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Audit Report

**Performance Audit of the
HOTEL OCCUPANCY TAX
COLLECTION –**

SHORT TERM VACATION RENTALS

February 22, 2011

Office of the City Auditor
Austin, Texas

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City of Austin



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Date: February 22, 2011

To: Mayor and Council

From: Kenneth J. Mory, City Auditor

Subject: Performance Audit of Hotel Occupancy Tax Collection – Short Term Vacation Rentals

I am pleased to present this report on the performance audit of Hotel Occupancy Tax (HOT) Collection – Short Term Vacation Rentals. This is the first review that has included short term vacation rental properties. These properties are primarily residential properties rented out by owners for short periods of time.

We found that evidence strongly suggests that there are short term vacation rentals operating in Austin that are not paying HOT as required by City ordinance. In addition, City departments could coordinate better to identify short term vacation rental properties and inform them of the requirement to charge and remit HOT.

Based on our work, we recommend that the City website be updated to better inform short term vacation rental operators as to their responsibilities. We also recommend that City departments coordinate to better identify short term vacation rental properties, and that the update to the HOT ordinance make it clear that the ordinance applies to short term vacation rentals. Management has agreed to each of these recommendations

We appreciate the cooperation and assistance we received from staff in the Controller's Office, Code Compliance Department and Planning and Development Review Department during this audit.

cc: City Manager
Assistant City Managers
Controller
Public Information Officer

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COUNCIL SUMMARY

This report presents the results of the Hotel Occupancy Tax Collection –Short Term Vacation Rentals audit project.

City Code requires that lodging providers collect a nine percent Hotel Occupancy Tax (HOT) from occupants and remit the tax to the City Controller's Office. Included among those required to remit the HOT are tourist homes, lodging houses, rooming houses, or other building where a room is furnished for a consideration.

We found that evidence strongly suggests that there are short term vacation rentals operating in Austin without paying hotel occupancy taxes to the City. A January, 2011 review of listings on a worldwide vacation rental advertising website showed over 200 properties listed for Austin. However, the Controller's Office has only about 80 short term vacation rental property owners registered with the City.

We also found that improvements in communication and coordination between City departments are required to maximize HOT revenue collections for short term vacation rental properties. The Controller's Office, Code Compliance Department and Planning and Development Review Department should work together to make sure the Controller's Office is aware of the existence of short term vacation rental properties.

We also found that the Controller's Office could facilitate revenue collection by making the HOT reporting form more accessible to short term vacation rental property owners. Because the Controller's Office is not aware of all these properties, it cannot send information to property owners on the requirements to pay HOT. In addition, the HOT reporting form is not easy to find on the Controller's website.

Finally, we found that the most recent version of the HOT Ordinance update being prepared by the Controller's Office does not clarify the requirements for short term vacation rental properties.

We issued three recommendations as a result of our work:

- The Controller's Office should update its web site to make the HOT reporting form easier to find and work with major short term vacation rental marketing companies to provide links to the site
- The Controller's Office should coordinate with other departments to be informed of the existence of short term vacation rental properties.
- The Controller's Office should update the proposed amended HOT Ordinance to clarify that it applies to short term vacation rental properties.



ACTION SUMMARY HOTEL OCCUPANCY TAX – SHORT TERM VACATION RENTALS



Recommendation Text	Management Concurrence	Proposed Implementati on Date
1. The Controller's Office should update its web site to make it easier for short term vacation rental property owners to find the instructions for calculating and remitting HOT, and should work with major short term vacation rental marketing companies to provide links to the updated website	Concur. The Controller's Office will make available the Hotel Occupancy Tax forms and registration information on the Austin Finance Online website. The Controller's Office will also work with the Corporate Public Information Office to include the forms in the listing of City services on the City's main webpage.	6/30/2011
2. The Controller's Office should coordinate with the Code Compliance Department and Planning, Development and Review Department to implement procedures for the Controller's Office to be informed of the existence of short term vacation rental properties	Concur. The Controller's Office will work with Code Compliance Department and Planning, Development and Review Department to implement a process to notify the Controller's Office of short term vacation rental properties that are identified by these departments.	12/31/2011
3. The Controller's Office should update the proposed amended HOT Ordinance to clarify that it applies to short term vacation rental properties	Concur. Although the general requirements of the draft Hotel Occupancy Tax ordinance clearly specifies that it applies to overnight stays in excess of \$2, the Controller's Office will work with the Law Department to consider amending the ordinance to specify the requirement of short term vacation rental property owners to collect and remit Hotel Occupancy Taxes to the City of Austin.	6/30/2011

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BACKGROUND

City Code requires that lodging providers collect a nine percent Hotel Occupancy Tax (HOT) from occupants and remit the tax to the City Controller's Office.¹ Included within the designation of businesses required to collect and remit the HOT are hotels, motels, tourist homes, tourist courts, lodging houses, inns, rooming houses, or other building where a room is furnished for a consideration. The Controller's Office works with the City Law Department to collect delinquent taxes.

The revenues generated from HOT benefit four specific activities. These include the Austin Convention Center Department, Venue Projects, Tourism and Promotion, and Cultural Arts.

HOT revenues represent a significant resource to the City. Actual revenues for FY 2009 were \$41 million, and revenues were estimated at nearly \$40 million for FY 2010. Revenues are budgeted at nearly \$41 million for FY 2011.

The Office of the City Auditor has conducted HOT revenue reviews since 2005 and has reviewed over one hundred hotels, motels, and bed and breakfast inns for compliance with the HOT requirements and has identified \$1.87 million in delinquent tax revenue for collection. However, this is the first review that has included short term vacation rental properties. These properties are a relatively new enterprise that results from the high demand for short-term lodging in the City of Austin.

¹ City Code Chapter 11-2 – Hotel Occupancy Tax

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OBJECTIVES, SCOPE, AND METHODOLOGY

The Hotel Occupancy Tax – Short Term Vacation Rentals project was conducted as part of the Office of City Auditor's FY 11 Service Plan, as accepted by the Council's Audit and Finance Committee.

Objectives

Our audit objective was to determine whether the City has processes in place to assure that short term vacation rental properties are registered with the City and paying HOT.

Scope

The audit focused on the practices and procedures employed by City departments related to registration and HOT collection for short term vacation rental properties.

Methodology

To accomplish our audit objectives, we performed the following steps:

- Interviewed City personnel in departments involved in the development process, inspection, licensing, regulation, and collection of fees and taxes involved with lodging facilities
- Interviewed short term vacation rental industry personnel
- Researched web sites that advertise short term vacation rentals to get an estimate of the number of short term vacation rental properties operating in Austin

Scope Limitation

OCA attempted to quantify the number of short term vacation rentals operating in the City that were not paying the HOT. OCA began contacting Austin property owners who were advertising vacation rentals on a worldwide vacation rental website to determine if they were paying the tax. However, the owners of the site, on advice from their attorney, directed OCA to cease that activity. Subsequently, the City's Law Department has directed OCA that it has the right to contact the property owners. Therefore, HOT revenues related to short term vacation rentals will be the subject of a future report.

The web site owners stated a willingness to work with the City to help inform Austin property owners of the requirements for registering with the City and paying the HOT. Providing this information to property owners operating short term vacation rental in Austin could enhance revenue collection for the City.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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.

AUDIT RESULTS

The evidence suggests that short term vacation rental properties are operating in the City that have not been identified by the Controller's Office and are not paying HOT to the City. However, City departments can improve the process for identifying short term vacation rental property owners and informing them of the requirement to register with the City and remit Hotel Occupancy Taxes.

FINDING 1: Evidence strongly suggests that short term vacation rental properties are operating in Austin without paying hotel occupancy taxes to the City.

By City Code, the City levies the HOT on overnight stays costing more than two dollars in hotels, motels, tourist homes, tourist courts, lodging houses, inns, rooming houses or other building where a room is furnished for a consideration.² The City loses revenue to the extent that any short term vacation rental property owners are not remitting this tax to the City.

A search of a worldwide vacation rental website in January showed over 200 properties for rent in Austin. However, the Controller's Office estimates that there are only approximately 80 short term vacation rental property owners registered with the City. OCA was unable to determine whether the short term vacation rental registered with the City match any of the properties listed on vacation rental websites because of the scope limitation discussed earlier in this report.

The properties listed on vacation rental website ranged in size from a studio space attached to a private home suitable for two people to a six bedroom home suitable for fifteen people. The rental rates ranged from \$100 to \$3,000 per night. In addition, there are other websites where vacation rental properties may be advertised. There may also be properties that the owners do not advertise. Therefore, the short term vacation rental properties not registered with the City could represent a loss of HOT revenue.³

Short term vacation rental properties are almost exclusively residential properties. This presents a unique challenge in determining when they are being operated as rentals. As will be detailed later in this report, property owners are not required to identify these residential properties as rental properties when applying for a certificate of occupancy.

In addition, some property owners may not be aware of the requirements related to operating a residential property as a vacation rental. According to the management of a worldwide vacation rental website, most short term vacation rental property owners have limited experience dealing with local governmental regulation.

² City Code Chapter 11-2 – Hotel Occupancy Tax

³ OCA did not complete work to estimate the possible revenue stream from these properties as part of this audit because of the scope limitation discussed earlier in this report.

FINDING 2: Improvements in communication and coordination between City departments are required to maximize HOT revenue collections for short term vacation rental properties.

The City should be working to inform short term vacation rental property owners about the requirements to remit HOT. However, the processes within the City of Austin are not currently designed to recognize new or existing entrants into this industry. As a result, the City is not collecting all of the HOT revenue to which it is entitled.

The City does not notify short term vacation rental property owners of the requirement to register and pay HOT taxes when these properties are built or modified to become vacation rentals. The City periodically compares the list of entities registered with the state to the City's list. However, for property owners who are not registered with the City or the state, the City relies on the property owner to be informed of the requirement to register and pay HOT.

Planning and Development Review Department (PDR) does not require short term vacation rental property owners to identify the properties as such when the owners are seeking permits for building, remodeling, or expansion. PDR also does not communicate the existence of short term vacation rentals to the Controller's Office when they become aware of these rental properties. The Code Compliance Department (CCD) issues the operating license required for lodging facilities. PDR inspects properties for remodels and home additions and has oversight over zoning, development, and permitting for new properties.

CCD does not believe that short term vacation rentals are covered by the current City Codes. For instance, if a property owner intends to open a bed and breakfast, they are required to obtain a Change of Use Permit from the City's One Stop Shop. They can then obtain a Certificate of Occupancy and an operating license for the property. There is no such requirement for short term vacation rentals. In addition, there is an application and fee required for lodging licenses for entities such as hotels, motels and bed and breakfast inns. This is not the case with short term vacation rentals, and the City relies on property owners to voluntarily register their properties.

FINDING 3: The Controller's Office could improve public information and facilitate revenue collection by making the HOT reporting form more accessible to short term vacation rental property owners.

As stated earlier in this report, the City is currently relying on short term vacation rental property owners to be informed of the requirements to register their property and collect and remit HOT taxes to the City. It is therefore important for the City to make information easily available for property owners who are attempting to comply with HOT requirements.

The Controller's Office sends out the HOT reporting form, which includes instructions on how to compute the tax and a definition of who must pay the tax, to new hotel owners along with a list of frequently asked questions. However, because CCD and PRD are not informing the Controller's Office of the existence of short term vacation rental properties, the Controller's Office does not have a complete list of property owners who should be receiving the reporting form.

In addition, while the HOT reporting form is available on the Controller's Office website, it is not easy to find. Starting from the City Connection, it is necessary to go to the Financial Services Department website and from there to the City Controller's website in order to find the reporting form. It is not clear how the property owner would know where to find this form if they had not previously been required to file it.

FINDING 4: The most recent proposed update to the HOT Ordinance does not clarify the requirements for short term vacation rental properties.

City Management has been working to revise the HOT ordinance for approval by the City Council.⁴ However, based on the most recent draft version of the revised ordinance reviewed by OCA, it was not clear that the rules would apply to short term vacation rental properties. Clarifying that short term vacation rentals are considered lodgings would allow the City to inform property owners of the requirements related to these properties and to enhance the City's ability to collect HOT revenue from these rental properties. A possible alternative is to state that the HOT tax must be paid by any entity charging more than two dollars per day for lodging, then listing the exemptions from the rule.

⁴ City Code Chapter 11-2 – Hotel Occupancy Tax

Recommendations:

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. We believe that these recommendations provide reasonable approaches to help resolve the issues identified. We also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches and we encourage them to do so when providing their response to our recommendations. As such, we strongly recommend the following:

1. The Controller's Office should update its web site to make it easier for short term vacation rental property owners to find the instructions for calculating and remitting HOT, and should work with major short term vacation rental marketing companies to provide links to the updated website.

MANAGEMENT RESPONSE: Concur

The Controller's Office will make available the Hotel Occupancy Tax forms and registration information on the Austin Finance Online website. The Controller's Office will also work with the Corporate Public Information Office to include the forms in the listing of City services on the City's main webpage.

2. The Controller's Office should coordinate with the Code Compliance Department and Planning, Development and Review Department to implement procedures for the Controller's Office to be informed of the existence of short term vacation rental properties.

MANAGEMENT RESPONSE: Concur

The Controller's Office will work with Code Compliance Department and Planning, Development and Review Department to implement a process to notify the Controller's Office of short term vacation rental properties that are identified by these departments.

3. The Controller's Office should update the proposed amended HOT Ordinance to clarify that it applies to short term vacation rental properties.

MANAGEMENT RESPONSE: Concur

Although the general requirements of the draft Hotel Occupancy Tax ordinance clearly specifies that it applies to overnight stays in excess of \$2, the Controller's Office will work with the Law Department to consider amending the ordinance to specify the requirement of short term vacation rental owners to collect and remit Hotel Occupancy Taxes to the City of Austin

APPENDIX A

MANAGEMENT RESPONSE

ACTION SUMMARY

HOTEL OCCUPANCY TAX – SHORT TERM VACATION RENTALS

Recommendation Text	Management Concurrence	Proposed Implementation Date
4. The Controller's Office should update its web site to make it easier for short term vacation rental property owners to find the instructions for calculating and remitting HOT, and should work with major vacation rental marketing companies to provide links to the updated website	Concur. The Controller's Office will make available the Hotel Occupancy Tax forms and registration information on the Austin Finance Online website. The Controller's Office will also work with the Corporate Public Information Office to include the forms in the listing of City services on the City's main webpage.	6/30/2011
5. The Controller's Office should coordinate with the Code Compliance Department and Planning, Development and Review Department to implement procedures for the Controller's Office to be informed of the existence of short term vacation rental properties	Concur. The Controller's Office will work with Code Compliance Department and Planning, Development and Review Department to implement a process to notify the Controller's Office of short term vacation rental properties that are identified by these departments.	12/31/2011
6. The Controller's Office should update the proposed amended HOT Ordinance to clarify that it applies to short term vacation rental properties	Concur. Although the general requirements of the draft Hotel Occupancy Tax ordinance clearly specifies that it applies to overnight stays in excess of \$2, the Controller's Office will work with the Law Department to consider amending the ordinance to specify the requirement of short term vacation rental owners to collect and remit Hotel Occupancy Taxes to the City of Austin.	6/30/2011