Local Issue Briefing Paper

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Transient Occupancy Tax (TOT)- Collection Practices in Placer County

DRAFT VI ------ Not For Distribution
"Abbreviated 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 TOT taxable events. Property managers report an increase in 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 requested.

Options:
1. Pursue local ordinance/code amendments to shield/disallow retroactive charging.
2. Pursue amendments to the Placer County Code to rein in the definition of what is to be included in a TOT taxable event (i.e., exclude cleaning fees, supplemental services…).
3. Consider a legal challenge of the ordinance and its application.
4. Request CAR legal to look into the matter and opine as to the liability exposure and how to best mitigate it.
5. Correspond with county supervisors regarding concerning aspects of the TOT Ord., past, present, and its future application; requesting clarification on some issues, and amendments in other areas.
6. Look into referendum procedures to rescind all or a portion of the TOT tax, by popular vote of the electorate (i.e., reduce or repeal by initiative).
7. Some combination or hybrid of policy/action options 1-6, or other(s)____.

Summary:
An internal audit was requested by the county's Executive Office to assess the level of compliance with the county's Transient Occupancy Tax. 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*):

(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 to read, "C. For the purposes of this section, 'on or before' shall be interpreted as (1) hand delivery; or (2) postal delivery of a properly stamped and addressed envelope containing the return and full amount of the tax to the United States Postal Service. Delivery to the Postal Service must be verified by the cancellation by the Postal Service showing a postmark date no later than midnight on the day the tax is due. *If the due date of the tax falls on a Sunday the tax due date shall be the next business day (excluding federal holidays.)* Private postal meter strips and dates shall not be considered evidence of delivery to the United States Postal Service."

(3) Section 4.16.100 "Determination of tax by tax administrator upon failure of operator to collect and report tax -- Notice and Hearing" was amended to read, "B. For 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."

The amendments were adopted on May 22, 2007, going into effect 30 days later. 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-conceived.

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 (Sec. 4.16) and the State's enabling act (Revenue & Taxation Code, Section 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 Clerk for the Board of Supervisors provided clarification regarding dates and details of the TOT Ordinance revisions of '07. The amendments were introduced on May 8, and approved at the Board's May, 22, meeting. Unfortunately, both "hearings" were conducted in Auburn. Equally disappointing, 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. This error in judgment meant that the issue was not addressed as an individual topic.

According to information received from the County Administrative Services Director, 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:
California's tax structure is broadly divided into two classes, "special" and "general". TOT taxes can be either a general tax or a special tax, depending upon how it was approved by the electorate (simply majority or super-majority), and based on the allowable uses of the funds collected (general fund for multiple uses or dedicated/earmarked for specific/limited uses). General taxes require a simple majority affirmative vote to achieve passage (50% + 1). Special taxes are imposed for specific purposes, with revenue restricted to use in the furtherance of these enunciated purposes (whether held in the Gen Fund or a separate account), requiring a "super-majority" of affirmative votes to pass (2/3rds).

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."

Committee Discussions
The TSBOR **LGR Committee** met on 29 January 2008. The group decided to "table" the issue in reference to possible action until next month's committee meeting. This was done specifically to afford the Property Management Committee an opportunity to review and comment upon the matter. However, the committee wanted to add a cautionary note related to the unintended consequences of pursuing certain courses of action. If one objective is to get residential properties (vacation rentals) split out from all other forms of short-term rental activity (such as hotel/motel uses) for separate treatment (e.g., not collecting TOT on cleaning fees), this could lead to a range of negative outcomes. A salient example can be found in the desire to reduce or eliminate all short-term rentals of residential properties, as proposed by the Tahoe Regional Planning Agency in 2003. TSBOR fought long and hard to preserve this right to rent. Arguments have been made that if short-term vacation rentals were to be removed from tourism rental options it would open up that segment of the second home market to affordable long-term rentals, or perhaps even sales to primary residents. The notion of zoning conformance has also been broached as a method to disallow short-term vacation rental activities in residentially zoned areas. TSBOR has also responded effectively to-date to these challenges. However, if differential treatment were to be pushed too vigorously by our organization it could produce "blow-back" in the form of renewed interest in limiting or prohibiting this form of rental altogether.

The TSBOR **Property Management Committee** met on 30 Jan. 2008 to discuss concerns regarding Placer County's approach to TOT assessment and collection. After much discussion, the committee made a multi-pronged motion to urgently recommend to the TSBOR Board of Directors that they,

> "Obtain formal clarification directly from the Placer County Board of Supervisors regarding ongoing ambiguity surrounding the TOT Ordinance's charge structure (4.16.020, .070, & .100), the language employed, and its intent. Linking to the language of the Code, as revised on May 22, 2007, and then further "interpreted" by

the county Auditor-Controllers Office, ***(a)*** seeking to nullify the determination rendered by that office as reflected in their correspondence to "All TOT Certificate Holders", dated December 26, 2007. To then ***(b)*** reaffirm or establish that items which are not "marked up" as a source of profit, representing a "pass-through" type of charge/expense, be excluded from any TOT tax liability. This pass-through expense could be ***(c)*** demonstrated by establishing that than independent contractor agreement exists for activities such as pre-or-post occupancy cleaning, and that payment to the contractor for such services rendered is reflective of the full amount charged and received for said agreement (i.e., without profit to the TOT Certificate Holder); documentation could include, but would not be limited to, a signed contractual agreement, Tax Form 1099 distributions, or accounting ledgers/books. ***(d)*** If the operator (i.e., TOT Cert. Holder) meets the conditions set forth in sections "b" and "c", then the option should be made available in practice and reflected on reporting forms as a line item expense exempt from TOT imposition."

Concurrently, ***(e)*** the Board of Supervisors should issue an immediate "stay" order to all departments, divisions, and individuals involved in the collection of TOT monies, which would hold in abeyance (forbearance) any actions, claims, or taxes accrued under the implementation of the disputed "Notice of Determination" issued by the Auditor-Controller's Office. This injunction upon implementation would remain in effect until such time as the Board of Supervisors takes specific action to rescind it; to be considered only during a regularly scheduled Board meeting, during 'open session', placed on the agenda as a "time certain" action item. In the event that the Board elects to retain all or some portion(s) of the determination of Article 4.16.020 as reflected in the correspondence from the county dated December 26, 2007, ***(f)*** retroactive TOT tax collections actions for that portion of taxable events reflective of the activities in dispute shall be forgone/forgiven by Placer County. No operator shall be held liable for past/back taxes due based upon the recent interpretation of the ordinance.

Additionally, ***(g)*** in acknowledgement of the lack of clarity in the TOT Ordinance language, a "grandfathering clause" shall be added to Article 4.16 of the County Code which excludes all short-term rental contracts entered into prior to 01 January 2008 from compliance with the Notice of Determination disseminated by the County, dated December 26, 2007; this contractual "safe harbor" shall apply to all agreements entered into before 01 January 2008, irrespective of the actual or anticipated date of occupancy.

Finally, the Property Management Committee respectfully requests that the Tahoe Sierra Board of Realtors® ***(h)*** retain legal counsel for the express purpose of providing advice and direction to members on this TOT matter."

Given the active (in-force) nature of the issue, the committee asked that staff approach the Board President, Cathy Harry, to request that she consider calling for (convening) a special meeting of the Directorship as soon as possible to review the matter and the committee recommendations for action. The Property Management Comm. also requested that the advocate look into the possibility of obtaining a reversal of the County's newly adopted TOT Certificate issuance strategy, in which every single home that is utilized as a short-term vacation-type rental must obtain an individual Certificate for the property in question, regardless of the property being professionally managed. At issue is the reporting and auditing nightmare that would ensue for the professional property manager who, under contractual arrangement, offers 25, 50, or even more homes up for occasional short term rental. It seems more reasonable and manageable to allow the property management

company to obtain/secure one TOT Certificate reflective of all properties under their control.

Other Issues of Concern:
Assembly Bill 1916 amending the State's enabling act for TOT in 2004. The bill was signed into law in September of '04, 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 appears to be liable for the uncollected back TOT taxes. From our industry's prospective, 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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