 333, 341 (N.H. 2019) (statute at issue explicitly limited lodging tax to "operators," and OTCs did not qualify as hotel operators), *and Pitt County v. Hotels.com, G.P., LLC*, 553 F.3d 308, 313 (4th Cir. 2009) (same).

The OTCs will likely argue that they do not constitute an "operator" under Clark County's Combined Transient Lodging Ordinance and, therefore, are not subject to the tax payment obligations. However, the ordinance specifically includes that "[w]here the operator performs his or her functions through a managing agent of any type or character other than an employee, the managing agent shall also be deemed an operator for the purposes of this chapter and shall have the same duties and liabilities as his or her principal." As discussed in *City of Phoenix*, OTCs clearly perform functions of an operator by marketing hotels, advertising rooms, soliciting customers, collecting customers' information, processing payments, confirming reservations, and providing customer service. The ordinance does not state that an agent must perform *all* functions of an operator. It specifically states that a managing agent is subject to the same duties and liabilities as the principal. Therefore, the ordinance specifically includes an expansive agency relationship as being within its definition of "operator."

In addition, the amount retained by OTCs as a "service fee," clearly fit within the ordinance's definition of rent. The OTCs' fee fits within § 4.08.005(17)(i) as a charge "that would normally be part of an all inclusive room rate, such as, but not limited to, payment processing fees, check-in fees, accommodation fees, facility fees, access fees, charges for additional guests, late check-out fees, and utility surcharges" or § 4.08.005(17)(viii) as a charge "for services, amenities, accommodations, or use, not otherwise specified above, that are mandatory in nature and charged in connection with rental of a sleeping/room space." Consumers do not have the option to not pay the amount that OTC retains as a service fee and it is charged in connection with booking a room. It is clear that the subject ordinance intends to tax the entire amount an OTC customer pays for the right to occupy a room.

### **III. Claim Against OTCs**

There may be multiple theories of liability to pursue. See complaint.

#### **a. Statute of Limitations**

No action may be commenced more than three years after the date of discovery of the activity, or more than six years after the activity occurred, whichever occurs later. This also depends on the causes of action and if fraud is alleged.

### **IV. Damages**

Considering the popularity of OTCs and the revenue generated by the transient lodging tax in Clark County in 2018, the amounts at issue are extraordinarily high and have potential to reach nine figures. In 2009, a Texas federal judge ordered OTCs to pay \$55.14 million, which later increased to \$88 million after accounting for increased penalties.<sup>9</sup> In 2015, the Hawaii Supreme Court ruled that OTCs owed the state \$70 million in taxes.<sup>10</sup> OTCs paid the City of Denver \$18.8 million, including tax, penalties, and interest, to settle its case with Denver after the Supreme Court of Colorado ruled in the city's favor.<sup>11</sup>

The average daily room rate in Las Vegas is \$150.00.<sup>12</sup> There is a total room inventory of over 148,000 in Las Vegas with an occupancy rate of 91%.<sup>13</sup> OTCs have gained market share capturing 39% of the online booking market and was forecasted to reach 41% market share in 2020. For example, at an 148,000 inventory rate with a lowered 80% occupancy rate, it is reasonable to assume at least 118,400 rooms are booked daily. Of that number, 39% or 46,176 rooms were likely booked by an OTC. The OTCs retained the non-taxed markup and service fee, which could reasonably range from \$25.00 to \$50.00 on a \$150.00 room. Assuming just a \$25.00 markup and service fee for 46,176 rooms would equal a daily amount of \$1,154,400. Over the length of a year and applying the 10% transient lodging tax to that amount equals \$4,213,560 in unpaid taxes over a span of one year. Therefore, a very conservative estimate shows that OTCs are liable for over \$25 million in unpaid taxes alone for a 6 year timeframe.

OTCs are liable for penalties and interest. The recoverable amount in penalties reaches the tens of millions as well. Although there would likely be considerably more violations per day, a single violation on the low end of the penalty spectrum of \$5,500 would amount to \$2,007,500 for one year for one OTC defendant. There are at least seven major OTCs, including Expedia, Inc., Hotels.com, Hotwire, Inc., Travelocity.com LP, Orbitz, LLC, Priceline.com, Inc., and Travelweb LLC that appear to operate in Nevada and would be named defendants in this matter with the addition of less recognizable OTCs that also appear to operate in Nevada including Site59.com, LLC, Trip Network, Inc., and Internetnetwork Publishing Corp. With at least ten named defendants, penalties would amount to about more than \$120 million over a six year timeframe.

Therefore, a conservative estimate of the recoverable amount is **\$195 million** in unpaid taxes, treble damages, and penalties assessed.

## V. Conclusion

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[https://www.mckoolsmith.com/assets/htmldocuments/2013%2004%2005\\_Travel%20Cos%20Ordered%20To%20Pay%20\\$55M%20In%20Texas%20Hotel%20Tax%20Case\\_Law360.pdf](https://www.mckoolsmith.com/assets/htmldocuments/2013%2004%2005_Travel%20Cos%20Ordered%20To%20Pay%20$55M%20In%20Texas%20Hotel%20Tax%20Case_Law360.pdf)

<sup>10</sup> See *Travelocity.com, L.P. v. Dir. of Taxation*, 135 Haw. 88, 346 P.3d 157 (2015) (holding that OTCs were exempt from hotel tax but were subject to the state's general tax on services.)

<sup>11</sup> <https://www.denverpost.com/2017/12/06/denver-priceline-expedia-travel-service-taxes/>

<sup>12</sup> <https://www.reviewjournal.com/business/tourism/average-daily-room-rate-in-las-vegas-reaches-all-time-high/>

<sup>13</sup> <https://www.statista.com/statistics/221046/hotel-occupany-rate-in-las-vegas/>

There is a conservative estimate of at least **\$195 million** in unpaid taxes, damages, and penalties at stake. However, this estimate could exceed \$500 million. With the economic loss from the pandemic the recovery of lost revenue from room tax is meaningful to the economy and the citizens of Nevada. This could immediately impact the County's budget and be a part of its revenue in the future.