Local Issue Briefing Paper

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01 February 2008 – Draft V *Extensive Background & Cross-Referenced Edition*
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Transient Occupancy Tax (TOT)- Collection Practices in Placer County

DRAFT VI ------ Not For Distribution
"Abbreviated Action Edition"

Issue:

Placer Co. is pursuing an aggressive programmatic approach to the collection of perceived past TOT underpayment. Concurrently, they are attempting to establish a particular but broad interpretation as to what constitutes TOT taxable events. Property managers are reporting receiving antagonistic audit notices from the county; notices intended to collect TOT funds presumed to be due via the broad inclusive definitional decision rendered by county staff. The window for response to the demand letter is very short (7 days). The revenue implications for the county are clear, but is their case compelling?

Action:

Policy direction was requested, and was received on 06 February 2008, by unanimous affirmative vote of the Tahoe Sierra Board of Realtors® Board of Directors. The Board's professional advocate is tasked with the pursuit of a multi-pronged approach to secure a reasonable and functional solution to the problems associated with the overreaching determination promulgated by county staff. These efforts are to include: Obtaining a letter of understanding from the county that there will be no retroactive application of the local ordinance/code amendments and subsequent notice of determination for the purposes of auditing past practices. Corresponding with the county supervisors regarding concerning aspects of the TOT Ord., historically, as presently written, and in regard to its future application. In drafting this letter we are seeking clarification on some issues, and amendments in other areas; with specific focus upon reining in the staff definition of what is to be included as a TOT taxable event (i.e., exclude cleaning fees, supplemental services…). Our objective is to return to the standard of practice that was widely understood and accepted in years past, codified in such a way so as to avoid misapplication or overextension of the tax's intent in the future. If a reasonable solution cannot be achieved by political means, then less attractive alternatives will be considered to achieve redress of the industry's legitimate grievances, such as (but not limited to) consideration of: a legal challenge to the ordinance and its application; pursuit of a referendum to rescind all or a portion of the TOT tax, by popular vote (i.e., reduce or repeal by initiative); and/or establishing partnerships affiliated interests, such as the Howard Jarvis Taxpayers Association, the Pacific Legal Foundation, the Reason Institute for Public Policy, et al. to bring additional expertise and pressure to bear on the issue. A state level legislative remedy might also be considered in the form of a bill that would serve to bracket how second-home vacation rental units are treated under the State enabling Statute (Revenue & Taxation Code, Section 7280 - 7283.51). Concurrently, given the complicating issues put into play by Assembly Bill 1916, signed into law in 2004, CAR's legal team will be approached to look into the Tax Clearance Certificate matter; to opine on the disclosure implications at-sale, as well as to comment upon any potential expanded liability exposure and how to best mitigate it.

Summary:

An internal audit was requested by the county's Executive Office to assess the level of TOT compliance. A Memo to the Supervisors from Rich Colwell (Chief Assistant C.E.O.), dated May

8, 2007, set the table for a series of amendments to the TOT code. It said, "…the Auditor-Controller made recommendations to update certain areas of the Ordinance that were not clearly defined." 3 sections of the county's Code (Article 4.16) were revised (*italics reflects 2007 amendments*). Of these, how 'rent' was to be defined has been subject to the greatest debate:

(1) Section 4.16.020 "Definitions" was amended to read, " 'Rent' means the consideration charged, 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, property and services of any kind or nature without any deduction therefrom whatsoever. *Rent does not include any additional items included in a special package rate, such as ski passes, or other recreational or other activity or additional service, as long as the operator separately states the rent and tax from other amounts on all receipts and books of record. If additional benefits or services are not stated separately as indicated above, the entire amount shall be presumed to be rent.*"
(2) Section 4.16.070 "Reports and Remittances" was amended regarding Postal Service delivery verification.
(3) Section 4.16.100 was amended to read, "(f)or purposes of determining the liability of any operator failing or refusing to file a return, there shall be a rebuttable presumption that the liability is the same as in the *maximum liability* quarter for the previous *fiscal* year."

These amendments to "clarify" the TOT ordinance only became operational in mid-year of 2007. It is concerning to hear from members that the county is attempting to impose the "maximum liability" presumption for "underreporting" in previous years based upon this recently "clarified" definition. To retroactively apply this new found (or newly articulated) clarity in the code to past practices seems ill-advised.

A letter from Placer County went out "To All Transient Occupancy Tax Certificate Holders", dated December 26, 2007. This TOT notice goes to the heart of the county's attempt to add another level of 'precision' to the number/type of TOT taxable events. It says, in pertinent part, that,

> "…it has been determined that any 'room-related fees and services necessary to occupy space' is subject to TOT tax. Per the Ordinance, the definition of rent 'means the consideration charged, whether or not received, for the occupancy of the space in a hotel valued in money, whether to be received in money, goods, labor or otherwise, including all receipts, cash, credits, property and services of any kind or nature without any deduction there from whatsoever.' Other receipts and services subject to TOT tax would include, but is not limited to, resort fees, reservation fees, gratuity fees, energy surcharge fees, maid fees, and cleaning fees."

This determination/interpretation of the Code was made by the Internal Audits Division of the Placer County Auditor-Controller's Office. One might argue that this approach is over-inclusive as a matter of policy, overreaching in its application, and at odds with the language and intent of both our local TOT Ordinance (Art. 4.16) and the State's enabling act (R & T Code, Sec 7280 - 7283.51). In any event, the letter of notification establishes that, "effective January 1, 2008, if you are not already doing so, you must collect and remit tax on all room-related fees and services." With a Jan. 01, 2008, "effective date", does this relieve the operator of prior claims by the county of TOT underpayment?

A dialogue is underway with our Supervisor (Dist 5), Bruce Kranz, on the matter. He appears to understand the issue and how it impacts our industry. He is attempting to address the back-tax collection confusion; it is our hope that he can secure concurrence with at least two other supervisors that individuals and their property management firms should not be held liable for previous years "underpayment" based upon the recently "clarified" TOT Ordinance. We have not received a definitive response from Supervisor Kranz or the County as to how those who manage the short-term rental of second homes will be treated. Until information to the contrary is received, the most up-to-date information is contained within the text of the correspondence that was sent by the County to "All TOT Certificate Holders", dated Dec., 26, 2007.

Background:

The TOT amendments were introduced on May 8, 2007, and approved at the Board of Supervisors' May 22, meeting. Both meetings were conducted in Auburn. Both the introduction of the TOT Ordinance revisions, and its passage later that month, were buried within extensive "consent agendas". Inclusion on the consent calendar is used to dispose of a large number of items believed to be non-controversial, anticipating no dissention or debate. On consent, Board took action on some 65 items via a single sweeping vote.

Placer has been looking into a notification process for some time, targeting individuals who engage in short-term rentals of their property but were unaware of the TOT Ordinance. The Revenue Services Div. was charged with the task to identify properties within Supervisorial District 5 that did not claim a 'homeowner's exemption'. Once identified, Placer mailed letters to 2,300 homeowners in and around Tahoe City on Oct. 5, 2007, inquiring about rental activity. It has been characterized as a "pilot" program, to evaluate responses against the operational impacts (possible revenue sources) from the initial mailing effort. If a respondent identifies their property as having been rented for short-term vacation rentals (i.e., 30 days or less per occupancy), then a 10% charge/tax should have been affixed to the rental rate. Of course, prior to operating as a hotelier, one should have obtained a TOT Certificate for the property. Purportedly, this audit of TOT subject properties is to "ensure fairness and competitiveness among local businesses and vacation properties that are required to collect Transient Occupancy Taxes." All remaining properties are slated to receive this letter inquiring about rental activity during a second and third phase.

Discussion - General:

Transient Occupancy Taxes (TOT), commonly referred to as a "bed tax", "room tax" or "hotel tax", have become a popular way for local government to backfill its General Fund in the wake of Prop. 13, the ERAF Shift and other fiscal impediments. Part of its appeal to both local government and the electorate is that TOT taxation is viewed as a tax "that someone else pays", namely tourists. In California, TOT rates range from eight percent (8%) to fifteen percent (15%). According to the California Lodging Association, the state average is a 10% TOT rate, which brings in more than $1 billion dollars a year in revenue to cities and counties. Across the nation, the TOT-type tax rates vary more widely. As of 2004, the reported national average TOT-type tax was 12.4%. The formula used for TOT collections, i.e., which transactions are TOT taxable events and which are not, also differs significantly from place to place. The one constant in all of this is, wherever TOT taxes are imposed, they become an important source of revenue for local government.

Discussion - Regional:

Placer has a countywide 8% TOT tax rate, with an additional 2% overlay in the High Sierra. This form of taxation does require voter approval. The voters of Eastern Placer County have "self-imposed" a 10% transient occupancy tax rate. Placer County structured its TOT to be a "general tax"; requiring only a simple majority to pass. The monies received are entered into the county's unrestricted General Fund.

Discussion – Resort Association Specific:

The principle beneficiary of the Tahoe area 2% TOT overlay, other than the county generally, is the North Lake Tahoe Resort Association (NLTRA). This non-profit group enters into agreements with Placer County to provide a wide range of services. The annual Tahoe area TOT collection totals are, at present, about seven million dollars per year. It is believed, but unconfirmed, that approximately 60% of the Tahoe TOT collections are returned to the area. NLTRA's mission is, "to promote tourism and benefit business through efforts that enhance the economic, environmental, recreational and cultural climate of the area." It does this, in large part, with TOT funding. Some 75% of the NLTRA's

annual budget, $2,771,985.oo in fiscal year 05/06, came from “Placer County TOT Grant Revenue”. These funds are used to, “…to support the NLTRA's marketing programs, visitor information services, transportation, and infrastructure projects.”

Other Issues of Concern:

Assembly Bill 1916, amending the State’s enabling act for TOT, was introduced in 2004. The bill was signed into law, taking effect on 01 Jan. 2005. This bill added concerns for our industry; in specific, muddying the waters related to title transfer and whether TOT matters run with the proprietor (operator) or with the property. Now “tax clearances” (R & T Code Sec. 7283.5) are available at or prior to sale. This provision allows, but does not require, a prospective purchaser of a property that was/is subject to the local TOT code to request a TOT Tax Clearance Certificate from the taxing authority. At the conclusion of the allotted timeline, the county must either: issue the clearance certificate; issue a certificate declaring the outstanding amount of TOT tax due and the time period reflected in this claim; or withhold the certificate by claiming that the records are insufficient to allow for an audit. If the prospective purchaser requests such a certificate then the county is obliged to act, with the information provided being deemed reliable for the purposes of the new property owners’ tax liability. This provision answers an important potential liability question for the buyer. However, if the purchaser does not request such a tax certificate, and monies were indeed due to the city or county as a byproduct of short-term rental activities by the previous owner, then the new owner could be liable for the uncollected back TOT taxes. This creates a significant potential liability for single-family residences and multi-unit properties that might have been offered as short-term rentals as an incidental aspect of owning a second home. Questions regarding seller’s disclosure obligations are made all the more complex in a resort second-home dominated community. These 2004 revisions to State law appear to establish that TOT liability can run with (attach to) the property, as opposed to being a solely proprietor / operator held liability. What intuitively “makes sense” in reference to a hotel-type commercial property seems out-of-place and unduly burdensome in regard to the second home incidental rental activity of a previous owner.

Conclusions:

On balance, the revenue-generating mechanism that is the Transient Occupancy Tax has merit, in that it provides another tool in the local government toolbox to spread the tax burden. This objective is made all the more compelling in resort areas, where the visitor/tourist has a dramatic impact upon not only the local economy but also the demand for locally provided services. At what point does an innovative practice become an illegal undertaking? When does interpretation of existing ordinance/code language become overreaching and considered a misapplication of intent? How far can a unit of government go in its efforts to expand the use or application of an existing tax before triggering a requisite vote of the people to confirm or deny the revenue expansion activity? There may well be aspects of Placer County’s TOT practices that could and should be called into question; but, in the quest for corrective action it might be advised to avoid “tunnel vision” on winning the point at the expense of a greater long-term good.

~END OF ISSUE BRIEF~

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