

MAKE SURE THEY
PAY!!!

Auditing for Smaller Revenue Streams

Maximizing Local Government Revenue

There are 4 key revenue functions in local government that maximize revenue and make up the lifecycle of effective tax management:



TAX ADMINISTRATION

This is the routine but critical processing of all the tax and fee payments a local government gets from sales and use, business licenses, lodging, alcohol, tobacco, and other locally collected taxes.



COMPLIANCE AUDITING

This is when taxpayers are on the tax rolls and are filing and paying taxes, but they may not be reporting everything they should be reporting. By finding irregularities, a local government prevents gaps in its community's resources.



DISCOVERY AND RECOVERY

This process identifies business that are not adequately registered to perform business within the jurisdiction.



DATA & ANALYTICS

A local government should be able to review the data it has from its many transactions to identify patterns, plan for the future, and identify additional revenue opportunities.

Tax Administration/Accounting

- Success depends on local ordinances, regulations, statutes, and laws
 - Do you have proper terminology/requirements
 - Is it complete?
 - Does it define?
 - What needs to be included:
 - Definitions
 - Exemptions
 - Interest & Penalty
 - Legal Counsel should review
- Return
- Registration Process
- Data - Tracking Remittance History
 - Reporting periods vs. Payment dates
 - By Address

Goals of Audits

Ensuring that all businesses are in compliance

Fairness and equity across the industry

Taxpayer education in business-friendly way

Uncover Revenue-Gaps



Hotel Industry – An Overlooked Resource

- 4 Top Markets in TX surpassed their Pre-COVID figures by Sept 2023
 - Dallas 108%
 - Houston 107%
 - San Antonio 105%
 - Austin just over 100%



Hotel Trends

- Mid-Market/Premium Economy hotels are on the rise
- Digital Transformation
 - Online/paperless bookings
 - Contactless check-ins/Keyless entry
 - Bleisure - Digital nomads – blend work/play, looking for unique properties
 - Sustainable – energy efficient lighting, re-using towels, going green
 - Personalization – TV greets you with your name



Auditing Hotel – Occupancy Tax

- Hotel Occupancy Tax – tax on the rental of rooms that the city, county, state or country may require
- Owed on price of accommodations/any additional fees (cleanings, extra guest,.....)
- Names include Occupancy Tax, Lodging Tax, Sales Tax, Room Tax, Tourist Tax, Hotel Tax, Venue Tax
- State 6% hotel occupancy tax
- Locals range anywhere from 7% to 13%



Who is responsible to collect/pay HOT?

Anyone that rents out for less than 30 days

- Hotel owners (operators or managers)
- Bed and Breakfasts
- Condominiums
- Apartments
- Houses

Includes Short-Term Rentals/Vacation Rentals



Short Term Rentals

- STR industry is \$83 billion and growing (nationwide)
 - Lost tax revenue
 - Complaints from community about noise, garbage, safety
 - Smaller cities are struggling with Administration/Registration, Discovery & Recovery, and Compliance
 - Establishment Stage 30% compliant
 - Enforcement Stage 30%-70% compliant
 - Endgame Stage 70%-100% compliant



STR Regulatory Compliance Stages

STAGE
01

- No Ordinance
- Code May or May Not Allow Them

- Ordinance in Place But No Data
- Little to No Enforcement

STAGE
02

STAGE
03

- Ordinance in Place AND Have Data
- Having Difficulties Quieting the Problem Down

COMPLIANCE FRAMEWORK



Who does not have to pay HOT?

STATE

Nonprofit religious, charitable or educational organizations

Specific nonprofit entities


Government – only US/federal and state agencies

Permanent Residents

LOCAL

Government – only US/federal and state agencies

Permanent Residents



What can you do with the HOT?

- Every expenditure must DIRECTLY enhance and promote tourism AND the convention and hotel industry
- 9 statutorily provided Categories

Results from HOT-Audits

- Recover missed revenue for last 4 years
- Future compliance with proper remittance going forward
- What errors are most common:
 - Incomplete records
 - System Changes
 - Management Company Changes
 - Invalid Exemptions
 - Successor Liability Issues
 - Not reporting Misc Fees



Types of Findings City Size

- Small Cities (Pop under 25,000)
 - Under reporting gross revenue
 - Over stating exempt revenue
 - Not reporting misc fees
 - Invalid exempt revenue
- Midsize Cities (Pop 25,000 - 100,000)
 - Under reporting gross revenue
 - Over stating exempt revenue
 - Not reporting misc fees
 - Invalid exempt revenue
 - Not reporting taxes
- Large Cities (Pop 100,000+)
 - Under reporting gross revenue
 - Over stating exempt revenue
 - Not reporting misc fees
 - Invalid exempt revenue
 - Invalid exempt revenue – company contracts
 - Not reporting taxes
 - Not collecting added venue taxes

Case Study

- Large city with population over 250,000. Hotel chain focusing on long term stays. Property was automatically refunding guests occupancy taxes after the first 30 days without obtaining the proper documentation. Resulted in over \$115,000 in occupancy tax for city.
- Midsized city with population over 80,000. Hotel was a smaller brand operating under a large chain name. Property opened during COVID and never registered with the city or county. Neither the city/county noticed due to staffing shortages. Property operated for nearly 2 ½ years without reporting taxes. Resulted in over \$70,000 in occupancy tax for city.
- Midsized city with population over 40,000. Hotel was a large chain with over 1,000 locations in the US. Property was backing into the exempt revenue amount rather than using PMS reports. Had a large amount of “partially” taxed transactions that led to issues when backing into exempt revenue. In addition the property could not tie the claimed exempt revenue to specific guests so the exempt revenue could not be validated. Resulted in over \$40,000 in occupancy tax for city.
- Small city with population less than 24,000. Hotel was a large chain with over 900 locations in the US. Property had a system change and used a report that they were not familiar with to file taxes. Property ended up using state exempt revenue on city tax return. Resulted in over \$20,000 in occupancy tax for city.

What are Franchise Fees?

- Fee paid by a Right of Way (ROW) user to the municipality for the privilege of using ROW; imposed to reimburse municipality for disruption of ROW.
- A “franchise” has been construed to mean a right or privilege conferred by law, and a privilege of doing that which does not belong to citizens generally by common right, to include the right to use public streets and other ways for the purpose of a business affected with a public interest within the municipality.

Franchise Fees

- Increase Utilities' Compliance with Franchise Fees
- Use of right of way, utility providers present a challenge to your jurisdiction's management. It is difficult to know if they're remitting the correct amount of franchise fees due to the extensive and complex technical jargon associated with multiple revenue streams.
- Can represent up to 10% of local government's revenue



Industries Effected

- Utility Companies
 - Natural Gas
 - Electricity
- Cable/Internet Providers
- Telecommunication Providers
- Solid Waste Haulers/Waste Management Company
- Landfills

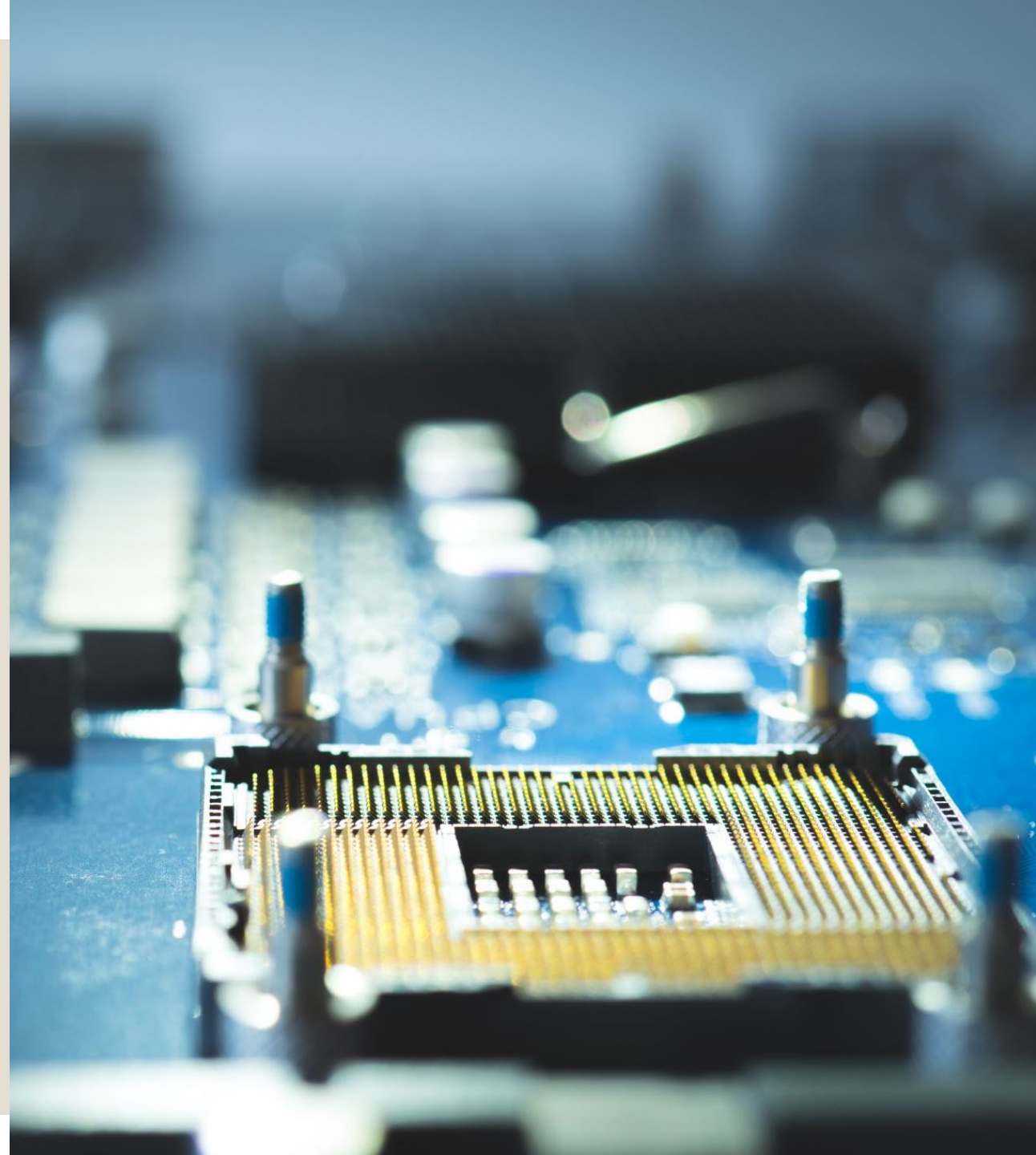
Audit Utility Companies

- Essential to review them and understand where opportunities exist to increase compliance.
- Review financial statements, customer lists, exemptions and the method used for calculating all revenues subject to the franchise fees.
- Compare the findings against payments remitted
- Geo-code customer list



Knowledge

- Technological advancements have become widespread in delivering certain utilities. More fees for:
 - Equipment
 - Connections
 - Service Upgrades
 - Premiums
 - Penalties
 - Services
- Need to be fluent with industry changes and industry language
- Main areas: Misallocation, omission, and/or accounting mistakes.



- **Regulatory Utility Commissions in Texas**
 - 1. Public Utility Commission of Texas**
 - a. Electricity**
 - b. Telecommunications**
 - c. Cable Service Provider**
 - d. Water**

 - 2. Railroad Commission of Texas (a/k/a Texas Railroad Commission)**
 - a. Gas**

 - 3. Texas Commission on Environmental Quality**
 - a. Municipal Solid Waste**

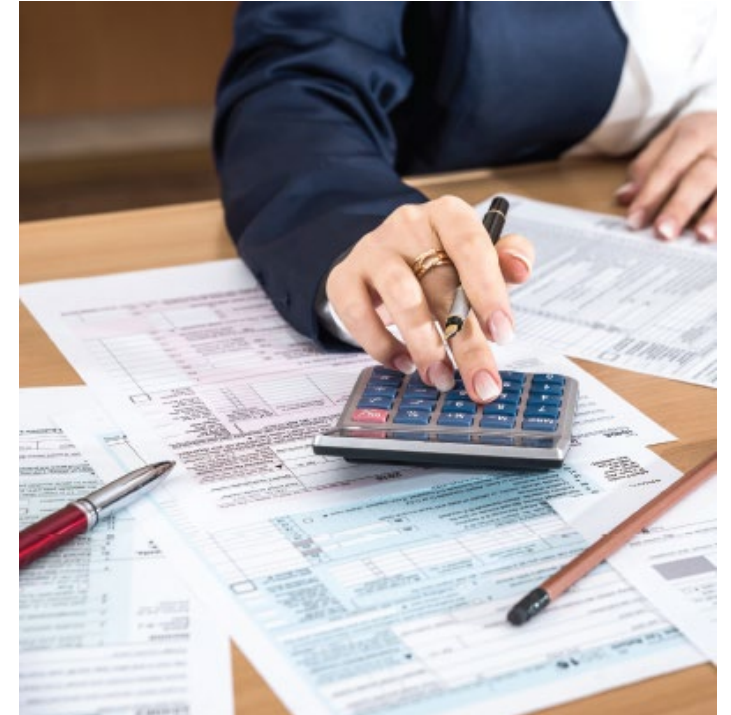
Municipal Franchise Agreements & Fees

Auditing Municipal Franchisees – Initiation

- **Audit Notification Letter and Request for Records**
 - Notification should be specific as to period under audit and should set mandatory dates for specific stages of audit*
- **Confidentiality & Non-Disclosure Agreements**
 - Typically the initial step in every Franchise Fee audit – whether conducted by governmental entity or private auditor
 - Universally requested by service providers across all industries
 - Can and will require legal efforts to negotiate and review these agreement
 - Watch out for pitfalls and traps that may hinder the audit

Auditing Municipal Franchisees - Records

- **Personally Identifiable Information (P.I.I.)**
 - Many utility companies will refuse to release records which contain P.I.I., even pursuant to tax or fee examinations
 - Some will request the City to issue an administrative subpoena prior to the production of such documents
 - Citing Federal Law (e.g. Title 47, U.S.C.A. 1 *et seq.* Federal Telecommunications Act & F.C.C.)



Conducting an Audit

Before The Audit Begins

How are franchise fees calculated? Gross Receipts? Per kWh? Does this include services?

Are gross revenues defined?

What products and services does the provider offer that fall under the definition (if provided)?

What kind of information would be necessary to verify franchise fees include all applicable revenue?

Common Industry Issues

- Correct classification of products and services
- Access line fees being charged correctly based on the customer type
- Customers being coded to the correct municipality
- Correct coding of exempt and resale customers
- Interpretations of the Ordinance/Agreement and Enabling Laws – i.e. Gross Receipts and Exclusions therefrom



Primary Issues on Audits

- **Interpretations of the Ordinance/Agreement and Enabling Laws – i.e. Gross Receipts and Exclusions therefrom**
 - Fee on Fee – i.e. reporting fees passed along to customers as revenues absent a statutory or lawful exemption
 - Exclusions of Various revenue categories – misc. fees
- **Failure to Make Widespread Corrections of Noncompliance After Audits have Exposed Them in Other Jurisdictions**
 - Any entity that hasn't been audited within 5 years
 - Entities that have had compliance issues on other jurisdictions



Partnership



Maintaining solid relationships demands uniform and fair collection and compliance with franchise fees



Investments that utility provider and jurisdictions make in each other will continue to deliver benefits through multi-year agreements

Case Study - Natural Gas

Natural Gas Audit- Large City

Issue found during audit

- Not including certain revenue accounts
 - Balancing Fees and Economic Development Fees
- Miscoded customers

Determination

- The fees were directly related to servicing the customers which fell within the definition of gross revenues.
- 700+ customers were found to be coded to the County when they should have been reported to the City. In contrast 500+ customers were coded to the City that should have been coded to the county.

Case Study - Natural Gas

(continued)

Natural Gas Audit- Large City

Results of the audit:

- ✓ Audit Findings: \$129,395 for Miscoded addresses + 86,702 for unreported revenue accounts.
- ✓ City has seen an average of \$60,000 increase in franchise fee payments annually from this provider.

Case Study - Natural Gas

(continued)

Natural Gas Audit- Small/Medium City

Issue found during audit

- Not including miscellaneous fees
 - Disconnect, reconnect, special service call fees, etc.

Determination

- Based on definition of gross receipts, the inclusion of miscellaneous fees were listed but only gave a partial listing; however, it was stated that the miscellaneous fees were “including but not limited to...”. Although these fees were not specifically listed, they were determined to be included as they were related to the provisioning of gas services.

Case Study - Natural Gas

(continued)

Natural Gas Audit- Small/Medium City

Results of the audit:

- ✓ Audit Findings: \$59,339 in franchise fees paid to the City.
- ✓ City has seen an average of \$20,000 increase in franchise fee payments annually from this provider.

Case Study - Electric

Electric Audit- Large City

Issue found during audit

- Miscoded customers
- Certain revenue accounts not reported

Determination

- One portion of the franchise fee is based on kWh provided to customers. Roughly 0.9% of customers were incorrectly coded. Rather than pulling the kWh for all miscoded customers, provider agreed to a calculation of an average monthly kWh rate for residential and industrial customer and applied the rates accordingly.
- The other portion of the franchise fee is a percentage of gross revenues from discretionary services. Certain service charges and move-in fees were not reported.

Case Study - Electric

(continued)

Electric Audit- Large City

Results of the audit:

- ✓ Audit Findings: \$118,872 in franchise fees paid to the City.
- ✓ City has seen an average of \$45,000 increase in franchise fee payments annually from this provider.

Case Study - Electric

(continued)

Electric Audit- Small/Medium City

Issue found during audit

- Not including franchise fees collected from customers

Determination

- Based on the franchise fee section of their agreement, the provider should be reporting on its "*gross revenues received from the furnishing of electric energy...*"

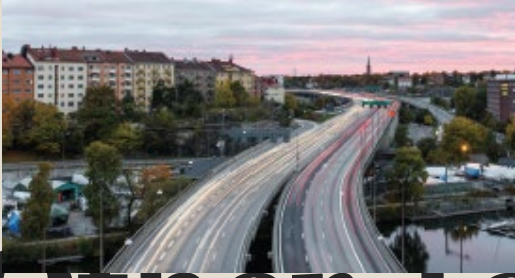
Case Study - Electric

(continued)

Electric Audit- Small/Medium City

Results of the audit:

- ✓ Audit Findings: \$288,392 in franchise fees paid to the City.
- ✓ City has seen an average of \$80,000 increase in franchise fee payments annually from this provider.



Other Taxes

Business/Occupational Tax

Rental/Lease Tax

Severance tax

Sugary Sweetened Beverage Tax

Utility Users' Tax

Business License Tax

Cannabis Tax

Gasoline Tax

Municipal Utility Tax

Income Apportionment Services

Sales & Use Tax

Solid Waste

Tobacco Tax