



Audit of Hotel Occupancy Tax

June 30, 2023

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Executive Summary

Objective and Scope

The objectives of this audit were to evaluate whether the City Controller ensures that: (1) the population of the hotels/short-term rentals is complete for collections; and, (2) all payments from known hotels/short-term rentals are received and accurately recorded.

The audit scope included tax collections from November 1, 2019, through March 31, 2022.

Recommendations

Management should:

- Develop and implement written procedures that ensure checks for hotel occupancy tax payments are safeguarded.
- Ensure all delinquent letters are sent timely.

Background

The hotel occupancy tax rate for the City of Dallas (City) was 7 percent of the room rate charged within city limits during the audit period. The tax rate was increased to 9 percent on January 1, 2023, to support the expansion of the Kay Bailey Hutchinson Convention Center Dallas and improvements at Fair Park. The tax is collected by the hotels at the point of sale and forwarded to the City monthly. Hotel occupancy tax applies to both hotels and short-term rentals. The City Controller is responsible for collecting the hotel occupancy tax.

The actual revenues of fiscal year 2020 and 2021 were significantly less than those of fiscal year 2019 and 2022 due to the onset of COVID-19 in March 2020. In Fiscal Year 2022, the City's Hotel Occupancy Tax revenue from hotels and short-term rentals was \$67.6M and \$2.8M, respectively. As of March 9, 2023, the City Controller's hotel occupancy tax list consisted of 270 hotels and 1,748 short-term rentals.

Observed Conditions

The City Controller's list of hotels that must pay hotel occupancy tax is complete and accurate. The City Controller has a list of short-term rentals that must pay hotel occupancy tax. However, the number of active short-term rentals is fluid, making it difficult for the City Controller to maintain a complete, accurate, and up-to-date list.

The hotel occupancy tax payments received are accurately recorded. However, there are opportunities for improvement in the collections process of the payments.

Objectives and Conclusions

1. Is the City Controller's list of hotels that have to pay hotel occupancy tax complete and accurate?

Yes. The City Controller's list of hotels is complete and accurate. According to the City Controller, as of March 9, 2023, the list consisted of 270 hotels. The City Controller follows written procedures to ensure that the list remains complete and accurate.

2. Is the City Controller's list of short-term rentals that have to pay hotel occupancy tax complete and accurate?

Generally, no. According to City Controller, as of March 9, 2023, the City Controller's list of short-term rentals included 1,748 entries. The City Controller has a contract with GovOS to detect newly active short-term rentals by researching online advertisements. The number of newly active short-term rentals identified by the City Controller ranged from 41 to 411 a month during the audit period. However, the number of active short-term rentals is fluid, making it difficult for the City Controller to maintain a complete, accurate, and up-to-date list. (See [Emerging Risk](#)).

3. Are hotel occupancy tax payments received during the audit period accurately recorded?

Yes. The City Controller accurately recorded hotel occupancy tax payments in the City's AMS Advantage 3 accounting system during the audit period.

4. Did the City Controller collect all the hotel occupancy tax owed to the City from hotels and short-term rentals on the City Controller's list?

Generally, yes. The City Controller follows written procedures to ensure the collection of all hotel occupancy tax owed to the City. However, there are opportunities for improvement in the following areas:

- Safeguarding payments made by check. (See [Observation A](#)).
- Delinquent account notifications. (See [Observation B](#))

Audit Results

Both *City Council Resolution 88-3428* and Administrative Directive 4-09, *Internal Control* prescribe policy for the City to establish and maintain an internal control system. The audit observations listed are offered to assist management in fulfilling their internal control responsibilities.

Observation A: Logs for Hotel Occupancy Tax Checks

Hotels and short-term rentals pay the hotel occupancy tax using GovOS online payment system or by mailing a check to Dallas Water Utilities' Division of Special Collections. Though payments are primarily made online, in March 2022, hotel occupancy tax payments made by check amounted to \$277,396, or 5.3 percent, of total payments. (See [Exhibit 1](#) below).

Exhibit 1:

Manual (Check) and Online Hotel Occupancy Tax Payments in March 2022

	By Check	Percent of Total	Online	Percent of Total	Total
Number of Payments	21	2.6%	779	97.4%	800
Amount of Payments	\$277,396	5.3%	\$4,986,339	94.7%	\$5,263,735

Source: City Controller

Special Collections does not record the receipt of the checks. Instead, the City Controller's staff pick up the checks from Special Collections; open the envelopes; retrieve the checks; post the amounts to the senders' accounts; and then bring the checks back to Special Collections. Once checks are returned, Special Collections records the checks in a log, and then deposits the checks. There is an increased risk that theft or loss of checks will not be prevented or detected.

Hotel occupancy tax payment checks mailed to the City may not be secure because two City departments have custody of the payment checks without recording them when received. Therefore, the City Controller cannot reliably reconcile the deposits against the checks received by Special Collections.

Criteria

- ❖ Standards for Internal Control in the Federal Government, *Principle 10.01 – Design Control Activities*
- ❖ Administrative Directive 4-09, Internal Control, *Section 5.1.3.1 – Control Activities*
- ❖ Administrative Directive 4-20, *Cash Handling and Cash Receipts*

Assessed Risk Rating:

Moderate

We recommend the **City Controller:**

A.1: Develop and implement written procedures that would ensure that hotel occupancy tax payment checks are safeguarded.

Observation B: Delinquent Account Notifications

The City Controller did not notify some delinquent accounts as described in their written procedures. Their written procedures note when a delinquent hotel occupancy tax is determined, the City Controller works with GovOS to send follow-up letters via e-mail to hotels/short-term rental owners.

However, follow-up letters were not sent on the first scheduled date for delinquent notices for three of the judgmental sample of 35 hotels (or 8.6 percent) selected for review. For the first account, a follow-up delinquent notice was not sent on the first scheduled date for delinquent notices (September 2020) but was sent in October 2020. The taxpayer paid the balance due on October 20, 2020. For the other two accounts, the notices were not sent on the first scheduled date (March 2021); however, the taxpayers paid the balances due before the second notices were scheduled to be sent in April 2021. If follow-up letters are not sent on time, the City may not maximize its hotel occupancy tax revenue.

The City Controller relies on GovOS to send follow-up letters to delinquent accounts but did not monitor GovOS to confirm all delinquent letters were sent promptly.

Criteria

- ❖ Standards for Internal Control in the Federal Government, *Principle 16.01 – Perform Monitoring Activities*
- ❖ City of Dallas Hotel Occupancy Tax Policies and Procedures, *Collection Process for Delinquent Taxes*.

Assessed Risk Rating:

Low

We recommend the **City Controller:**

- B.1:** Develop and implement written procedures that ensure monitoring of GovOS to confirm all delinquent letters are sent timely.

Emerging Risk:¹ Completeness and Accuracy of City Controller's Office's List of Short-Term Rentals

During the audit period, there was no legal requirement for short-term rental owners to register their property with the City, although they were legally required to report and remit their hotel occupancy tax to the City. Short-term rental owners can list and remove their properties on online platforms, such as Airbnb, at any time without the City's knowledge. The online listings do not include the short-term rental address, which further complicates detection. Therefore, it is difficult for the City Controller to maintain a complete, accurate, and up-to-date list of active short-term rentals required to pay hotel occupancy tax. As a result, the City could not maximize its hotel occupancy tax revenue.

The City of Dallas has a contract with GovOS, formerly known as MUNIRevs (see [Background](#) on page 7), to identify active short-term rentals that may owe hotel occupancy tax to the City. As of March 9, 2023, the City Controller's list of short-term rentals included 1,748 entries. The number of newly active short-term rentals identified by the City Controller ranged from 41 to 411 a month during the audit period.

During the June 14, 2023, City Council Agenda meeting the *Dallas City Code* was amended to add a new Chapter 42B "*Short-Term Rentals*," which requires all short-term rental owners and hosts to:

- Register annually through an application.
- Pay the annual registration fee.
- Allow initial inspection of property upon application and for renewal.
- Include rental registration number in public listings and advertisements.

The same chapter would require hosting platforms to:

- Register with the City of Dallas.
- Not collect fees for facilitating transactions of unregistered properties.
- Provide a monthly report of active listings within the City of Dallas.

¹ An emerging risk could impact the internal controls, effectiveness, and efficiency of activities performed by City Controller or other City departments.

Appendix A: Background and Methodology

Background

The City's hotel occupancy tax rate was 7 percent of the room rate charged within Dallas city limits during the audit period. The tax rate was increased to 9 percent on January 1, 2023, to support the expansion of the Kay Bailey Hutchinson Convention Center Dallas and improvements at Fair Park. The tax is collected by the hotel at the point of sale and forwarded to the City on the 15th day of the month following each month in which the tax is earned. The City Controller is responsible for collecting and distributing the hotel occupancy tax.

Hotel occupancy tax revenue is the largest revenue source for the Kay Bailey Hutchison Convention Center. Of the percentage the City receives, 67.4 percent supports operations and capital improvements at the Kay Bailey Hutchison Convention Center as required by *Dallas City Code*. The Fiscal Year 2023 budget shows that 25.1 percent will be distributed to VisitDallas to market and promote Dallas as a convention and tourist destination, and 7.5 percent will be distributed as a reimbursement to the Office of Arts and Culture to encourage, promote, and improve the arts.

On April 22, 2019, the City entered into a 60-month contract with MUNIRevs for \$591,000. In August 2021, MUNIRevs was acquired by GovOS. GovOS provides an online system to process registration and payments from hotels and short-term rentals. In addition, GovOS assists the City in detecting newly active short-term rentals by researching the advertisements online, which has been contributing to the increased number of short-term rentals on the City Controller's list (see [Exhibit 2](#)).

Exhibit 2:

Hotel and Short-Term Rental Counts by Fiscal Year

	2019	2020	2021	2022	As of March 9, 2023
Hotels	274	269	266	271	270
Short-Term Rentals	73	650	917	1,457	1,748
Total:	347	919	1,183	1,728	2,018

Source: City Controller

Definitions of Hotel and Short-Term Rental

During the audit period, the City of Dallas used hotel and short-term rental definitions from *Texas Tax Code*, according to which a hotel means any building in which members of the public obtain sleeping accommodations for consideration. The term includes a hotel, motel, short-term rental, tourist home, tourist house, tourist court, lodging house, inn, rooming house, or bed and breakfast. A short-term rental means the rental of all or part of a residential property for 30 days

or less. This includes homes or other units, such as a garage apartment or backyard cottage, listed for rent on platform websites such as Airbnb.

The City Controller handles the discovery and maintenance of a list of major hotels and motels (non-short-term rentals) by performing periodic reviews of the Certificates of Occupancy issued to hotels by the City's Development Services Department. The City Controller works with GovOS to discover and maintain a list of short-term rentals due to their fluid nature.

The City's Hotel Occupancy Tax Revenue

Hotel occupancy tax revenue declined sharply in Fiscal Year 2020 due to the onset of COVID-19 in March 2020. The hotel occupancy tax revenue recovered significantly in Fiscal Year 2022 (see [Exhibit 3](#)).

Exhibit 3:

Hotel Occupancy Tax Revenue by Fiscal Year

	2019	2020	2021	2022	As of January 31, 2023
Hotels	\$67,173,320	\$40,508,629	\$38,740,719	\$67,559,259	\$28,353,439
Short-Term Rentals	662,652	1,093,371	1,675,144	2,806,230	1,179,556
Total:	\$67,835,972	\$41,602,000	\$40,415,863	\$70,365,489	\$29,532,995

Source: City Controller

Hotel Occupancy Tax Exemption Rules

According to the *Dallas City Code*, certain guests are exempt from paying hotel occupancy tax. There are two types of exemptions: permanent and certificate.

A "*permanent exemption*" is granted to guests who have the right to use or possess a room in a hotel for at least 30 consecutive days, so long as there is no interruption of payment for the period. The guest must notify the hotel of their intent to stay at least 30 consecutive days by providing a letter of intent.

A "*certificate exemption*" is granted to guests affiliated with certain entities who have an official Texas Hotel Occupancy Tax Exemption Certificate (*Form 12-302*) from the State of Texas Comptroller of Public Accounts.

The hotel is responsible for ensuring that granted exemptions comply with the *Dallas City Code*. If the hotel mistakenly allows an ineligible exemption, the hotel is responsible for paying the City's applicable taxes (plus penalties and interest).

Tourism Public Improvement District

In addition to the Hotel Occupancy Tax, hotel guests in several Tourism Public Improvement Districts throughout Dallas pay an additional two percent assessment to the Dallas Tourism Public Improvement District Corporation. The Corporation provides incentives and marketing to bring more conventions, meetings, and visitors to Dallas. While, in general, the same rules that

apply to the hotel occupancy tax apply to the Dallas Tourism Public Improvement District Corporation assessment fee, it is an assessment that is separate from the hotel occupancy tax and is utilized for different purposes. As such, the Dallas Tourism Public Improvement District Corporation was outside of the audit scope.

City Controller's Hotel and Short-Term Rental Audits

To detect underpayment of hotel occupancy tax, the City Controller performs audits of hotels and short-term rentals. The City Controller's audit procedures state that hotels/short-term rentals may be selected for audit based on several reasons:

- Request for certificate of no tax due
- Request for a refund
- Failure to report
- Rotation basis
- Change of ownership or management
- Hotel closure
- Suspicion of fraud

In addition, the City Controller's Office performs periodic reviews to identify major hotels in the City that are not reporting hotel occupancy taxes. This review includes leveraging data collected by the state, including the hotels' monthly room receipts. The City Controller's Office compares this data to its hotel registration list to identify discrepancies. In addition, the City Controller's Office compares a listing of certificates of occupancy issued by the City to hotels to its hotel list to identify hotels that are not remitting hotel occupancy taxes.

In 2019, during a review of certificates of occupancy, the City Controller's Office identified a major hotel that had been operating in the City since October 2017 but had not paid hotel occupancy taxes. During the audit of this major hotel, the City Controller's Office discovered the proprietors owned a second major hotel operating in the City since 2009 which had also failed to pay hotel occupancy taxes. The City Controller's Office worked with the hotels to ensure they paid the tax, and completed audits of both hotels in 2019, which resulted in hotel occupancy tax assessments and collections totaling \$2,913,791.

The City Controller's Office's hotel and short-term rental audits have been effective in identifying and recovering, with the assistance of the City Attorney's Office, unpaid hotel occupancy tax assessments with the largest assessment in the amount of \$3,135,916 in fiscal year 2019 (see [Exhibit 4](#) on the next page).

Exhibit 4:

Hotel Occupancy Audit Recovery Amount by Fiscal Year

	2019	2020	2021	2022
Assessed Amount	\$3,135,916	\$26,833	\$117,131	\$587,084
Collected Amount	3,135,916	26,833	117,067	586,099
Outstanding Amount	\$0	\$0	\$64	\$985

Source: City Controller

Methodology

The audit methodology included: (1) interviewing personnel from the City Controller's Office and other city departments; (2) reviewing policies and procedures, the *Texas Tax Code*, applicable Administrative Directives, *Dallas City Code*, and Dallas City Council briefings; and (3) performing various analyses, including reviewing best practices. In addition, all five components of *Standards for Internal Control in the Federal Government* were considered.

We 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 upon our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major Contributors to the Report

Shino Knowles, CPA – In-Charge Auditor

Anatoli Douditski, MPA, CIA, CFE, ACDA – Engagement Manager

Appendix B: Management's Response

Memorandum



CITY OF DALLAS

DATE: June 22, 2023
TO: Mark S. Swann – City Auditor
SUBJECT: Response to Audit of Hotel Occupancy Tax Collections

This letter acknowledges the City Manager's Office received the *Audit of Hotel Occupancy Tax Collections* and submitted responses in consultation with the City Controller's Office (CCO).

The City Controller's Office (CCO) continually improves the Hotel Occupancy Tax collection processes. The City has a comprehensive process for identifying venues subject to hotel occupancy tax and ensuring complete and accurate tax collections. In 2022, the City's Hotel Occupancy Tax revenue totalled in excess of \$70,000,000, which in turn is invested in further developing the City as a premier travel and visitor destination.

The City believes its existing processes and controls are commensurate with the risks. However, the City has or will take additional steps to further mitigate the risks identified by the auditor.

For recommendation A.1., CCO has a common and effective compensating control to mitigate the risk of a lost or stolen check. GovOS sends weekly automated notifications to hotels and short-term rentals, alerting the taxpayer if a tax return is delinquent. If a taxpayer informs CCO that they filed the HOT return and paid the tax yet received a delinquency notice, CCO will initiate an investigation to resolve the matter. Further, with checks typically accounting for less than 3% of HOT payments, CCO believes the compensating control is a cost-effective control that adequately addresses the risks identified by the auditor.

In addition, CCO will enhance existing written procedures by changing the payment address on the tax return and instructions, so that taxpayers remit payments directly to CCO for processing, rather than DWU – Special Collections. CCO is confident the existing compensating control and further enhancements to the process will adequately safeguard HOT payment checks.

For recommendation B.1, CCO implemented an automated delinquent notification process in April 2022, shortly after the audit's scope period, to ensure delinquency notices are sent timely. Further enhancements to this process were completed in September 2022.

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Response to Audit of Hotel Occupancy Tax Collections
June 22, 2023
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Further, CCO will continue to periodically review its policies and procedures, and revise the process to respond to changes, including best practices that add value to the HOT collections process.

Sincerely,



tc broadnax (Jun 25, 2023 20:46 CDT)

T.C. Broadnax
City Manager

C: Genesis D. Gavino, Chief of Staff
Jack Ireland, Chief Financial Officer
Sheri Kowalski, City Controller

Assessed Risk Rating	Recommendations	Concurrence and Action Plans	Implementation Date	Follow-Up/ Maturity Date
Moderate	We recommend the City Controller:			
	<p>A.1: Develop and implement written procedures that would ensure that hotel occupancy tax payment checks are safeguarded.</p>	<p>Agree</p> <p>CCO is confident existing controls adequately mitigate the risks identified by the auditor. The City has a common and effective compensating control to mitigate the risk of a lost or stolen check.</p> <p>GovOS sends weekly automated notifications to hotels and short-term rentals, informing the taxpayer if a tax return is delinquent. If a taxpayer informs CCO that they filed the HOT return and paid the tax yet received a delinquency notice, CCO will initiate an investigation to resolve the matter. Further, with checks typically accounting for less than 3% of HOT payments, CCO believes the compensating control is a cost-effective control that adequately addresses the risks identified by the auditor.</p> <p>However, CCO will enhance existing written procedures by changing the payment address on the tax return and instructions, so that taxpayers remit payments directly to CCO for processing, rather than DWU – Special Collections. CCO is confident the existing compensating control and further enhancements to the process will adequately safeguard HOT payment checks.</p>	9/30/2023	3/31/2024

Assessed Risk Rating	Recommendations	Concurrence and Action Plans	Implementation Date	Follow-Up/ Maturity Date
Low	We recommend the City Controller:			
	<p>B.1: Develop and implement written procedures that ensure monitoring of GovOS to confirm all delinquent letters are sent timely.</p>	<p>Agree</p> <p>During 2019, the City contracted with GovOS, formerly MUNIRevs to implement software that allows online filing and payment of HOT returns. At the beginning of the contract, GovOS had a manual process in place to email monthly notices for the delinquent accounts.</p> <p>In April 2022, GovOS automated the email process to send the delinquent account notices every Tuesday. The City's HOT team has thoroughly tested the automated email process and is confident the process is working as designed.</p> <p>The automated process only sends delinquent notifications for accounts up to six months in arrears. In September 2022, the City Controller's Office worked with GovOS to implement a monthly manual email notification process for delinquent accounts greater than six months old.</p>	9/30/2023	9/30/2023