CITY OF RIVERSIDE

City of Arts & Innovation

Finance Committee

TO: FINANCE COMMITTEE **DATE:** MARCH 13, 2024

FROM: FINANCE DEPARTMENT **WARDS:** ALL

SUBJECT: TRANSIENT OCCUPANCY TAX AUDIT – COMPED ROOM PENALTIES AND INTEREST REVIEW

ISSUE:

Receive a report on penalties and interest paid by recently audited hotels in relation to Transient Occupancy Tax on complimentary rooms.

RECOMMENDATION:

That the Finance Committee:

1. Receive a report on penalties and interest paid by recently audited hotels in relation to Transient Occupancy Tax on complimentary rooms; and

2. Direct staff as to any action to be taken in relation to penalties and interest collected to date or identified as due and payable.

LEGISLATIVE HISTORY:

Chapter 5.32 of the Riverside Municipal Code (RMC) governs the City's application of transient occupancy tax revenue, stating that:

"*For the privilege of occupancy in any hotel, each transient is subject to and shall pay a tax…*".

Section 5.32.010 – Definitions, which states:

- *Occupancy means the use or possession, or the right or entitlement to the use or possession, of any room or rooms or portion thereof, in any hotel for dwelling, lodging or sleeping purposes.*
- *Rent means the amount of the consideration charged or chargeable to the tenant or person entitled to occupancy, for the occupancy of space, valued in money whether received in money, labor or otherwise, including the full value of receipts, cash, credits, property or services of any kind or nature, without any deduction whatsoever.*

BACKGROUND:

At the request of the City of Riverside, HdL Companies executed a comprehensive Transient Occupancy Tax (TOT) audit encompassing ten (10) hotels for the assessment period spanning January 2019 through December 2021, successfully concluded in August 2022. Additionally, HdL conducted an audit for an additional ten (10) hotels covering the period from January 2020 to July 2023, with completion achieved in November 2023. These audits were conducted remotely, with subsequent follow-up via telephone calls, emails, and information exchanges in the ensuing months. The audits of the remaining hotels are scheduled to commence in 2024.

Utilizing the data supplied by both the City and lodging providers, HdL meticulously analyzed each hotel's monthly TOT returns submitted during the audit period. The analysis included rigorous assessments of accuracy, incorporating reasonableness tests and trend analyses based on historical data and prevailing market trends within the City. The analysis and trend assessments were further augmented by a detailed examination of sample periods within each filing year.

In the course of conducting TOT audits for the twenty hotels examined thus far, HdL identified discrepancies in the reporting of complimentary rooms for seven (7) of the twenty (20) audited hotels. These discrepancies arose from comped rooms found in the Daily Revenue Report that were not assigned a monetary value. As a result, TOT was not assessed for those rooms by the hotelier. To address this deficiency, the auditor used the Average Daily Rate (ADR) for each year to compute the TOT due.

On January 10, 2024, the Marriott Riverside at the Convention Center initiated an administrative appeal regarding the taxability of complimentary rooms. The Financial Performance and Budget Committee (Committee) subsequently voted in favor of the City of Riverside, affirming the taxability of complimentary rooms as per the Riverside Municipal Code (RMC). Additionally, the Committee requested the Business Tax Division present a report, at a later date, on the compliance or non-compliance of all audited hotels in relation to the collection of TOT on comped rooms.

DISCUSSION:

Establishments routinely extend complimentary accommodations to customers, employees, contractors, or referred to as "guests," without a corresponding monetary valuation. These complimentary rooms, commonly known as "comped rooms," are typically documented in the operator's financial reports, such as the Profit and Loss (P&L) or Monthly Operating Report (MOR). Despite the absence of a specific assigned value, it is imperative to recognize that comped rooms involve a transfer of value from the operator to the beneficiary, i.e., the guest. In this context, HdL referred to the City of Riverside's Transient Occupancy Tax (TOT) ordinance (5.32.010 – Definitions) for comprehensive guidance.

According to the ordinance, "Occupancy" is defined as the utilization or entitlement to utilize hotel rooms for dwelling, lodging, or sleeping purposes, while "Rent" refers to the consideration charged or chargeable to the tenant entitled to occupancy, whether received in monetary form, labor, or otherwise.

The rationale behind providing comped rooms is multifaceted, primarily intended to secure benefits for the operator. These complimentary accommodations serve to maintain guest loyalty, function as barter for additional services rendered to the operator or contribute to employee retention. While these considerations provide enrichment in a non-monetary form, they are valued in monetary terms, falling under the definition of rent. Both HdL and the City of Riverside asserted that comped rooms constitute taxable rent under the Riverside Municipal Code (RMC). In its ruling in the Marriott appeal, the Committee agreed with this interpretation but also stated that the ordinance could be made clearer regarding the taxability of comped rooms. The City and HdL further assert that the value of comped rooms is attributable to the aforementioned purposes: guest loyalty, barter, or employee retention. Although these purposes may carry distinct values, HdL observed a lack of assigned values in the operator's records. Therefore, for the sake of consistency, HdL utilized the Average Daily Rate (ADR) for each year, where available, or for the audit period, as these values are determined by the operator.

Audit Findings

RMC Section 5.32.090 Delinquency established penalties and interest on unpaid TOT:

*Any operator who fails to remit any tax to the City or any amount of tax required to be collected and remitted to the City, including amounts based on determination made by the Tax Administrator under Section 5.32.110, within the time required, shall pay penalties of **ten percent** of the tax in addition to the tax amount due the first day on which the tax required to be collected becomes delinquent, **25 percent** in addition to the tax amount due shall be imposed on the thirtieth day of delinquency, and **50 percent** in addition to the tax amount due shall be imposed on the sixtieth day of delinquency. In addition, interest of one percent per month, or fraction thereof, shall be imposed from the date on which the tax required to be collected becomes delinquent until the day of payment.*

At the January 10, 2024, Committee meeting, the councilmembers contemplated the clarity of the RMC in relation to the taxability of comped rooms, the degree of hotels' compliance in collecting TOT on comped rooms, and whether penalties and/or interest should be waived. The Committee requested that staff return with more information to facilitate discussion on this topic.

HdL identified discrepancies in the reporting of complimentary rooms for seven (7) of the twenty (20) audited hotels. Of the seven (7) hotels, to date;

- 1 hotel has paid the TOT due as well as the related penalties and interest assessed.
- 6 hotels have been notified of the amount due but have not yet remitted payment.

COMPED ROOMS NOT REPORTED	TAXABLE AMOUNT	PENALTIES	INTEREST	GRAND TOTAL P&I
PAID	$1,565.88	$782.94	$475.49	$1,258.43
UNPAID	$31,649.05	$15,824.52	$8,056.88	$23,881.40
TOTAL	$33,214.93	$16,607.46	$8,532.37	$25,139.83

If the Committee directs a waiver of penalties and/or interest, staff would refund amounts paid to date and send a letter to all hotels clarifying the taxability of comped rooms. Enforcement would begin on March 1, 2024, allowing non-compliant hotels time to receive the notice and start taxing the comped rooms. If waiver is not directed, staff would promptly send a letter to all City hotels to clarify the taxability of the comped rooms so that they may ensure compliance and avoid penalties and interest going forward. Staff is in the process of developing recommendations to update RMC 5.32 to provide clearer language on the taxability of comped rooms.

STRATEGIC PLAN ALIGNMENT:

The topics included in the report support Strategic Priority 5 – High Performing Government and Goal 5.3: to Enhance communication and collaboration with community members to improve transparency, build public trust, and encourage shared decision-making.

1. **Community Trust** – Community trust within the business community is enhanced by transparent practices in assessing and collecting TOT fees. This transparency, coupled with the consideration of the fairness of penalties and interest for comped rooms, contributes to a positive relationship between the City and businesses, promoting mutual understanding, cooperation, and a fair application of tax regulations

2. **Equity** – This report and meeting discussion underscores Riverside's commitment to diversity and equitable treatment by addressing potential disparities in the taxation of comped rooms and ensures fairness and equitable treatment to all hotels/motels.

3. **Fiscal Responsibility** – Riverside's commitment to fiscal responsibility and prudent stewardship of public funds is demonstrated by conducting thorough TOT audits to identify discrepancies and bring businesses into compliance going forward.

4. **Innovation** – The City contracts HdL, which employs the most current resources, technologies, and strategies to ensure compliance with the City’s TOT ordinance. By proactively identifying and addressing discrepancies in the taxation of comped rooms, the City demonstrates adaptability and forward-thinking.

5. **Sustainability & Resiliency** – Through the review and implementation of best practices, particularly in addressing comped room taxation, the City demonstrates a proactive stance in ensuring businesses' compliance. This dedication to best practices not only meets current needs but also strengthens the City's resilience to face future challenges, emphasizing a balanced approach that ensures businesses thrive within legal parameters while safeguarding the community's interests.

FISCAL IMPACT:

The fiscal impact is contingent upon the Committee’s direction to staff. The maximum fiscal impact known to date is $25,140, representing penalties and interest assessed for non-compliant hotels regarding comped rooms. Future audits may reveal additional non-compliance, and a decision to waive penalties or interest would mean foregoing this additional revenue collected by the General Fund.

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