

Capitola City Council

Agenda Report



Meeting: January 25, 2024
From: Finance Department
Subject: Transient Occupancy Tax Audit Update

Recommended Action: Receive report and provide direction to staff.

Background: In January 2022 HdL Lodging Tax began administering the City's Transient Occupancy Tax (TOT) program. HdL's services include processing registrations, tax returns, and payments, monitoring short-term rental sites, and conducting audits. HdL's first audit was conducted in 2022.

Discussion: During 2023 HdL audited five hotel properties for the three years between January 2020 and July 2023. The hotels were provided with a three week notice to gather requested documentation and an opportunity to meet virtually with HdL following a review of the submitted documents.

Four of the hotel operators were responsive to the requests and the auditors were able to complete the audit of those properties. One operator has requested several extensions and HdL and staff continue to work with the operator to complete the fifth audit.

Of the four completed audits, one property was found to be completely compliant, while the other three had various charges that were not properly taxed. The Capitola Municipal Code defines Rent as *"the consideration, whether or not received, for the occupancy of space in a hotel, valued in money, whether to be received in money, goods, labor or otherwise, including all receipts, cash, credits and property and services of any kind or nature, without any deduction therefrom whatsoever."* The charges that were not taxed included items such as cancellation fees, pet fees, room upgrades, extra person charges, smoking, and cleaning fees, as well as exempt and compensated rooms. A summary of the audit findings is as follows:

Property	Finding	TOT	Penalties	Interest	Total
Hotel 1	Untaxed guest charges	6,448	1,290	2,206	\$9,944
Hotel 2	Untaxed guest charges	14,377	2,875	4,458	\$21,710
Hotel 3	Untaxed guest charges, exemptions, comp rooms	10,678	2,136	4,324	\$17,138
Totals		31,503	6,301	10,988	\$48,792

It should be noted the TOT was not collected by the hotels and the penalties and interest are calculated from the date the TOT was due if it had been collected as a portion of the rent charged.

HdL has provided three options for the City to consider regarding the audit findings:

1. Require hotels to provide all requested documents to confirm tax-exemptions. Hotels unable to provide all requested documents will have exemptions become taxable rent with uncollected TOT charges, penalties, and interest.
2. Follow option one but waive penalties and interest.
3. Allow hotel exemptions to stand during the audit period. Require hotels to use updated forms with a standard checklist as provided by the City beginning with a specified filing period.

HdL is recommending option 1, however, staff would like to use the audit as an educational opportunity and is recommending option 3 beginning with the January 2024 filing period due March 11, 2024. This item was presented to the Finance Advisory Committee (FAC) on January 16th and the FAC concurred with staff's recommendation.

Fiscal Impact: Option 1 would result in additional one-time revenue of \$48,792 and an estimated on-going annual revenue of \$10,000; Option 2 would result in additional one-time revenue of \$31,503 and an estimated on-going annual revenue of \$10,000; and Option 3 would result in estimated additional on-going annual revenue of \$10,000.

Report Prepared By: Jim Malberg, Finance Director

Reviewed By: Julia Gautho, City Clerk, Samantha Zutler, City Attorney

Approved By: Jamie Goldstein, City Manager