



CITY OF NEWPORT BEACH FINANCE COMMITTEE STAFF REPORT

Agenda Item No. 5D
October 14, 2021

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Scott Catlett, Finance Director/Treasurer
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**SUBJECT: FINANCE DEPARTMENT REVENUE DIVISION AUDIT PROGRAM
UPDATE**

SUMMARY:

The City's Revenue Auditor ensures compliance with City vendor agreements and the Newport Beach Municipal Code (NBMC) by auditing vendor payments, transient occupancy tax, charter tax, waste hauler franchise, and other types of payments. The auditor's main tasks (among others) are to identify and prioritize taxpayers and contracts for auditing; recommend an audit schedule of taxpayers and vendors and execute such audits in the priority assigned by the Finance Director; ensure payments or refunds are made in a timely manner; and to develop internal controls to support revenue management activities and loss prevention.

The table below summarizes the number and type of audits conducted year to date since June 1, 2020. This period generally covers the activity that has occurred since the last report was provided to the Finance Committee. These audits have resulted in preliminary findings of taxes and other payments owed that amount to approximately \$82,000.

Audit Type	Audited to Date	Main Issue	Appeals	Prelim. Findings
Marine Charter Passenger Tax	3	Operating without MAP & Late Filing	0	\$2,000
TOT-STL Agents & Owners	16	Late Filing & Cleaning Fees	3	\$40,000
TOT-Hotels	1	Cancellation Fees	3	\$0
Franchise Solid Waste Haulers	20	Incorrect Gross Receipts	0	\$40,000
Total	40		6	\$82,000

RECOMMENDED ACTION:

Receive and file.

DISCUSSION:

Marine Charter Passenger Tax Audits

Boat charter operators are required to obtain an annual Marine Activities Permit (MAP) under NBMC Section 17.10. In addition, under NBMC Sections 3.34 and 5.04, charter operators are required to remit monthly marine charter passenger tax and obtain a business license, respectively. Under NBMC Section 3.34.110, the City of Newport Beach (City) has the right to review charter operator records. The number of charters in the City has grown from nine operators in 2019 to 25 in 2021. The Harbor Department's Code Enforcement Division has cited charter companies that were operating without a MAP and/or a business license. These discoveries are audited for charter tax owed to the City for previous periods. Three audited charters were discovered in early 2020 owing over \$2,000 in charter tax.

In March 2020, the Governor of California issued a stay-at-home Executive Order N-33-20. As a result, many Charter operators ceased operation in the months that followed. Some charters that were operating failed to file their monthly charter tax returns. The City assessed penalties and interest and brought these operators into compliance.

Transient Occupancy Tax (TOT) Audits

Under NBMC Section 3.16, transients who rent a room or space for 30 days or less shall pay a tax of nine percent of the rent charged by the operator. In addition, under NBMC Section 3.28, transients who rent a room or space for 30 days or less shall pay a fee of one percent of the rent charged by the operator. Under NBMC Section 3.16.110 the City has the right to audit the operator's records.

Hotels

In 2019 all hotels were audited by firms Davis Farr and Gruber & Associates. One common audit result was that some hotels failed to report cancellation fees. The City Attorney's office confirmed that cancellation fees are taxable under the NBMC Section 3.16. To improve future filings, the City provided cancellation fee information to the hotels. One hotel that had previously excluded cancellation fees had a follow up audit in 2021 and was found to be in compliance.

There is open communication between hotel management, and the City, to resolve issues such as taxable versus non-taxable fees and confirming exemptions prior to submitting

their monthly returns. This communication with the hotels is vital, as many hotels have recently experienced management and/or ownership changes this past year.

Three hotels filed appeals in 2020, all regarding late penalties. All three resulted in upheld decisions by the hearing officers.

Short-Term Lodging Agents

In 2019, 18 agents were audited by firms Davis Farr and Gruber & Associates. A common audit finding was that many agents who represent short term lodging permittees failed to report cleaning fees as part of taxable gross rent. The City provided cleaning fee information to the all the agents in an effort to improve future TOT filings.

NBMC Section 5.95 was revised in 2020. This change required agents to confirm they will collect and remit TOT on behalf of their clients and register with the City's Finance Director. Forty-three short term lodging agents registered with the Finance Director. Of those, 10 new agents were added this last year. New agents are reaching out to the City to obtain TOT returns and when doing so, are provided information on the City's tax requirements.

Short Term Lodging Owners

A total of 1,045 short term lodging owners filed their annual return in 2020. Seventy-six owners filed late returns resulting in late penalties and interest. Three owners filed appeals challenging late penalties, all of which resulted in upheld decisions by the hearing officers. Sixteen owners required an audit of their returns due to incorrect reporting. The majority of owners audited were represented by agents, which resulted in an audit of both the owner and their agents' returns.

New discoveries by the Revenue Division and enforcement of the code as it pertains to the illegal operation of short term lodging units continued throughout the year, resulting in the payment of back taxes and fees. One discovery resulted in taxes owed for three years in the amount of \$40,000.

Solid Waste Hauler Franchise Fee

NBMC Section 12.63 requires any person providing commercial solid waste handling services to obtain a franchise and pay a fixed percent franchise fee based on the quarterly receipts. The franchise fee is 18% and defined under Ordinance 2017-16. Consulting and audit firm Michael Balliet Consulting (Balliet) was engaged to conduct 30 audits on solid waste haulers for franchise fees for an audit period of one year. Balliet has completed 20 of the audits and discovered that a third of the haulers have tonnage and gross receipt reporting errors. In addition, haulers may also be subject to penalties and interest. Early audit findings have resulted in taxes owed of approximately \$40,000.

Findings

These audits have resulted in preliminary findings of taxes and other payments owed that amount to approximately \$82,000. Audits for TOT, Charter and Solid Waste will continue with a continued focus on new operators and franchises.

Prepared and Submitted by:

/s/ Antonio Velasco

Antonio Velasco
Revenue Auditor