



Results of Transient Occupancy Tax Agreed-Upon Procedures

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INTRODUCTION

Objective, scope, and methodology

Transient occupancy taxes (TOT) represent a significant portion of the city's governmental fund revenues. As a result, it's important that the city perform oversight measures to ensure hotels are complying with Carlsbad Municipal Code (CMC) that governs transient occupancy taxes and related business improvement districts.

The objective of this engagement was to determine if a selection of hotels operating within the City of Carlsbad properly remitted and reported their TOTs and any applicable assessments for calendar years 2018, 2019 and 2020. The program's assessments are comprised of as many as two business improvement districts, the Carlsbad Tourism Business Improvement District (CTBID) and the Carlsbad Golf Lodging Business Improvement District (CGLBID).

To fulfill this objective, the city engaged a regional CPA firm, CliftonLarsonAllen, LLP to perform a transient occupancy tax agreed-upon (AUP) procedures engagement. The engagement calls for the firm to perform a set of agreed upon procedures, as listed in the appendix, to evaluate the degree to which a group of 11 selected hotels are complying with the existing municipal code chapters 3.12, 3.37, and 3.38 pertaining to TOT, CTBID, and CGLBID respectively. This report summarizes the results of those procedures.

It is important to note that this is not an audit. Rather, this is an agreed-upon procedures engagement, which is a limited scope engagement carried out by performing a predetermined set of procedures. The procedures are identified by the city and agreed to by CliftonLarsonAllen, LLP, prior to beginning the engagement. At the conclusion, the city is presented with the results of the procedures for each hotel and that concludes the engagement. In contrast, an audit engagement would involve a broader focus, a risk assessment would be performed to determine the scope of procedures to perform, and at the conclusion of the engagement there would be an auditor's opinion. The agreed-upon procedure engagement is well defined, provides sought after results and information the city must then act upon in accordance with the relevant municipal codes.

BACKGROUND

California Revenue & Taxation Code Sections 7280-7283.51 sets forth the state's regulations for transient occupancy taxes and Chapter 3.12 of the Carlsbad Municipal Code sets forth the city's regulations on its TOT. This tax applies to hotel guests who occupy a hotel room for a period of up to 30 days. There are several conditions that exempt guests from this tax. One common exemption is available to federal and state employees when traveling on official business. Guests wishing to be exempted from TOTs typically must attest to the status which makes them exempt at the beginning of their stay. The revenues generated from TOTs are allocated to the city's General Fund.

In addition to TOTs, the city collects assessments from hotels to support its two business improvement districts, the CTBID and CGLBID. The regulations governing the two districts are set forth in Carlsbad Municipal Code Chapters 3.37 (CTBID) and 3.38 (CGLBID). Proceeds from the CTBID assessments, which are paid by all hotels operating within the city’s boundaries, are utilized to fund marketing and sales promotion efforts to benefit the hotels. Proceeds from the CGLBID assessments, which are paid by hotels that elected to join the district, are spent to promote golf related tourism within the boundaries of the CGLBID, as well as marketing related capital improvements such as golf signage, equipment and to pay for administrative costs.

Hotels participating in the CTBID and CGLBID are required to report and remit the following assessments:

- For CTBID, through October 31, 2020, all hotels in the City of Carlsbad are to pay \$1 per occupied room, per rental night.
- For CTIBD, beginning November 1, 2020, all hotels in the City of Carlsbad are to pay 2% of gross room revenues.
- For CGLBID, hotels who opt to participate in the improvement district, are to pay a flat fee of \$2 per occupied room per night.

Hotels report and remit TOTs and assessments to the city monthly. The city’s Finance Department is responsible for collecting and administering the TOT program. The table below (Table 1) summarizes total TOT, CTBID, and CGLBID revenues received by the city during fiscal years 2018 through 2020.

Table 1: TOT Revenues by Fiscal Year

Fiscal Year	TOT	CTBID	CGLBID
FY2018-19	26,320,000	1,332,185	719,735
FY2019-20	18,898,000	1,086,188	534,241
FY2020-21	15,584,000	1,867,249	335,402

SUMMARY OF RESULTS

Results of agreed-upon procedures

The procedures performed for the 11 selected hotels for calendar years 2018 through 2020 identified additional revenue owed to the city along with associated penalties and interest. Tables 2 and 3 below present the findings by hotel, however the names of the hotels are intentionally omitted. Of the 11 hotels selected only one was a participant in the CGLBID and there were no findings associated with the CGLBID assessments.

As a result of the procedures performed it is noted that hotels owe additional TOT to the city for a few specific reasons:

- Overreporting tax exempt rent revenues because the hotel was unable to provide support for exemptions claimed.

- Variances were found when the mathematical accuracy of tax remittances were evaluated.
- Not adhering to the city's new (November 2020) CTBID assessment rate.

Table 2: TOT underpaid or overpaid by hotel for calendar years 2018 through 2020

Hotel #	TOT Revenues Collected 2018-2020	TOT underpaid (overpaid)	Penalties & Interest	Total due to city (owed by city)
1	1,232,045			-
2	664,355	1,765	1,138	2,903
3	707,716	15,129	13,410	28,539
4	2,272,701	1,002	927	1,929
5	1,224,817	2,489	1,764	4,253
6	5,404,442	310	266	576
7	440,660	1	-	1
8	761,864	529	418	947
9	1,336,075	-	-	-
10	10,002,965	-	-	-
11	571,332	-	-	-
Total	24,618,972	21,224	17,923	39,147

Table 3: CTBID overpaid or underpaid for calendar years 2018 through 2020

Hotel #	CTBID Collected 2018-2020	CTBID underpaid (overpaid)	Penalties & Interest	Total due to city (owed by city)
1	82,853	84,565	35,180	119,745
2	85,598	634*	-	634
3	57,207	-	-	-
4	144,966	-	-	-
5	105,079	-	-	-
6	188,303	-	-	-
7	19,434	-	-	-
8	42,553	-	-	-
9	114,680	-	-	-
10	307,962	-	-	-
11	80,908	-	-	-
Total	1,229,543	84,565	35,180	120,379

*Note: In November 2020 the city adopted a new CTBID assessment, which changed the way the assessment is calculated. Due to the new calculation, the city waived penalties and interest for hotels that did not correctly calculate their CTBID assessments in the first month after adoption.

When a deficiency is identified during an audit, the Carlsbad Municipal Code Section 3.12.080 requires the tax administrator to invoice the hotel operator for the following:

- Net tax deficiency (underpayment)
- An audit deficiency penalty of 10%, CMC Section 3.12.080(E)
- Interest of 1.5% per month, or fraction thereof, CMC Section 3.12.080(C)

The penalties and interest, referenced in the tables above account for the penalties cited here as well as the net deficiency.

Transient occupancy tax ordinance

During the TOT engagement there were several hotels that became unresponsive to requests for records from the city's consultant, CliftonLarsonAllen, LLP. The hotels in question, simply stopped responding to requests, despite actively responding in the early stages of the engagement. As a result, the city's internal auditor, with support from code enforcement staff and in consultation with the City Attorney's Office, implemented administrative measures to obtain their cooperation. The measures ranged from additional outreach in the form of calls and visits to the referenced hotels, to the city's Code Enforcement Division issuing notices of violation and administrative citations, which carry fines.

The process of applying additional administrative measures utilized considerable resources on the part of both the consultant and city staff. While there are periods in TOT engagements where city staff coordinate with the hotels directly to obtain reports or additional data, the measures required in this engagement are atypical.

During the process of following up with the hotels in question staff looked to the applicable municipal code, Chapter 3.12 Transient Occupancy Tax, for language that would aid in obtaining compliance from all hotels. In doing so, it was noted that language concerning penalties in the TOT ordinance focus solely on the accurate remittance of TOTs. There was no mention of penalties if hotels refused to cooperate. While the city has more severe administrative actions and penalties it may apply, there is no reference to those actions.

To further support the city's inspection of TOT records, required by CMC 3.12.110 to be retained by hotels and made available to inspection for a period of three years, it was recommended to staff that the TOT ordinance be reviewed and updated. Doing so would support the city's oversight and collection of TOT remittances. As a result, the Finance Department and City Attorney's Office, with input from the city's internal auditor, have begun a thorough review of the TOT ordinance. Several recommendations, aimed at facilitating the city's review of TOT records are due to be brought forward for City Council's consideration prior to the end of calendar year 2023.

Review of transient occupancy tax filings

Effective November 1, 2020, the city's CTBID assessment was increased from one dollar per room, per occupied night to two percent of gross room rental revenues per month. This represented a significant increase in the CTBID assessment. During the TOT engagement one of the selected hotels was discovered to still be paying the previous CTBID assessment amount of one dollar per room, per occupied night.

Despite the city thoroughly communicating the change in the assessment as well as noticing and holding the required public hearing and public meeting sessions, the hotel in question continued filing their TOT returns as they had been and paying the previous assessment. As a result, the hotel accrued a large net deficiency associated with their CTBID assessments plus penalties and interest.

In addition to the hotel not recognizing the change in the assessment and identifying the error, the city continued to receive and process the hotel's TOT returns, including the incorrect CTBID assessments, without identifying the error. This carried on for well over a year, until the error was identified by the city's consultant during the TOT engagement. To ensure such an error does not repeat, the Finance Department was notified of the oversight and instructed to review their process for receiving and recording TOT, CTBID and CGLBID assessments. As a result, the Finance Department corrected this item on the spot, by establishing a process by which TOT filings received by the Finance Department are subject to a detailed review before being recorded. Additionally, since the new assessment went into place, the city has begun accepting online remittances of TOTs from hotels. This allows hotels to remit their TOTs online, in a streamlined digital payment process. This process collects the same information the TOT forms require. Additionally, any time there is an update to the TOT form, the updates are automatically published within the online payment process. This serves to limit the likelihood of errors and streamlines the city's process.

Transient Occupancy Tax Agreed-Upon Procedures Appendix

SCHEDULE OF PROCEDURES TO BE PERFORMED

Our procedures for each Hotel as agreed upon by the management of the City of Carlsbad will be as follows:

1. We will obtain and read the City Municipal Code Title 3 Chapter 3.12 Transient Occupancy Tax and resolution related to the transient occupancy tax, as well as review the City Municipal Code Title 3 Chapter 3.37 Carlsbad Tourism Business Improvement District and Chapter 3.38 Carlsbad Golf Lodging Business Improvement District.
2. We will recalculate the mathematical accuracy and observe the timeliness of the monthly transient occupancy reports filed with the City for the calendar years 2018, 2019, and 2020.
3. We will trace the transient rent receipts reported on each transient occupancy tax returns prepared by the Hotel during the calendar years 2018, 2019 and 2020 to the transient rent receipts recorded in their accounting records.
4. We will select a sample of 45 daily rental transactions (3 days each year and 5 guests per day) and for each transaction selected, we will recalculate tax computations and trace the amounts of rental revenues and transient occupancy tax collected to the books and records of the Hotel.
5. We will trace the total number of days each unit/hotel room is occupied on the transient occupancy tax returns prepared by the Hotel to the total number of days each unit/hotel is occupied per Hotel records.
6. We will inquire of management of the Hotel to determine the following:
 - a. How “transient rent receipts” were accounted for and reported to the City.
 - b. What procedures were in place to identify transient and non-transient guests?
 - c. How exemptions, including complimentary rooms, were documented, and reported to the City.
7. We will select 1 month each year (2018, 2019 and 2020) and will review the transient occupancy tax returns for claims of exemption from tax. For up to 5 exemptions per month we will review the Hotel’s documentation supporting the exemption.

8. We will inquire how the Hotel handles reservations and payments done online through a third party such as Expedia.com and how the transient occupancy tax was collected and reported to the City for these transactions.