

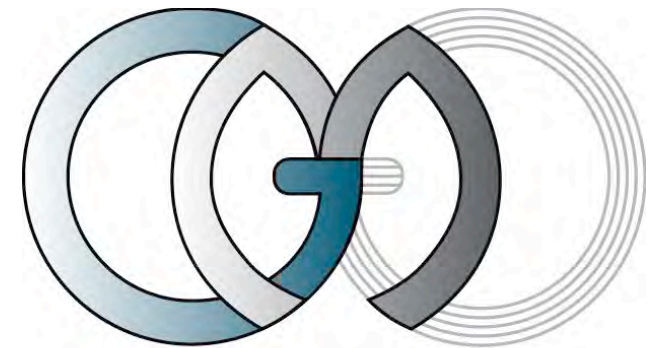


SAN DIEGO COUNTY  
**LODGING**  
ASSOCIATION

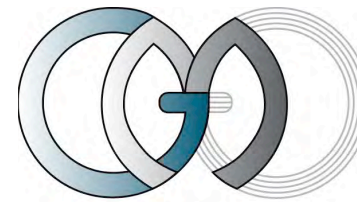


# GETTING AUDITED?

**Mitch Bryk, CPA**  
**Director, Grant McCarthy Group, LLC**



Grant McCarthy Group, LLC  
a tax consulting firm



Grant McCarthy Group, LLC  
a tax consulting firm



## Mitchell Bryk

Grant McCarthy Group

**Certified Public Accountant**

- Previously Vice President of Property, Sales & Lodging Tax at Starwood Hotels & Resorts
- Multistate Taxation Experience:
  - Sales/Use/Occupancy Taxes
- Industry Experience:
  - Hospitality
  - Public Accounting
  - Medical
  - Energy

GMG specializes in hotel industry transaction tax related issues.

# Overview

---

- OTC:
  - Terminology / Booking Process / Issues
- Legislation & Litigation
  - Occupancy Tax Ordinance + Regulations
  - San Diego Supreme Court / Appellate Court Cases
- Hotel Letter from City of San Diego (9/18)
- San Diego Tax Return (Revised 4/21)
- Hotel Audits
- Hotel/OTC Agreements
  - OTC Addendum

# OTC Terminology

---

- ❑ **Online Travel Companies (OTC)**

- Referred to as Third Party Intermediary or Room Remarketer.
- Arranges for the transfer of occupancy of accommodations.



- ❑ **Discounted Rate** – Agreed rate charged to the OTC by the hotel operator.

- ❑ **Posted Rate** – Room rate paid by the customer to the OTC.

- ❑ **Facilitation Fee**

- Profit margin (mark-up) earned by the OTC.
- Difference between Posted & Discounted rate.



- ❑ **Service Fee**

- Form of service charge set by OTC website.
- Bundled with tax & shown as "*Taxes & Services Fees*".



# OTC Terminology (Cont'd)

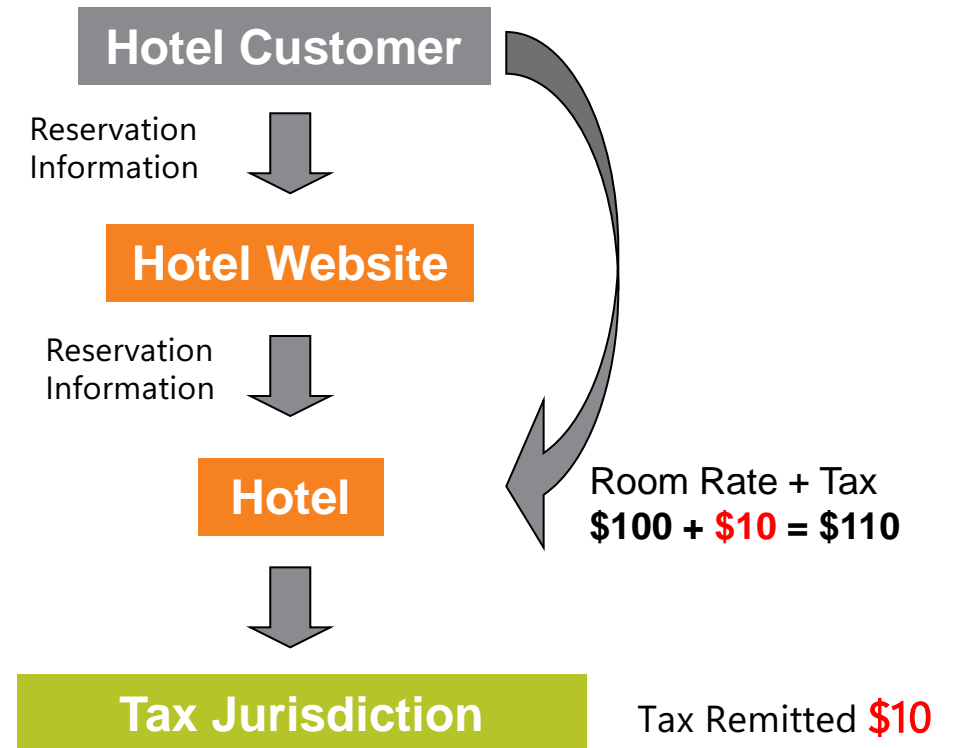
---

- ❑ **Direct Hotel Booking**
  
- ❑ **Commissionable Booking (Travel Agent Model)**
  - Travel agent (i.e., American Express).
  - Commission received by travel agent.
  
- ❑ **OTC Booking (Merchant Model/Wholesale)**
  - **Transparent**
    - ❑ Consumer selects both the rate and the hotel.
  - **Opaque**
    - ❑ Consumer selects price, area and hotel class,
    - ❑ Actual hotel name revealed only after payment.

# Direct Hotel Website Booking

1. **Customer** confirms reservation on **Hotel Website** at \$100 without up-front payment.
2. **Hotel Website** sends reservation information to specific hotel selected by consumer.
3. Room rate + applicable taxes (**\$110**) are paid directly by guest to hotel *at check-out*
4. **Taxes** on room rate (**\$10**) are remitted by hotel to appropriate tax jurisdiction

Customer Pays **\$110** *At Check Out*  
Room Rate \$100 / Room Tax Rate \$10



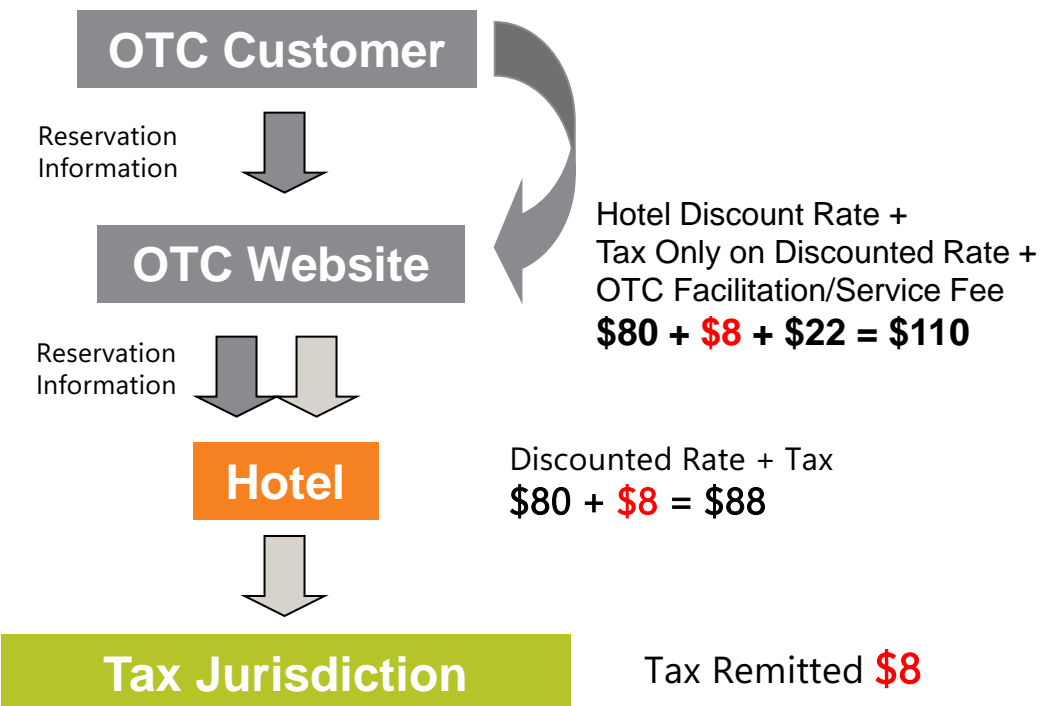
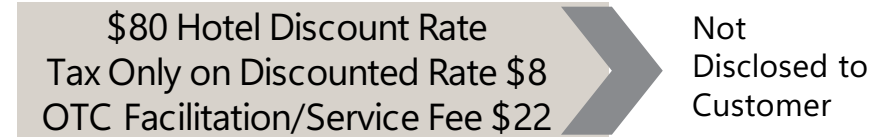
*Note – Tax Rate 10% for illustration purposes.*

# OTC Website Booking (Merchant Model/Wholesale)

- At time of booking, **OTC Website** collects from consumer:
  - Posted Rate + "Taxes and Fees" ( $\$100 + \$10 = \$110$ ) (Set by OTC) Comprised of:
    - \$80 Discounted Rate by Hotel  
+ Taxes Based on Discounted Rates ( $\$8$ ) ( $\$80 * 10\%$ )
    - \$22 OTC Facilitation/Service Fee
- Consumer Pays Total of \$110 + Stays at Property  
*Hotel has not yet received room & tax from OTC.*
- OTC Pays Hotel:
  - Hotel Discounted Rate ( $\$80$ ) +
  - Taxes Based on Discounted Rate ( $\$8$ )
  - Taxes previously collected by OTC at time of booking.*
- OTC Collects Facilitation/Service Fee ( $\$22$ )
- Hotel Remits Taxes on Discounted Rate ( $\$8$ ) to Appropriate Tax Jurisdiction

## Customer Pays **\$110 In Advance**

Posted Rate \$100 / "Taxes and Fees" \$10



*Note – Tax Rate 10% for illustration purposes.*

# Direct Hotel Website vs. OTC Booking

Direct Hotel Website Booking				
Room	Room + Tax	Full Hotel Rate		Tax Jurisdiction
\$100	\$110	\$100		\$10
Online Travel Company Website Booking				
Room	Room + Tax	Discounted Hotel Rate	OTC Facilitation/ Service Fee	Tax Jurisdiction
\$100	\$110	\$80	\$22	\$8

Hotels remit tax on the Full Hotel Rate / OTC's remit tax on Discounted Hotel Rate.

*Note – Tax Rate 10% for illustration purposes.*



# OTC Booking Issues

---

- ❑ Is the Facilitation Fee and Service Fee subject to state & local sales tax and/or occupancy taxes?
  - OTC's claim:
    - ❑ This is a retail transaction with two components:
      - Hotel Room Rental Rate and Facilitation/Service Fee

OTC's argue that they are service providers – merely facilitating the rental of a hotel room by a customer.

- ❑ If the Facilitation/Service Fee is subject to tax, who (hotel operator or OTC) should collect and remit the tax and file the appropriate tax return?
  - Dual Remittance System, or
  - Single Remittance System

# OTC's - Dual vs. Single Remittance

---

## □ Dual Remittance:

- OTC collects tax on the Posted Rate & remits tax on Discounted Rate to the hotel.
- Hotel remits tax to the state & local jurisdictions based on the Discounted Rate.
- OTC remits tax to the state & local jurisdictions based on the difference between the Posted Rate and the Discounted Rate.

## □ Single Remittance:

- OTC collects tax on the Posted Rate.
- OTC will remit the full amount of tax to the hotel.
- Hotel remits the full amount of tax to the state & local jurisdictions.

-or-

- OTC remits the full amount of tax to the state & local jurisdictions.

# Issue Summary

---

- ❑ Applicable taxes are already being collected by OTC websites on wholesale rate and remitted via local hotels.
- ❑ Hotels are not aware of actual selling price to the customer.
- ❑ Complete data on amounts received from customers resides only in the hands of the OTC's.
- ❑ OTC Websites are able to collect taxes on entire consumer payment as applicable net rate revenue taxes are levied today.

# Tax Jurisdictions Claims for OTC's

---

- ❑ OTC's are:
  - ❑ Hotel operators,
  - ❑ Control occupancy, and/or are
  - ❑ Resellers of hotel rooms.

OTC's should pay tax on the full amount paid by the consumer, not the lesser discounted rate the hotels receive.

# Legislation & Litigation

---

- State and Local tax jurisdictions have sought to address the issue through:
  - Legislation,
  - Litigation, and/or
  - Administrative provisions
- Several jurisdictions are taking steps legislatively to:
  - Amend statutes & ordinances,
  - Modernize the language, and
  - Clarify that the full room rate is subject to tax.

# Legislation – General Terminology

---

- ❑ **Operator** - Person who is the proprietor of the hotel.
- ❑ **Occupancy** - The use or possession, or the right to the use or possession, of any room, or portion thereof, in any hotel.
- ❑ **Rent** - The total consideration charged to a transient as shown on the guest receipt for the occupancy of a room.
- ❑ **Rate Parity:**
  - Legal agreement between a hotel and the OTC, providing the same rates for the same room on all the distribution channels.
  - San Diego states - Rate Parity is an agreement where the Operator sets the minimum amount that can be charged by the OTC for the Operator's room.
  - In general, it provides the same rates on all the OTC's booking platforms as well as on the hotel's own website.
- ❑ **Transient Occupancy Taxes (TOT) and Tourism Marketing District (TMD)**

# San Diego Municipal Code

---

## §35.0102 Definitions

- ❑ **“Operator”** - The Person who is the proprietor of the Hotel, Recreational Vehicle Park, or Campground, whether in the capacity of owner, lessee, sublessee, mortgagee in possession, licensee, or any other capacity. “Operator” includes a managing agent, a resident manager, or a resident agent, of any type or character, other than an employee without management responsibility.
- ❑ **“Rent”** - The total consideration charged to a Transient as shown on the guest receipt for the Occupancy of a room, or portion thereof, in a Hotel, or a space in a Recreational Vehicle Park or Campground. ... “Rent” includes all receipts, cash, credits, property, and services of any kind or nature without any deduction therefrom.

# San Diego Regulation - April 1, 2021

- ❑ **Purpose** - This regulation clarifies the definition of rent that is charged to transients and subject to the City's Transient Occupancy Tax (TOT).
- ❑ The following charges are considered "Rent" for the purposes of calculating TOT due:

Taxable Charges	
Rate Parity Amounts	Cancellation Fees + Non-Refundable Deposits
Third-Party Provider Fees Charged to the Guest	Forfeited Deposits
Equipment Rentals	Group Cancellation Fees
In-Room Movies + Entertainment	Attrition Fees
Early Check-In + Late Check-Out Fees	Resort Fees



# Litigation

---

- ❑ Many tax jurisdictions have sought clarification through litigation.
- ❑ Court decisions mixed because outcome turns on many factors:
  - Judicial interpretation of applicable statutes and ordinances,
  - Whether the locality complied with mandatory administrative tax assessment procedures prior to bringing suit against the taxpayers, and
  - The degree of control the OTC exercises with respect to the room rentals.
- ❑ Statutes and ordinances are vague on the issue.
  - Expanding interpretation of existing statutes & ordinances to encompass a new way of doing business
  - Merchant model wasn't contemplated when the statutes & ordinances were originally drafted.

# CA Supreme Court Case – 12/12/16

---

- ❑ **Legal Action** - Whether the San Diego transient occupancy tax is payable on the amount retained by the OTCs above the amount remitted to the hotels as the agreed wholesale cost of the room rental.
  
- ❑ The Court concluded: Under the San Diego ordinance, in a “merchant model” transaction of the sort at issue here:
  - The **operator** of a hotel is liable for tax on the wholesale cost plus any additional amount for room rental the operator requires the OTC to charge the visitor under what have been termed “rate parity” provisions of hotel-OTC contracts but,
  - As San Diego has effectively conceded, **OTCs** are not operators within the meaning of the ordinance.

# CA Court of Appeal – 3/28/18

---

- ❑ ... the city seeks to capitalize on the Supreme Court's comment that, "to the extent a hotel determines the OTC's markup, such as by contractual rate parity provisions requiring the OTC to quote and charge the customer a rate not less than what the hotel is quoting on its own website, it effectively 'charges' that amount.
- ❑ "To the extent a hotel determines the markup, such as by contractual rate parity provisions requiring the OTC to quote and charge the customer a rate not less than what the hotel is quoting on its own website, it effectively 'charges' that amount, whether or not it ultimately receives or collects any portion of the markup . . . ."
- ❑ The Court further explained that the only taxable amount is: "The wholesale room rate plus any portion of the markup set by the hotel pursuant to the contractual rate parity provisions or otherwise.
- ❑ Thus, it is the wholesale room rate plus the hotel determined markup, exclusive of any discretionary markup set by the OTC, that is 'charged by the Operator' and subject to the tax."

# San Diego's Position

---

- ❑ As set forth in the California Supreme Court Ruling, an OTC is a company that publishes on its website comparative information about hotels and motels and allows consumers to book reservations with these hotels and motels.
- ❑ OTCs contract with hotels and motels to advertise and rent rooms to the general public.
- ❑ OTCs handle all financial transactions related to the hotel and motel reservations and become the merchant of record as listed on the customer's credit card receipt, but OTCs do not themselves own, operate or manage hotels.

# Hotel Letter – September 10, 2018

HANDOUT #4

Letter to Hotels +  
SD Revised Tax Return

## Subject: California Supreme Court Ruling on Transient Occupancy Tax

- ❑ The California Supreme Court issued an opinion that may impact your hotel's payment of TOT and TMD assessments to the City of San Diego.
- ❑ The Opinion affects those hotels who sell rooms through OTCs under the "merchant model" and who have a rate parity agreement with one or more OTCs.
- ❑ Any rooms sold through an OTC, your hotel must remit TOT and the TMD assessment based on the minimum retail rate you require an OTC to charge its customer, otherwise known as the rate parity amount.
- ❑ Before the Opinion, hotels had only remitted occupancy taxes to San Diego on the wholesale room rate, resulting in underpayment of TOT and TMD assessments.

# Hotel Letter – September 10, 2018

---

**HANDOUT #4**  
Letter to Hotels +  
SD Revised Tax Return

- ❑ Many hotels have indemnification agreements with OTCs in which the OTCs have agreed to indemnify the hotels for any TOT and TMD assessment liability that results from the underpayment of TOT and TMD assessments in these circumstances.
- ❑ The purpose of this letter is to ensure that (1) you are complying with the Opinion and the City has been made whole for past TOT and TMD assessment underpayments resulting from erroneously calculated remittances to the City, and (2) on a going-forward basis, the City is paid TOT and TMD assessments on the rate parity amount and not the wholesale rate for merchant model transactions.
- ❑ To confirm your compliance with the Opinion, please send us all contracts and documents between your hotel(s) and all OTCs with whom you have had agreements from 2000 to the present.

# SD Tax Return – Revised 9/2020

HANDOUT #4

Letter to Hotels +  
SD Revised Tax Return

- ❑ Taxable/Assessable Rent - For rooms sold through an OTC, revenue received based on the Wholesale Room Rate must be included in Taxable/Assessable Rent.
  - The Wholesale Room Rate is the amount that an Operator charges an OTC for the Operator's room.
- ❑ Additional OTC Rent is the difference between the Wholesale Room Rate and the Rate Parity Amount for transactions in the reporting period.
  - The Rate Parity Amount is the minimum rate that an OTC must charge to sell an Operator's room which is set pursuant to an agreement between an Operator and an OTC (also known as a Rate Parity Agreement).
  - Additional information can be found at:  
<https://www.sandiego.gov/treasurer/taxesfees/tot/rateparityfaq>

# Hotel Audits

---

- ❑ City issues letter with audit period and request for documentation.
- ❑ Auditor may provide guides for how to run OTC reservation report and how to find guest payment summary.
- ❑ Requests screenshot of the guest reservation information and payment summary for a sample period.
- ❑ Refers Taxpayer to revised regulation clarifying definition of rent and link to the City's page regarding TOT/TMD Rate Parity.
- ❑ Notifies Taxpayer that they will estimate underreported OTC rent using audit procedures if requested documentation is not provided.



# Hotel Audits (Cont'd)

---

- ❑ Notify management of tax audit.
- ❑ Notify OTC of tax audit pursuant to any indemnification agreement with OTC.
- ❑ Comply with audit request in writing and on a timely basis.
- ❑ If OTC agreements are requested, notify corporate legal department.
- ❑ Seek outside professional advice if necessary.
- ❑ If tax assessment is received, notify OTC and protect appeal rights (14 days).

# Conducting an Audit

---

- ❑ **Pre-audit meeting** - Discuss hotel operations & the audit process.
- ❑ Review prior audit results.
- ❑ Identify any known problems, concerns or exposure issues.
- ❑ Relationship development is important.
- ❑ Keep the audit under control.
- ❑ Ask questions and request support.
- ❑ Set appointment dates.
- ❑ Get all requests in writing.
- ❑ Be consistent in answering questions.
- ❑ Set realistic expectations of when information can be provided.
- ❑ All information requests should be responded to in writing.
- ❑ **Exit conference** - Get a full explanation of the audit results.

# Hotel/OTC Agreements

---

## Confidentiality Clauses

- ❑ Many hotels have been audited by the City of San Diego (and other municipalities) and, in some instances, the City has requested the hotels to provide their OTC agreements.
- ❑ It is important for each member to thoroughly read and understand your OTC agreements, most importantly any confidentiality and indemnification clauses included in that agreement.
- ❑ Confidentiality clauses typically prohibit disclosing the OTC agreement to a third party without the express written consent of the Party whose information will be disclosed.
- ❑ The OTC's permission is required "in writing" before handing over the OTC agreement to any taxing jurisdiction.

# Hotel/OTC Agreements (Cont'd)

---

## Indemnification Clauses

- ❑ The agreement may include a clause which indemnifies and defends your hotel against a formal assessment by a governmental taxing authority.
- ❑ These “Indemnification Clauses” commonly include provisions requiring the other party to the agreement to be notified of an audit or formal assessment within a specific period of time.

# OTC Addendum - Sample

---

- ❑ The OTC's have provided many hotels with an "Addendum", which may impose changes to your existing OTC agreement.
  - The Addendum may offer to indemnify and defend your hotel against any assessment by a local taxing authority in the state of California.
  - One of the terms in this Addendum may involve the "**Rate Parity**" and/or "**Best Available Rate**" provisions included in your current OTC agreement.
  - The Addendum may require that your hotel agree that the OTC can display room prices for bookings at your hotel that are lower than the relevant "**Rate Parity**" and/or "**Best Available Rate**".
  - Since this language may have a major impact to your current OTC agreement and the manner in which room prices are marketed, we encourage you to seek legal counsel prior to agreeing to the terms of this addendum.

# OTC Addendum – Sample (Cont'd)

---

## Changes to Your Lodging Agreement with OTC's

- ❑ Certain jurisdictions have sent notices to hotels claiming that hotels owe TOT on portions of the Room Price for bookings that are retained by OTC's under the California Supreme Court case in re *Transient Occupancy Tax Cases* (the "**San Diego Case**").
- ❑ Below are the terms and conditions regarding OTC's agreement to indemnify you in certain circumstances and OTC's rights regarding the display Room Prices for your rooms. Please confirm acceptance of this agreement by signing below.
  1. With effect from the date of OTC's signature below, You agree that OTC can display Room Prices for bookings at your property that are lower than the relevant Best Available Rate.
  2. With effect from [Date] OTC agrees to indemnify and defend you against a formal assessment by a government taxing authority in California asserting a claim that under the San Diego Case, TOT are owed by you on the difference between the Remittance and Room Price {a "**Tax Claim**"}; provided that notice of a request for indemnity...

# Question & Answer

---

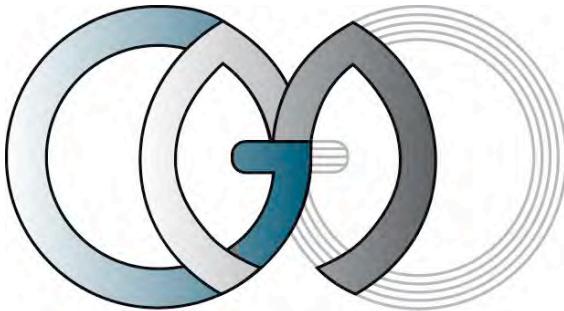
## Thank You!

Mitchell Bryk  
Director, Grant McCarthy Consulting  
[mbryk@gmgconsulting.com](mailto:mbryk@gmgconsulting.com)

Fred Tayco  
Executive Director  
[info@lodgingsd.com](mailto:info@lodgingsd.com)  
(619) 678-1195



# Thank You!



Grant McCarthy Group, LLC  
a tax consulting firm

**Mitch Bryk**  
Director, Grant McCarthy Group  
[mbryk@gmgconsulting.com](mailto:mbryk@gmgconsulting.com)

**Fred Tayco**  
Executive Director  
[fred@lodgingsd.com](mailto:fred@lodgingsd.com)  
(619) 678-1195

