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# OFFICE OF THE CITY AUDITOR

## AUDIT OF THE SHORT TERM MOTOR VEHICLE RENTAL TAX COLLECTIONS

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**September 20, 2002**  
**Report No. 366**

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## Memorandum



CITY OF DALLAS

September 20, 2002

Honorable Mayor and Members of the City Council  
City of Dallas

We have conducted an audit of the Short Term Motor Vehicle Rental Tax collections for the period January 2001 through February 2002.

In our opinion, rental car companies (with one exception) complied with the City Code provisions for the motor vehicle rental tax. However, we did note administrative matters that need management's attention. We also identified potential recoveries of \$352,363 in motor vehicle rental taxes, penalties, and interest owed by one rental car company as of June 30, 2002. These matters are discussed in the *Opportunities for Improvement* section of this report.

We also noted a minor administrative item, which we have reported to the director in a separate letter dated August 27, 2002.

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

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## AUDIT OF THE SHORT TERM MOTOR VEHICLE RENTAL TAX COLLECTIONS

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## INTRODUCTION

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### Authorization

We audited the Short Term Motor Vehicle Rental Tax (MVRT) collections for the period January 2001 through February 2002. This audit was conducted 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. In addition, City Code, Section 44-46 authorizes City access to the rental companies' books and records as necessary for determining the correctness of reports filed with the City.

### 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.

The objectives of this audit were to determine whether:

- Vehicle rental companies have complied with the City Code for collecting, reporting, and remitting motor vehicle rental taxes to the City.
- The City's Special Collections Group (SCG) has appropriate procedures in place to effectively administer this tax program.

In order to develop an understanding of relevant controls, policies, and procedures and to meet our audit objectives, we:

- Reviewed applicable sections of the City Code and the SCG policies and procedures for administration of this program.
- Interviewed SCG management and staff regarding accounting controls and administrative activities.
- Reviewed the enrollment process utilized by the SCG to initiate the monthly reporting by vehicle rental companies.
- Selected a sample of vehicle rental companies and performed audits of their books and records that had been used in preparing the monthly reports for the MVRT.
- Conducted site visits to various Dallas vehicle rental companies to review and verify taxable revenues.

## INTRODUCTION

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We selected a judgmental sample of twelve auto rental agencies from the SCG master list of seventy-four agencies. The sample selection was based on whether the entity was a/an:

- New car dealership
- National brand leasing company
- Locally owned company
- Entity having exceptions (mistakes, paying late, etc.)

For the selected agencies, we analyzed and tested various tax returns and the related data maintained by the SCG. We examined records maintained by local offices and requested that corporate offices send us appropriate records and reports if not available locally. We noted that reporting companies utilized different methods and procedures for reporting their tax collections.

### Overall Conclusion

Rental car companies (with one exception) complied with the City Code provisions for the motor vehicle rental tax. However, we did note administrative matters that need management's attention. These matters are discussed in the *Opportunities for Improvement* section of this report. We also noted a minor administrative item, which we have reported to the director in a separate letter dated August 27, 2002.

### Background

In January 1998, the voters of the City of Dallas approved the collection of a tax, not to exceed 5%, based on the gross rental receipts from short-term motor vehicle rentals within the City. This tax was to be used for the purpose of financing a portion of a Dallas sports arena project. This tax was authorized pursuant to Chapter 334 of the Texas Local Government Code.

City Ordinance No. 23456 provides for the imposition of this tax and states that the tax rate will not exceed 5% of the gross rental receipts from the rental of a motor vehicle. The effective date of the tax was May 1, 1998. The tax is to continue for as long as any sports arena bonds obligations are outstanding. The SCG is responsible for the administration of the MVRT.

## INTRODUCTION

The MVRT is not a tax imposed on the vehicle rental company. Individuals and businesses that rent motor vehicles pay the tax. The rental company is responsible for the collection and remittance of the taxes to the City each month.

The State of Texas also assesses a vehicle rental tax of 10%. The state tax program has some differences in defining what constitutes a short-term motor vehicle rental. Generally, the base revenue amounts reported to the state approximate the revenues that are reported to the City. The State Comptroller of Public Accounts administers the state tax.

Certain qualifying individuals and entities are exempt from the MVRT. Also, the rental car companies may deduct an administration fee (1% of the taxes collected) if they remit taxes to the City in a timely manner. If the taxes are not remitted in a timely manner, the car rental company is assessed penalties and interest.

A four-year summary of the MVRT revenues is shown in the following table.

Fiscal Year Ending	Amount **	Cumulative Total
9-30-98 *	\$1,289,000	\$1,289,000
9-30-99	3,897,000	5,186,000
9-30-00	4,290,000	9,476,000
9-30-01	4,680,000	14,156,000

\* Partial year

\*\* Amounts are reported in the City's audited Comprehensive Annual Financial Statements - Motor Vehicle Rental Tax

## **MANAGEMENT'S ACCOMPLISHMENTS**

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In anticipation of this report, 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 rental agencies responsible for collecting Short Term Motor Vehicle Tax and ensure that all appropriate actions are taken to collect un-remitted taxes. Incorporated the following:*
  - a) *Review of Internet and Yellow Pages.*
  - b) *Database application to select all non-reporting rental agencies and produce an automated letter, sent by certified mail on a monthly basis, notifying the rental agency of the necessity of filing reports as well as the consequences of non-filing.*
  - c) *If non-reporting status is not corrected, the rental agency is reported to the City Attorney's Office for legal action.*
  
- 2) *Eliminated the need to use several programs by developing a database of all rental agencies with report capabilities to monitor financial status, corresponding receivables and delinquencies, and a listing of non-filers. Includes the following:*
  - a) *An Aged Rental Agency Tax Receivable Report is now prepared monthly for use in collection procedures.*
  - b) *A Rental Report containing the history of all rental agencies, beginning with FY00-01.*
  - c) *The ability to add prior fiscal year filing months for uncollected taxes for billing and reporting purpose.*
  
- 3) *Revised procedures to systematically verify posting of payments, deposits, and reconciliation of deposits with RESOURCE.*
  
- 4) *Revised all forms utilized by Special Collections Group to conform to applicable provisions of the Code.*
  
- 5) *Revised Short Term Motor Vehicle Tax procedures to include step-by-step procedures to be followed for delinquent collections and a timeline for each step. Includes:*
  - a) *Development of procedures for tracking collection activity by the City Attorney's Office.*
  - b) *Development of procedures for uncollected rental agency tax to be written off annually.*
  
- 6) *Developed a Short Term Motor Vehicle Tax Information Packet, which is distributed to new rental agencies, to aid companies in understanding the law and training their employees.*

## OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, practices, and procedures that should be improved. 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. One auto rental company has not paid taxes since November 2000.

As of June 30, 2002, one auto rental company (currently located on Mockingbird Lane near Dallas Love Field) has not reported or paid taxes to the City since November 2000. The company has not responded to the City Auditor's Office request to make its books and records available for audit. We observed that the company is currently operating its vehicle rental business.

We have computed an estimate of \$352,363 due in taxes, penalties, and interest, as of the end of June 2002.

	1998	1999	2000	2001	2002	Total
<i>Live Oak</i>	13,489	35,606	25,452	2,658		77,205
<i>Mockingbird</i>	31,112	80,114	62,454	69,280	32,198	275,158
<i>Total</i>	\$ 44,601	\$ 115,720	\$ 87,906	\$ 71,938	\$ 32,198	\$ 352,363

Estimates were used for calculations of unreported monthly revenues based on prior data that the State Comptroller's Office had used to compute revenue estimates for this company. Thus, our calculations were based on this data and on SCG records of reports and payments. Computations for penalties and interest are based on the Dallas City Code for the MVRT. Since we have not been able to audit the books and records of this company, no exemptions were allowed. We noted that the state also excluded exemption amounts from its calculated estimates.

This company has a history of delinquency. Past agreements have included one payment arrangement, which the company suspended after only seven payments. This arrangement was followed by a City Attorney's Office action, which obtained certain court-approved sanctions against the company. The company defaulted on its obligations under this court order. The City Attorney's Office has recently agreed to initiate a civil suit against this company.

Contributing causes for the continued delinquency and build up of this account include:

- Lack of visible, consistent reporting and communication of case status.
- Reassignment of case responsibilities within the City Attorney's Office.
- Changes in the receivable accounting system utilized by the SCG, so that this account's past activity was not being updated and reported in the new system.

## OPPORTUNITIES FOR IMPROVEMENT

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- Changes in the reporting structure of the SCG from the City Controller's Office to Dallas Water Utilities.
- Lack of written procedures for computing estimates of unreported revenues.

Collection of delinquent accounts is time sensitive. Tax collecting entities that refuse to remit taxes collected, without adverse consequences, are likely to ignore future collection efforts.

Further, taxpayers under the MVRT program may not remit the taxes collected if City departments do not actively and persistently endeavor to collect payments due. To be effective, the status of delinquent taxpayers should be routinely and frequently reported to appropriate officials, and management follow-up should be consistent and timely.

The Dallas Motor Vehicle Rental Ordinance calls for certain penalties and interest to be assessed and collected for late payment of taxes by car rental agencies. The ordinance also provides for criminal penalties, which are set out in the City Code, as shown below:

Section 44-47, PENALTIES, states that:

*(a) an owner of a motor vehicle commits an offense if that person:*

- (1) fails to collect the tax imposed by this article;*
- (2) fails to file a report as required by this article;*
- (3) fails to pay the director the tax when payment is due;*
- (4) files a false report*
- (5) fails to make and retain complete records as required by Section 44-43(d) of this article; or*
- (6) fails to comply with Section 44-44(a) when purchasing a motor vehicle rental business*

*(b) An offense under Subsection (a) of this section is punishable by a fine not to exceed \$500, except that an offense under Subsection (a)(5) of this section is punishable by a fine of not less than \$25 or more than \$500.*

*(c) In addition to any criminal penalties imposed under Subsection (b) of this section,*

- (1) Failing to pay the tax to the director by the 25<sup>th</sup> day of the month following the month in which the tax is required by this article to be collected shall pay an additional amount equal to 10 percent of the tax due as a penalty.*
- (2) An additional penalty equal to 10 percent of the tax due must be paid 30 days later if the tax is still not paid.*
- (3) Delinquent taxes draw interest at the rate of 10 percent per year beginning 60 days after the date the tax is due to the director.*

It appears that the mere assessment of penalties and interest may not be sufficient motivation for a company that has a history of delinquency.

The State of Texas has a law that enhances the ability of the State Comptroller of Public Accounts to collect all types of taxes, including the motor vehicle rental 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

## OPPORTUNITIES FOR IMPROVEMENT

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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 collection, accounting, and remittance of the taxes collected and held in trust.

State law defines responsible individuals as 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.

A City ordinance similar to the state law described above would provide that all local taxes, including the motor vehicle rental taxes and hotel 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. An ordinance of this type would encourage the prompt monthly payment of the motor vehicle rental taxes. Addition of this provision would likely require that enabling statutes be enacted by the state legislature.

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

- Request periodic updates from the City Attorney's Office on the collection/litigation status on the delinquencies referred to the City Attorney's Office by the SCG.
- Require that written policies and procedures be developed to estimate the amount of taxes due from the motor vehicle rental agencies that do not file the monthly reports with the City. By having established procedures for estimating the amount of revenues and taxes due, collection efforts can begin immediately, using data on hand. These procedures should be communicated to all rental car companies.
- Require that written policies and procedures adequately address the accounting and tracking of delinquent accounts.

**We further recommend** that the Director of Dallas Water Utilities obtain an opinion from the City Attorney concerning whether or not it is feasible to encourage the City to adopt an ordinance that contains provisions similar to Section 111.016 of the Texas Tax Code.

### Management's Response:

- 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.
- The Dallas Water Department will take this recommendation under review.
- The Dallas Water Department will take this recommendation under review.

## OPPORTUNITIES FOR IMPROVEMENT

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Management concurs. A request for a City Attorney's opinion will be requested by September 13.

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

Management has stated that they intend 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.

### **2. The descriptive information on the MVRT monthly report form is not consistent with the terms and definitions contained in the City Code.**

The City's preprinted MVRT Special Collection form requests reported amounts for:

1. *Total Rental Receipts for Location*
2. *Exemptions*

These terms are unclear to the reporting companies because the form does not accurately convey the City Code's definitions for the terms *Gross Revenues* and *Exemptions* (see definitions below).

We found that some companies are reporting all revenues from all sources as *Total Rental Receipts for Location* on the City tax form. These companies are then combining non-taxable revenue items and exemptions in one amount and reporting this amount as *Exemptions*. Other companies do not report non-taxable revenues and do not provide information on exemptions claimed. Because of these variances, it is likely that reporting errors would not be readily detected by the SCG staff and could preclude reliable trend analysis of the tax returns.

The City Code (Chapter 44, Article VI, Section 44-40) contains the following definition:

*GROSS RENTAL RECEIPTS means the value promised or received as consideration to the owner of a motor vehicle for the rental of the vehicle, but does not include:*

- (A) *separately stated charges for insurance;*
- (B) *charges for damages to the motor vehicle occurring during the rental agreement period;*
- (C) *separately stated charges for motor fuel sold by the owner of the motor vehicle; or*
- (D) *discounts.*

The City Code provides for the same exemptions as provided in Chapter 152, Subchapter E of the Texas Tax Code. The exemptions in the Tax Code include such items as:

- (1) *Lease of Motor Vehicle by Public Agency*
- (2) *Rental of Motor Vehicle for Purposes of Re-Rental*
- (3) *Driver Training Motor Vehicles*
- (4) *And Others*

## OPPORTUNITIES FOR IMPROVEMENT

These terms from the City Code and Tax Code were incorporated into the first two lines on the City’s tax form (*Total Rental Receipts for Location and Exemptions*). The terminology is brief and does not clearly convey the reporting requirements as described in the Codes. Therefore, rental car companies can interpret the terms differently, affecting the way in which taxable revenue and exemptions are reported. The following table illustrates how unclear definitions can affect reported revenue and exemptions.

Rental Car Company	Exemptions Claimed	Reporting Methodology
#1	\$30,683.00	Reported nontaxable revenues within the exemption category, rather than exemptions only.
#2	\$31.74	Reported exemptions only.

Further, reporting agencies have multiple locations in various cities and states, where they are expected to comply with many differing tax regulations. Consequently, many of the companies rely on common industry practices in the delineation of “revenue” terminology and the reporting of taxable revenue. Some companies simply keep track of the tax collected and “gross up” the revenue to be reported on the tax return.

**We recommend** that the Director of Dallas Water Utilities revise the MVRT form to agree with the terms and definitions of the City Code, and clearly communicate to tax collecting entities which revenues are subject to tax, which revenues are exempt, and how each item is to be reported. We also recommend that the SCG use the City’s website to provide information for the MVRT program as well as provide instructions for the reporting form.

### Management’s Response:

Management concurs. Currently, the ordinance is merely cited on the MVRT monthly report form due to space limitations on the form. The MVRT monthly report form will be revised to be consistent with the terms and conditions contained in the City Code.

The SCG will work with the City’s webmaster to determine if reporting information and instructions on the MVRT program can be included on the City’s website.

### 3. The City should consider utilizing the State Comptroller’s Office to collect the MVRT.

From the inception of the MVRT in May 1998, the SCG has been responsible for collecting the MVRT. While this activity does not require a full-time employee, substantial effort is required each month to mail tax forms to the auto rental companies and to process the tax payments.

## **OPPORTUNITIES FOR IMPROVEMENT**

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As noted earlier, a similar tax at the rate of 10% is assessed by the State of Texas. The State Comptroller of Public Accounts (Comptroller) collects this tax. During the past several years, other local jurisdictions have implemented an MVRT. These jurisdictions include the Houston Sports Authority and the City of Euless. The Houston Sports Authority and the City of Euless have entered into an interlocal cooperation contract for the collection of their MVRT. The Comptroller's responsibilities, with regard to the administration of the tax, are defined by those contracts. In a manner similar to sales tax collections, the MVRT collections are remitted monthly to the cities.

Since the SCG is collecting this tax, the City is spending local funds for a service that could be performed by the state. Although the Comptroller could charge for this service, it has not. By getting the state to perform these collection functions, the City could save staff time and the costs associated with mailing out forms; handling individual taxpayer payments; and doing related record keeping. Duties that would remain with the City, if the initial reporting and collection functions were transferred to the state, include some collection procedures and various record keeping functions.

A request to the Comptroller to perform this service must be initiated by the local jurisdiction.

**We recommend** that the Director of Dallas Water Utilities confer with the City Attorney regarding whether there are any legal impediments in the transferring of MVRT collection responsibilities from the SCG to the Comptroller. If no impediments are found, the City Manager or Mayor should be asked to contact the Comptroller to discuss an interlocal cooperation contract for the collection of this tax. If an agreement is achieved, the City should retain its right to audit.

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

Dallas Water Utilities will take this recommendation under review.

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

Management has stated that they intend 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.