



GARLAND

INTERNAL AUDIT

Hotel/Motel Occupancy Tax Audit

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Table of Contents

	<u>Page</u>
Authorization	1
Objective	1
Scope and Methodology	1
Overall Conclusion.....	2
Background.....	3
Management Accomplishments*	4
Opportunities for Improvement	5
Exhibit A.....	10
Exhibit B.....	11

Authorization

Internal Audit ("IA") has conducted an audit of the Hotel/Motel ("Hotel") Occupancy Tax ("HOT"). This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

The objectives of the audit are:

1. Determine whether Garland hotels are paying the correct HOT in accordance with Section 351 of the Texas Tax Code and City Ordinance.
2. Verify if hotel HOT is being paid in a timely manner in accordance with the City Ordinance.

Scope and Methodology

IA conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit scope included review of documentation for revenue and exemptions reported by six hotels for 10 quarters from 1st quarter of 2012 to 2nd quarter of 2014. However, in certain instances, the scope was expanded to include other calendar years as well. The following details of 20 hotels in the City were reviewed and analyzed before the six hotels were selected for this audit:

- Amount of exemptions claimed
- Type of hotel (residential/semi-residential/transient)
- Number of rooms
- Recent organizational changes
- Reports of crime
- HOT payment timeliness

To adequately address the audit objectives and to describe the scope of our work on internal controls, IA performed the following:

- Reviewed the City Ordinance, HOT report, Section 156 & 351 of Texas Tax Code and Texas Administrative Code Rule 3.161. (Obj.1)
- Conducted meetings with the City Attorney's office to obtain legal advice. (Obj. 1&2)

- Conducted meetings with the City Tax Department to gain an understanding of their processes. (Obj. 1&2)
- Conducted a Metroplex-wide survey in order to gain an understanding of other cities HOT billing and collection process. (Obj. 1&2)
- Developed and obtained hotel(s) details through questionnaires. (Obj. 1)
- Interviewed hotel owners, operators, managers and/or their representatives (CPAs) to gain an understanding of their HOT reporting process. (Obj. 1&2)
- Validated the accuracy and completeness of the listing of hotels reporting HOT to the City by conducting online search and comparing the lists to the report available on the State Comptroller website. (Obj. 1)
- Reviewed quarterly reports from the tax department and compared the reports to the State Comptroller's reports. (Obj. 1)
- Reviewed and reconciled hotels' general ledgers to the amount of HOT received by the City, to ensure the appropriate amount of taxes was paid. (Obj. 1)
- Examined source documents, such as folios, daily and monthly reports, exemption certificates, etc. Judgmental and/or random sampling methodologies were used in selecting these documents. The type and extend of sampling quantities were determined based on risks identified during IA's preliminary comparison of the City's HOT report to the State Comptroller's reports, hotels' monthly/daily reports, general ledger, etc. Once the sampled documents were analyzed, the results were projected to the intended population (Obj. 1)
- Obtained and reviewed Crime reports from City's Police department.
- Reviewed HOT reports, payment information and City's General Ledger to verify timeliness of payments. (Obj. 2)

To assess the reliability of data, IA compared quarterly reports to source documents. As a result of our testing, we determined that the data was sufficiently reliable for the purposes of this report for 4 of the 6 hotels reviewed.

Based on the audit work performed, any deficiencies in internal control that are significant within the context of the audit objectives are stated in the Opportunities for Improvement section starting on page 5.

Overall Conclusion

IA's audit of six hotels revealed that they all are making HOT payments to the City on a quarterly basis. However, we identified approximately \$39,368 in HOT revenue deficiencies from two hotels (See Finding #1). The audit also revealed the need for updating the City's Ordinance and HOT Report in order to provide guidance, reflect current business practice, capture relevant information and enforce compliance (See Finding #2).

Background

The City of Garland Tax Department has the day-to-day responsibility for collecting, accounting for, and administering HOT. Revenue is collected quarterly. The hotel tax is levied at 7% for the occupancy of any sleeping room, furnished by any hotel where the cost of occupancy is at the rate of \$2.00 or more per day, to be paid by the occupant of the sleeping room to the hotel. HOT is originally paid by the hotel customer to the hotel, and is then rendered to the City on a quarterly basis.

According to Sec. 40.10 of the City Ordinance “Hotel shall mean any building or buildings in which the public may, for a consideration, obtain sleeping accommodations. The term shall include hotels, motels, tourist homes, houses, courts, lodging houses, inns, rooming houses or other buildings where rooms are furnished for a consideration, but “hotel” shall not be defined so as to include hospitals, sanitariums, or nursing homes”.

As of the 2nd Quarter of 2014, there were 20 establishments listed by the State Comptroller's Office and the City's Tax Department, as collecting HOT within Garland city limits.

The following is a breakdown of gross receipts, taxable receipts and amount paid to the City in calendar years 2012, 2013 and the first two quarters of 2014:

Period	Gross Receipt *	Taxable Receipts **	HOT Paid to the City **
2012	\$12,988,840.74	\$11,417,496.22	\$799,585.16
2013	\$13,801,906.18	\$11,957,952.57	\$837,013.82
Quarter 1&2 - 2014	\$7,744,639.35	\$6,732,550.67	\$471,275.20
Total	\$34,535,386.27	\$30,107,999.46	\$2,107,874.18

*Source: Texas Comptroller of Public Accounts

** Source: City Tax Department

According to Texas Administrative Code Rule 3.161, hotel guests listed below are exempt from paying local HOT.

- United States Federal Agencies or Foreign Diplomats.
- Texas State Government Officials and Employees.
- Entities Exempted by Other Federal or State Law (Example: Federal Land banks and federal land credit associations, State housing authorities, health facilities development corporations, etc.).
- Permanent residents (A person who has the right to use or occupy a room or space in a hotel for at least 30 consecutive days without interruption. A person may be an individual, organization, or entity).

However, guests representing charitable entities, educational entities and religious organizations are not exempt from local HOT.

Management Accomplishments*

For the fiscal year 2013/2014 the City of Garland Tax Department set a new record for total taxes collected. The 99.25% collection rate is the highest ever in the history of the department.

*Please note that "Management Accomplishments" are written by the audited entity and that Internal Audit did not audit or verify its accuracy.

Opportunities for Improvement

During our audit IA identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding # 1 (Obj. 1)

Condition (The way it is)

Our audit of six Garland Hotels revealed the following:

1. Hotel A reported approximately \$555,905 in HOT exemption between January 2011 and June 2014. However, none of the exemption certificates were available for IA to verify compliance. This resulted in a HOT revenue deficiency of \$38,913.41.
2. Hotel B reported inaccurate taxable revenue on three occasions which resulted in a net HOT revenue deficiency of \$455 (overpayment of \$630 for the 1st Quarter of 2012, overpayment of \$70 for the 1st Quarter of 2014 and under payment of \$1,155* for the 2nd Quarter of 2014).
3. Hotel C did not obtain written agreements or up-front monthly payments from several of its permanent residents. Based on IA's review of daily reports maintained since 2012 and folios from June 2014, we were able to reasonably verify that the exemptions issued were for permanent residents. However, since they did not maintain customer folios prior to June 2014, we were unable to identify the beginning date of permanent resident(s) stays and assess potential HOT tax deficiency.
4. No significant compliance issues were noted with Hotel D, E and F.

*Upon IA's notification, Hotel B immediately processed the underpayment of \$1,155 to City's Tax Department.

Criteria (The way it should be)

1.
 - According to Section 351.006 (g) of Texas Tax Code, "The right to use or possess a room in a hotel is exempt from taxation under this chapter if the person required to collect the tax receives, in good faith from a guest, an exemption certificate stating qualification for an exemption provided in Subsection (c). The exemption must be supported by the documentation required under rules adopted by the comptroller and the municipality."
 - According to the Texas Administrative Code, Rule 3.161 "Any organization or individual claiming exemption from the payment of hotel occupancy tax

must furnish the hotel with a signed exemption certificate”. It also states, “A hotel claiming exemptions of its receipts from hotel occupancy tax must provide proof that the receipts were exempt, either through exemption certificates or other competent evidence”.

2. Accurate taxable revenue and HOT should be reported to the City on a quarterly basis.
3. A person becomes a permanent resident by either providing a written intent to occupy a room for 30 or more consecutive days or paying in advance for 30 days. Guests who do not have a written commitment or have not made payment in full, do not become permanent residents until the 31st day. Therefore they owe tax on the first 30 days. These records along with customer folios should be maintained for audit purposes.

Effect (So what?)

- Internal Audit was unable to verify if exemptions were issued to guests properly or if taxable revenue was reported to the City accurately.
- Potential loss of HOT revenue for the City.

Cause (Difference between condition & criteria)

1. Hotel A either did not obtain documentation from its clients or did not maintain records properly.
2. Hotel B erroneously entered taxable amount on City’s quarterly report and calculated the HOT amount due (7%) based on the incorrect information.
3. Hotel C was not aware of the Permanent Resident documentation requirements. According to their Management, guest folios prior to June 2014 were thrown out accidentally by their custodian.

Recommendation

City’s Tax Department should perform the following:

1. Collect tax deficiencies from Hotel A.
2. Issue a credit in the amount of \$700 to Hotel B to offset overpayments from 2012 and 2014.
3. Issue a notification letter to Hotel C to inform them of the requirement of obtaining and maintaining guest agreements, folios, payment information and/or other related documents.
4. Reconcile revenue reported (Gross and Taxable) with other sources of information, such as the State Comptroller’s website, on a quarterly basis. Also, analysis should be performed to detect any variations/trends in

revenue and exemptions reported by the hotels. If anomalies are identified, further review should be performed. This may include review of hotel's quarterly/monthly reports, general ledger, folios, exemption documents, etc.

Management Response

Concur.

Action Plan

1. A certified letter has already been sent to Hotel A requiring payment indicating a due date of December 18th. If payment is not received the Tax department will likely consider pursuing legal action against Hotel A.
2. A credit of \$700 will be applied to Hotel B's quarterly statement to be mailed December 31, 2014.
3. A notification letter has already been sent to Hotel C outlining the appropriate hotel occupancy tax exemptions.
4. The department currently reconciles revenue reported with the State Comptroller's web site. Also, a new process and spread sheet has been developed to ensure variations and trends related to revenue collected can be more easily monitored and detected.

Implementation Date

December 2014 - Appropriate action has already taken place on each item.

Finding # 2 (Obj. 1&2)

Condition (The way it is)

IA's review of City's Ordinance (Article II. Hotel Occupancy Tax) and HOT Report (the form provided by the City to Hotel Management in order to report the HOT revenue on a quarterly basis) revealed the following:

City Ordinance

- There are no provisions in the Ordinance about late payment interests, even though it is mentioned in the HOT Report form and assessed by the City when payments are delayed. The HOT Report states a late payment interest rate of 10% of the tax due for each thirty days or portion thereof.
- The Ordinance allows a 10-day window from the last day of the quarter for Hotel Management to submit their quarterly reports and payments. This seems unreasonable and contradicts with the current practice of assessing late fees and/or interest after 30 days from the last day of the quarter.

HOT Report

- The form (see Exhibit A) does not cite the most current Ordinance information. Instead, it cites the original Ordinance from Sep 16, 1975. The local HOT rate has increased from 3% to 7% since the publication of the original Ordinance.
- The form does not provide areas for Hotel Management to report pertinent information such as gross revenue and break down of HOT exemptions given to permanent residents, United States Federal Agencies, Foreign Diplomats, Texas State Government Officials and Employees, Military Personnel, etc.
- The form does not provide adequate information or instruction to Hotel Management regarding the HOT requirements. Information such as definitions of various types of exemptions, requirements of obtaining and retaining exemption certificates and client agreements and differences between City and State tax exemptions are not provided.

Criteria (The way it should be)

- The City Ordinance is updated to reflect current business practices, provide guidance and evaluate compliance.
- HOT report cites the current Ordinance number, captures relevant information and provides appropriate guidance that Hotel Management has to comply.

Effect (So what?)

- Inappropriate interest may be assessed.
- Multiple hotels are not able to remit the report and payment within the required 10-day limit. It may also create confusion about when to assess late fees and interest.

- Listing the old Ordinance on the form may create confusion and leave an opportunity for Hotel Management to remit wrong payments to the City, based on the previous tax rate.
- Without pertinent information, City Management will not be able compare hotel reports with other source of information such as the State Comptroller's office. City Management will also not be able to identify any violations such as application of inappropriate exemptions to City HOT revenue, trend variations in exemption reporting, etc., in a timely manner.
- Due to confusion regarding the interpretation of City tax law, some of the hotels were inappropriately claiming exemptions and not obtaining and/or retaining exemption certificates and client agreements.

Cause (Difference between condition & criteria)

The City Ordinance and HOT Report have not been reviewed or revised recently to reflect current practices and requirements or to capture pertinent information.

Recommendation

City Management should consider the following:

- Update the current Ordinance with late payment provisions (interest and timing) and present it for City Council's approval.
- Update City HOT Report* to include: the latest ordinance information, areas for Hotel Management to document pertinent information, and adequate information and instructions that Hotel Management has to comply.

* IA has developed a sample HOT Report form for Management (See Exhibit B).

Management Response

Concur

Action Plan

The Tax Department Management team will work with the City Attorney's office to develop a proposed revised ordinance for council consideration. The Hotel Occupancy Tax (HOT) reporting form has been updated and will be utilized in December when the next quarterly reporting period is due.

Implementation Date

Finalize ordinance revisions and present to Council in March 2015. The new HOT report form was finalized in December 2014 (thank you internal audit).

Exhibit A

REPORT OF HOTEL OCCUPANCY TAX	CITY ORDINANCE 2608 SEPTEMBER 16, 1975
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There is hereby levied, for the purposes provided in Article 1269j-4.1 Vernon's Annotated Civil Statutes, a tax upon the cost of occupancy of any room or space furnished by any hotel where such cost of occupancy is at the rate of Two Dollars (\$2.00) or more per day, such tax to be equal to seven percent (7%) of the consideration paid by the occupant of such room. (Ord. No. 4125)

Collection – Every person owning, operating, managing, or controlling any hotel shall collect the tax imposed.

Reports – Not later than ten (10) days from the last day of March, June, September and December of each year, a hotel affected by this article shall report to the tax office, on forms provided by the City, the receipts collected during the preceding three (3) months. Every person required by this article to collect the tax shall pay the tax due on all occupancies in the preceding quarter to the tax office at the time of filing the report.

Penalties – If any person required by the provisions of this ordinance to collect the tax imposed herein, or make reports as required herein, and pay to the Tax Assessor and Collector the tax imposed herein, shall fail to collect such tax, file such report, or pay such tax, or if any such person shall file a false report, or if any such person shall violate any of the provisions of this ordinance, such person shall be deemed guilty of a misdemeanor and upon conviction be punished by a fine not to exceed Two Hundred Dollars (\$200.00) for each offense, and shall pay to the Tax Assessor and Collector the tax due, together with a penalty of ten percent (10%) of the tax due for each thirty (30) days or portion thereof, that the same is not timely filed.

Please complete the following two (2) boxes, retain the top portion for your records, sign and return the bottom portion with your payment to:

**City of Garland – Tax Department
P O Box 462010
Garland, TX 75046-2010**

Total Receipts Taxable: \$ _____ Amount of Tax @ 7% \$ _____ Penalty \$ _____ Interest \$ _____ Amount Due \$ _____	This Report is for Quarter Ending: <p align="center"><u>**Due the 10th day of **</u></p>
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PLEASE DETACH AND RETURN THIS PORTION WITH PAYMENT

"I Declare, under penalties prescribed, that the information contained in this document is True and Correct to the best of my knowledge."	Signed: _____ Total Receipts Taxable: \$ _____ Amount of Tax @ 7% \$ _____ Penalty \$ _____ Interest \$ _____ Amount Due \$ _____
This Report is for Quarter Ending: <p align="center"><u>**Due the 10th day of **</u></p>	

Exhibit B



City of Garland Hotel/Motel Occupancy Tax Report

Ordinance No. 4125, Dated September 1, 1987

REPORT MUST BE FILED EVEN IF NO TAX IS DUE

Taxpayer Name, Mailing Address, Email Address & Phone Number _____ _____ _____	Texas Taxpayer Number _____ _____ _____ _____ _____ _____ _____ _____ _____ _____
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1. Facility Trade Name, Location, Address, Email Address & Phone No.	2. Total Gross Room Receipts	3. Exemptions	4. Taxable Room Receipts
_____ _____	\$ _____	\$ _____	\$ _____
_____ _____	\$ _____	\$ _____	\$ _____

5. Total Gross Room Receipts (Total of Column 2).....	5.				\$ _____
6. Less: Exemptions for permanent residence (30 days or longer).....	6.				\$ _____
7. Less: Exemptions for United States or State of Texas	7.				\$ _____
8. Less: Exemptions for diplomatic personnel with a card.....	8.				\$ _____
9. Less: Exemptions for military personnel on official business.....	9.				\$ _____
10. Total Taxable Receipts (Line 5 minus lines 6-9) (Total of Column 4)....	10.				\$ _____
11. Total Hotel Motel Occupancy Tax Due (7% of Line 10)	11.				\$ _____
12. Over/Under Payments	12.				\$ _____
13. PENALTY	13.				\$ _____
14. INTEREST	14.				\$ _____

MAKE CHECK PAYABLE TO: CITY OF GARLAND

Mall to: City of Garland
Tax Department
PO BOX 462010
Garland, TX 75046

I declare that the information contained in this report and any attachments is true and correct to the best of my knowledge and belief.	
SIGN HERE ➤	Taxpayer or Duty Authorized Agent
Phone number: _____	Date: _____