

---

# OFFICE OF THE CITY AUDITOR

## AUDIT OF THE HOTEL OCCUPANCY TAX COLLECTIONS

**Thomas M. Taylor, CPA  
City Auditor**

**Prepared by:**

Joe R. Saucedo, CPA, CFE  
Audit Manager

Robert W. Reynolds, JD, CPA, CFE  
Audit Supervisor

**September 20, 2002**  
**Report No. 367**

---

## Memorandum



CITY OF DALLAS

September 20, 2002

Honorable Mayor and Members of the City Council  
City of Dallas

We have conducted an audit of hotel occupancy tax collections by selected hotels.

Our audit disclosed some financial and operational matters that warrant management's attention and action. We have identified potential recoveries from individual hotels and motels totaling \$30,137 for occupancy taxes, penalties, and interest owed to the City as of July 31, 2002. These matters are discussed in the *Opportunities for Improvement* section of this report.

We appreciate the cooperation of City staff during our examination.

*Thomas M. Taylor*

Thomas M. Taylor, CPA  
City Auditor

c: Teodoro J. Benavides, City Manager

---

## AUDIT OF THE HOTEL OCCUPANCY TAX COLLECTIONS

---

### CONTENTS

	PAGE
INTRODUCTION	1
Authorization	1
Scope and Methodology	1
Overall Conclusion	1
Background	1
MANAGEMENT'S ACCOMPLISHMENTS	4
OPPORTUNITIES FOR IMPROVEMENT	5

---

## INTRODUCTION

---

### **Authorization**

We conducted this audit of the hotel occupancy tax collections by selected hotels under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by City Council. The Special Collections Group (SCG), a section of the Revenue and Taxation Division of Dallas Water Utilities, administers the City's hotel occupancy tax collection.

### **Scope and Methodology**

Our audit was conducted in accordance with generally accepted government auditing standards and, accordingly, included tests of the accounting and related records and other procedures that we considered necessary in the circumstances. We made inquiries into, and reviews of, the individual hotel/motel occupancy tax returns relative to the tax owed and payments received. In addition, we visited eleven hotel facilities to verify the accuracy of the occupancy tax liability and financial information reported on the reviewed monthly occupancy tax returns.

The objective of our audit was to determine whether the selected hotels/motels properly collected and remitted all occupancy taxes owed to the City in compliance with applicable regulations and guidelines. The principal focus of this audit was to review and test a limited number of tax returns that were filed for the period January 1, 2001, to February 28, 2002.

### **Overall Conclusion**

Our audit disclosed some financial and operational matters that warrant management's attention and action. We have identified potential recoveries from individual hotels and motels totaling \$30,137 for occupancy taxes, penalties, and interest owed to the City as of July 31, 2002.

### **Background**

Since 1969, the City has imposed a tax on rentals of all commercial sleeping rooms except those rentals of less than \$2 a day, rentals to representatives of federal government agencies and certain designated state officials, or for any consecutive rental period of thirty or more days. The ordinances imposing this tax defines "hotel" as any building in which members of the public obtain sleeping accommodations for consideration. The term includes hotels, motels, rooming houses, bed and breakfasts, and similar facilities.

The authority for imposing the tax is derived from Chapter 351 of the Texas Tax Code and Chapter 44 of the Dallas City Code.

## INTRODUCTION

State law requires that revenues derived from the collection of occupancy taxes be used for designated purposes, which include:

- Programs to attract tourists and conventions.
- Expenditures in connection with a convention/visitor center complex.
- Debt service on bonds issued for a convention center.

Prior to August 1998, the City's hotel tax rate was 7% of the room charge. In January 1998, the voters of the City approved the collection of an additional 2% hotel tax to be used for the purpose of financing a portion of the cost of a sports and community venue project. This tax was authorized pursuant to Chapter 334 of the Texas Local Government Code and Article VII to Chapter 44 of the Dallas City Code and became effective on August 1, 1998.

The hotel occupancy tax is not a tax imposed on a hotel. The role of individual hotels is to collect the taxes from guests and remit those taxes to the City each month. Hotels retain a small administration fee (1% of the taxes collected) if the remittance is made in a timely manner.

Dallas Water Utilities has been designated by the City Manager to administer and enforce the collection of these taxes. As noted above, the SCG has the day-to-day responsibility for collecting, accounting for, and administering these taxes.

A five-year summary of the hotel occupancy tax revenues is as follows:

<b>Fiscal Year Ending</b>	<b>Convention Center</b>	<b>Sports Arena</b>	<b>Total*</b>
9-30-97	\$27,533,000	n/a	\$27,533,000
9-30-98	\$31,310,925	\$564,075	\$31,875,000
9-30-99	\$34,473,000	\$9,800,000	\$44,273,000
9-30-00	\$36,707,000	10,365,000	\$47,072,000
9-30-01	\$36,499,000	\$10,427,000	\$46,926,000

\* Amounts are reported in the City's audited Comprehensive Annual Financial Statements as Convention Center/Enterprise Fund Revenue.

## INTRODUCTION

---

The State of Texas assesses a 6% hotel tax and has slightly different definitions of what constitutes a taxable room rental, as well as different criteria under which certain entities are allowed exemptions from the state occupancy tax. State occupancy taxes are paid to and administered by the Comptroller of Public Accounts.

In December 2000, our office issued an audit report titled "Audit of Hotel Occupancy Tax Administration." As a result of this audit, substantial improvements have been made by the SCG in the administration of the City's hotel occupancy tax revenues. This audit identified approximately \$1.5 million of hotel occupancy taxes, penalties, and interest that were owed the City as of December 31, 1999. As of June 2002, approximately \$886,575 of past due balances have been referred to the City Attorney's Office for collection. Our previous audit identified a substantial portion of these delinquent accounts.

## MANAGEMENT'S ACCOMPLISHMENTS

---

The management staff of the SCG was asked to provide comments on procedural and operational changes and improvements. Their unedited comments are included below.

1. *Developed procedures to reasonably ensure identification of all hotels responsible for collecting hotel occupancy tax and ensure that all appropriate actions are taken to collect unremitted taxes. Incorporated the following:*
  - *Review of Internet, Yellow Pages, Building Permit reports, Certificate of Occupancy reports and hotel drive-bys to identify new hotels.*
  - *Database application to select all non-performing hotels and produce an automated letter, sent by certified mail on a monthly basis, notifying the hotel of the necessity of filing reports as well as the consequences of non-filing.*
  - *If non-reporting status is not corrected, the hotel is reported to the City Attorney's Office for legal action.*
2. *Developed a database of all hotels with report capabilities to monitor financial status, corresponding receivables and delinquencies and a listing of non-filers. Includes the following:*
  - *An Aged Occupancy Tax Receivable Report is now prepared monthly for use in collection procedures.*
  - *Contains the history of all hotels, beginning with FY 99-00. Prior to that time, the history is contained in hotel files.*
3. *Revised the hotel filing system to have all information on a single hotel maintained in a single folder.*
4. *Revised procedures to require posting of all hotel tax payments to the new database system, verification of database posting with deposits, and reconciliation of deposits with RESOURCE.*
5. *Revised all forms utilized by Special Collections Group to conform to applicable provisions of the Code.*
6. *Revised Hotel Occupancy Tax procedures to include step-by-step procedures to be followed for delinquent collections and a timeline for each step. Includes:*
  - *Development of procedures for tracking collection activity by the City Attorney's Office*
  - *Development of procedures for uncollectible hotel tax to be written off annually.*
7. *Developed a Hotel Occupancy Tax Report Information Packet, which is distributed to new hotels, to aid hotels in understanding the law and training their employees.*
8. *Participated in a seminar with the Hotel/Motel Association, Dallas Convention and Visitors' Bureau on various aspects of the Hotel Occupancy Tax.*
9. *Conducted a training session for a specific hotel, upon request of the hotel.*
10. *Submitted a request for legislative change, to enact enabling legislation similar to the provisions of the State's tax code, for inclusion in the 2001 legislative package; was not approved by the State Legislature.*
11. *Requested that the City Attorney review all Code provisions pertaining to the hotel occupancy tax to determine if amendments are necessary in order to conform to State law.*
12. *Hired a Hotel/Motel Tax Auditor to perform frequent, regular audits of hotel records to verify the hotel tax remitted to the City.*

## **OPPORTUNITIES FOR IMPROVEMENT**

---

We identified certain policies, practices, and procedures that should be improved. As stated earlier, the primary focus of our audit was to determine whether the selected hotels/motels complied with the City Code for the collection and remittance of the hotel occupancy taxes.

The audit was not intended to be a detailed study of all systems, procedures, and transactions. Accordingly, the opportunities for improvement presented in this report may not be all-inclusive of areas where improvement may be needed.

### **1. Three hotels did not report, or incorrectly reported, taxable revenues and/or occupancy taxes.**

- A. One hotel did not file an occupancy tax return for the first five weeks of its operations.

This hotel opened for business on February 21, 2001, and filed its first tax return for the month of April 2001. The tax collected for the omitted five-week period amounted to \$1,332. Our assessment, which includes penalties and interest through July 31, 2002, amounted to \$1,695.

- B. One hotel understated its gross taxable revenue for November 2001 through February 2002 and did not remit taxes for the months of November and December 2001 and January 2002.

Our review of hotel records revealed that for the four-month period ended February 2002, the revenues and applicable taxes were understated on the tax returns submitted to the City and state. No taxes were remitted to the City for three of the four months.

The taxes, penalties, and interest due to the City for the four-month period amount to \$24,492 as of July 31, 2002. Additionally, the SCG has billed the hotel for late fees of \$1,023 for its late submission of the October 2001 payment. These late fees have not been paid. Total assessments for this four-month period are \$25,515.

This hotel has a history of delinquency. Our previous audit identified \$96,059 in delinquent taxes, penalties, and interest as of December 31, 1999. At that time, the hotel was operating under a different name and with different management (but the same owner). This previous audit assessment (\$111,787 as of June 2002) has not been paid and has been referred to the City Attorney's Office for collection.

- C. One motel did not remit all occupancy taxes collected and has not paid penalties applicable to the late filing of tax returns.

The SCG previously identified and billed the motel for penalties related to the late filing of the tax returns for October 2001 through January 2002. Late fees (\$1,546) have not been remitted to the City. In addition, our audit of the motel's records indicates that for

## **OPPORTUNITIES FOR IMPROVEMENT**

---

the four-month period ended February 2002, the City occupancy taxes collected from guests were greater than the amounts remitted to the City. As of July 31, 2002, the balance due (including penalties and interest) for those four months amounts to \$1,381. Our total assessment for this motel is \$2,927.

**We recommend** that the Director of Dallas Water Utilities refer these delinquent accounts to the City Attorney for collection.

### **Management's Response:**

Management concurs. The memos, referring the three delinquent accounts, are in the process of being drafted and will be completed by September 6, 2002.

### **2. Exemptions for hotel occupancy tax cause confusion.**

We found that hotel managers were unclear on the application of the City Code and the Texas Tax Code relating to the tax-exempt status of certain hotel guests. There is confusion on this issue due to several factors, including:

- The state allows an occupancy tax exemption for individuals and groups representing educational, religious, and charitable organizations. The City does not grant an exemption for guests representing these organizations.
- Only federal employees with proper credentials are exempted from both the City and state tax.
- Most state employees are not exempt from the City or state tax. Only members of the legislature, legislative employees, members of the judiciary, and certain executive employees of state agencies are granted this tax exemption. Eligible state employees must present a tax-exempt identification card indicating that they are exempt from the hotel occupancy tax.
- If guests are seeking a tax exemption based on continuous occupancy of thirty days, they are required to declare this intention at the beginning of their stay.

Our audit revealed instances where hotels did not properly apply the tax exempt qualifications.

The exceptions were not material to warrant assessments, but were discussed with management to demonstrate the need for training of hotel staff. The following examples are typical of the errors we noted.

## OPPORTUNITIES FOR IMPROVEMENT

---

- Exemptions from the City occupancy tax were erroneously claimed for guests affiliated with religious, charitable, and educational organizations. Hotels did not make the distinction between state law and the City Code. Guests that were improperly granted City tax exemptions included a deputy sheriff, employees of both in-state and out-of-state colleges, church groups, and state agencies.
- Exemptions were claimed for extended-stay guests that did not sign a form indicating their intention to stay for period of thirty days or more. Some facilities that promote weekly rentals, routinely interpret the thirty-day requirement to be satisfied with 28 days of continuous occupancy. At least one facility reported all revenue for the first 28 days as taxable, even though the entire stay by the guest exceeded 30 days.

Educational materials are essential to inform individual hotels about all aspects of the occupancy tax. Hotel management, especially front desk personnel, is subject to frequent staff turnover. Each individual is not necessarily trained on, or familiar with, all provisions of the City's hotel occupancy tax ordinance. At present, hotels receive most of their information on the hotel tax from the Texas Comptroller of Public Accounts.

**We recommend** that the Director of Dallas Water Utilities develop an ongoing educational program for hotel management for the administration of the hotel occupancy tax. Materials that are sufficiently comprehensive and easily understandable should be provided to the hotels as needed. The materials should include information that is suitable for distribution to hotel guests. An "official" information sheet, published in the name of the City, could assist hotel staff in answering guests' questions relating to occupancy tax exemptions. The Director should also provide the hotel tax information on the City's website.

### **Management's Response:**

As the SCG becomes aware of new hotels or changes in hotel ownership, it sends an information packet to the establishment. Although this information refers to the exemption provisions in Chapter 156 of the Texas Tax Code, it does not specifically list categories of hotel guests that are exempt from local hotel occupancy taxes. During routine audits conducted by the City's Hotel/Motel Tax Auditor, additional information is informally provided to each hotel if the hotel is unclear about eligible local tax exemptions. A similar "official" information sheet is being drafted and will be printed for distribution to all hotels in the city of Dallas. In addition, the Texas Hotel and Motel Association provides its members with exemption information. The SCG will work with the Dallas Convention Center to provide the hotel tax information on its website.

## **OPPORTUNITIES FOR IMPROVEMENT**

---

### **3. The SCG should expand its policies to improve administration of the hotel occupancy tax.**

The SCG has significantly improved its overall communications with hotels regarding the City's hotel occupancy tax. Each month, a hotel-specific tax form is mailed to the hotel for completion. Additional occupancy tax information is provided to new hotels and to those hotels that have a change in ownership.

The City Code provides that "the director [the appropriate City departmental director] shall have the power to make any rules and regulations necessary to effectively collect the tax. The director shall, upon giving reasonable notice, have access to all books and records necessary to enable the director to determine the correctness of any report filed as required by this article and the amount of taxes due under this article."

This requirement and other administrative rules and regulations contemplated by the Code have not been formalized and communicated to the hotels responsible for collecting the occupancy tax. Examples of requirements that should be formalized are:

- All records should be available for inspection at the local hotel office.
- Returns should be submitted monthly on a form prescribed by the City and should be signed by a person who attests to the correctness of the information reported.
- All data should be reported on the return, including gross revenue, exemptions, and taxable revenue.

The City does not have a formal process to estimate revenues and applicable taxes if a hotel has not submitted the monthly tax return. Therefore, the City does not determine amounts owed in a consistent manner.

**We recommend** that the Director of Dallas Water Utilities develop formal administrative policies for the hotel occupancy tax. Such policies should include a requirement that hotel records be available in the City and include guidelines for the estimation of taxes when hotels do not submit monthly tax returns. These administrative policies should be communicated to all hotels.

### **Management's Response:**

Dallas Water Utilities will take this recommendation under review.

## **OPPORTUNITIES FOR IMPROVEMENT**

---

### **Auditor's Comment:**

Management has stated that it intends to review the Auditor's recommendations for the areas identified above. We encourage management to go past reviewing these recommendations and take the steps required to achieve the intended objectives shown in the Auditor's recommendations.

#### **4. The City should enforce ordinances to improve collections of delinquent hotel occupancy taxes.**

Administrative Directive 4-10 establishes the policy and procedures for handling delinquent and uncollectible accounts receivable. This directive provides that all practical efforts should be made to collect delinquent accounts. It also specifies the responsibilities and required procedural efforts relative to the management of accounts receivable. Additionally, the hotel occupancy tax ordinances contain provisions to apply to hotels that do not file, or do not file in a timely manner, monthly occupancy tax returns and/or remit the taxes owed.

The hotel occupancy tax ordinances provide for:

- A penalty of 15% of the tax due for remittances made after the 25th of the month following the month of collection.
- Interest to be imposed at the rate of 10% commencing on the 30th day after the due date of the return.
- A criminal penalty for failure to collect the tax; failure to file a report; failure to pay the tax when due; or the filing of a false report. The penalty consists of a fine not to exceed \$500 per occurrence.
- The Texas Tax Code (Section 351) authorizes the City to seek a court order to enjoin a person who has failed to file a return or pay the tax from operating a hotel in the municipality until the tax is paid or the report filed.

Generally, the SCG has been diligent in tracking the payment dates for tax remittances and assessing delinquent hotels the appropriate amounts of penalties and interest. A list detailing past due taxes, penalties, and interest is prepared each month and sent to the City Attorney's Office. However, SCG has not received an updated status on these collections from the City Attorney's Office; thus, collections have not had the proper visibility.

We noted that three hotels owed the City late fee penalties for one or more months. One of these hotels, which was the subject of a prior audit, had not paid the previous assessment of \$32,648. Several other hotel properties that received assessments from our previous audit

## OPPORTUNITIES FOR IMPROVEMENT

---

have not remitted delinquent taxes, penalties, and interest to the City.

The SCG routinely refers hotels with past due balances to the City Attorney's Office for collection. However, the City has not attempted to assess the criminal penalties or to seek injunctive relief against these hotels. The criminal penalties and injunctive relief are available through the courts and must be initiated by the City Attorney's Office. We were unable to find a single instance where the City has taken any of these actions against a hotel that did not comply with the hotel occupancy tax provisions of the City Code.

Section 113.001 of the Texas Tax Code provides that all taxes, fines, interest, and penalties due by a person to the state are secured by a lien, which is subject to execution, on all of the person's property. The Comptroller of Public Accounts files these liens approximately 45 days after deficiency determination has been issued if the delinquent tax liability is \$100 or more.

When the lien is filed, the taxpayer's title to the property is clouded and cannot be cleared until the lien is satisfied.

The state has an additional law that enhances the Comptroller's ability to collect all types of taxes, including the hotel occupancy tax. This law, Section 111.016 of the Texas Tax Code, provides that any person who receives or collects a tax from another person, *holds the amount so collected in trust for the benefit of the state*, and is liable to the state for the full amount collected plus any accrued penalties and interest on the amount collected. This law provides that the personal liability created with respect to the tax collected extends to individuals responsible for the control or supervision of the collection, accounting, and remittance of the taxes so collected and held in trust. Responsible individuals are defined to be partners, officers, managers, directors, and employees who are under a duty to perform an act with respect to the collection, accounting, or payment of taxes owed to the state. The dissolution of a corporation, association, limited liability company, or partnership does not affect a responsible individual's liability under this law.

Existing hotels and motels frequently have the need to obtain building permits and Certificates of Occupancy from the City for repair and remodeling projects. These permits are obtained from the Building Inspection Division and are not coordinated with the SCG. Hotel owners who anticipate City departments will coordinate the collection of tax revenues with the issuance of permits are more likely to report and remit tax payments in a timely manner.

Failure to pay the hotel taxes owed deprives the City of revenues.

**We recommend** that the Director of Dallas Water Utilities:

- Refer all delinquent accounts to the City Attorney for legal action.

## **OPPORTUNITIES FOR IMPROVEMENT**

---

- Request from the City Attorney's Office periodic updates on the collections/litigation status on the delinquencies referred by the SCG.
- Request an opinion from the City Attorney to determine whether it is feasible for the City to adopt an ordinance that contains provisions similar to Section 111.016 of the Texas Tax Code. Such an ordinance would provide that all occupancy taxes collected on behalf of the City are held in trust until remitted to the City. The individuals responsible for the collection and payment of all taxes owed to the City would then be held personally liable in the event of non-payment. Addition of this provision would likely require enabling statutes be enacted by the state legislature. Such enabling statutes should be pursued.

An ordinance of this type would encourage the prompt monthly payment of hotel occupancy taxes. This ordinance could also be used to enforce remittance of other taxes collected on behalf of the City, such as the motor vehicle rental tax and certain telephone franchise fees.

- Explore other options, such as the withholding of a Certificate of Occupancy by the Building Inspection Division, to ensure collection of delinquent hotel taxes.

### **Management's Response:**

- All delinquencies in excess of \$1,000 are already routinely referred to the City Attorney's Office, in accordance with the Collection Procedures for Hotel Occupancy Taxes prepared by the City Attorney's Office.
- On a monthly basis, the SCG already routinely requests status updates from the City Attorney's Office. No response has ever been received from the City Attorney's Office.
- Prior to requesting that the City Attorney's Office prepare an ordinance change, it is necessary for the State Legislature to enact enabling legislation similar to the provisions of the Texas Tax Code, covering the collection of State Hotel Occupancy Tax. The Texas Tax Code governs what cities can do regarding local taxation. This legislative change was requested in the 2001 legislative package but was not approved by the State Legislature. The legislation will again be included in the 2003 legislative package.
- Dallas Water Utilities will take this recommendation under review.

### **Auditor's Comment:**

If status updates from the City Attorney's Office are not received in a timely manner, the City Attorney should be notified.