TORONTO

REPORT FOR ACTION

Supplementary Report: Alternate Collection Options for Municipal Accommodation Tax (Hotel and Short-Term Rental Tax)

Date: January 30, 2018
To: City Council
From: Acting Chief Financial Officer
Wards: All

SUMMARY

In its consideration of Item EX30.4: *Implementation of Municipal Accommodation Tax (Hotel and Short-Term Rental Tax)* on January 24, 2018, the Executive Committee requested that the Interim Chief Financial Officer report directly to the City Council meeting on January 31, 2018 on alternative models for the collection of the Municipal Accommodation Tax (Hotel and Short-term Rental Tax), or MAT.

This report provides a comparison of alternate options for the collection of the Hotel Tax portion of the Municipal Accommodation Tax (MAT-Hotel), detailing the cost, efficiency and timing implications of alternate collection models.

RECOMMENDATIONS

The Acting Chief Financial Officer recommends that:

1. City Council receive this report for information.

FINANCIAL IMPACT

There are no direct financial impacts arising from the recommendation in this report.

However, should Council choose an alternate model for collection of the Hotel Tax portion of the MAT, e.g. in-house collection using City resources, rather than using the Greater Toronto Hotel Association (GTHA) as the City's collection agent as recommended in Item EX30.4, this decision will carry both cost and revenue implications, as set out below.

The estimated costs (annual + one-time set-up) to have the GTHA act as the City's collection agent totals approximately $587,000, compared to costs of $1,030,000 if collections were provided using City resources. This represents a total difference in costs of $443,000 for the first full year of operations (factoring in start-up costs), and an annual difference of $309,000 in each subsequent year. If, in future years, the City's collections costs are reduced (i.e., fewer positions required or efficiencies achieved), these savings would be reflected in future year operating budgets.

In addition, the 2018 budget estimate for hotel tax revenues in Item EX30.4 identifies projected gross revenues of $16.1 million, based on an April 1, 2018 implementation date (as proposed by the GTHA). Delaying the start date from April 1 to June 1 (i.e., using an in-house collection model) would result in a loss of potential tax revenue of $3.8 million over the current 2018 budgeted amount.

The total financial impact on current 2018 budget estimates of electing to utilize an in-house collection model is therefore a potential revenue loss of approximately $4.0 million, reflecting the reduction in potential hotel tax revenue from a June 1 start date, and the additional costs associated with using an in-house collection model.

DECISION HISTORY

On January 24, 2018, the Executive Committee, in its consideration of Item EX30.4: *Implementation of Municipal Accommodation Tax (Hotel and Short-Term Rental Tax)* requested that the Interim Chief Financial Officer report directly to the City Council meeting on January 31, 2018 on alternative models for the collection of the Municipal Accommodation Tax (Hotel and Short-term Rental Tax). Link to Committee decision: http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX30.4

COMMENTS

Item EX30.4 *Implementation of Municipal Accommodation Tax (Hotel and Short-Term Rental Tax),* includes a number of recommendations to authorize and implement a new Municipal Accommodation Tax (MAT), consisting of a Hotel Tax (MAT-Hotel) and a Short-Term Rental Tax (MAT-STR).

The recommendations include that, for the Short-Term Rental Tax, licensed short-term rental companies (e.g., internet site hosts) be authorized to act as the City's collection agent under an agreement with the City. This remains the preferred and recommended option for collection of the Short-Term Rental Tax, given that data on short-term rentals resides with the short-term rental companies, and that the taxes could be collected and remitted efficiently via electronic means by the licensed short-term rental companies (website hosts), under a voluntary agreement.

For the Hotel portion of the MAT, Item EX30.4 recommends that the Greater Toronto Hotel Association (GTHA) be appointed as the City's collection agent under an agreement with the City. The primary rationale for recommending the GTHA as the City's collection agent is to take advantage of the GTHA's experience in collecting the Destination Marketing Program (DMP) fees that it presently collects from participating hotels.

A key factor in the decision to appoint the GTHA as the City's collection agent lay in the urgency of implementing the hotel tax as early as possible in 2018, so as to maximize taxation revenue in the current fiscal year. Although Council had endorsed the implementation of a hotel tax in February of 2017, and had identified hotel tax revenues in planned budgets for both 2017 and 2018, the provincial regulations necessary to implement the tax were not enacted until December 1, 2017 with the passage of O. Reg. 436/17.

Given the short timeline that was set to begin collecting the hotel tax to maximize revenue collection in 2018, it was felt the GTHA, through their existing collection pathways, forms and reporting mechanisms, and their existing database of participating hotels, would be able to provide this service sooner, more efficiently, and at less cost than if the City was required to develop and implement its own systems to collect the tax.

Alternate Collection Options

A number of potential collection options for the Hotel Tax were evaluated by staff in the fall of 2017. These included:

- Competitive bid process to engage an external collection agent
- Collection by the Canada Revenue Agency
- Collection by the Greater Toronto Hotel Association
- Collection by the City using in-house resources

A summary of the advantages and disadvantages of each of these potential options are discussed below, and set out in Table 1.

Competitive bid process to engage an external collection agent

In considering potential collection models, the City evaluated whether a traditional competitive bid process could be utilized to identify external firms capable of providing this service, with a view to securing the lowest price for the service. However, given the need to have a collection agent appointed and in place as early as possible in 2018, and understanding that a traditional RFP approach could take between 6 to 12 months (including RFP development, award and lead time for the collection agent to begin collecting the tax), this option was not pursued further.

Collection by the Canada Revenue Agency

City staff contacted the Canada Revenue Agency (CRA) to determine whether the CRA would be able to provide collection, administration and audit services for the MAT-Hotel, as an extension of their current HST activities. A potential benefit of using the CRA for this service was that HST records could be used in the validation of the revenue amounts reported by hotels.

The CRA indicated that a realistic timeframe for implementation of the MAT-Hotel collection on behalf of the City would be approximately two years, i.e., by 2020. Additionally, staff concluded that the revenues reported for HST payment are not sufficiently matched to the revenues used to determine MAT-Hotel amounts, and so could not be used to verify hotel tax amounts payable. As such, and given the proposed timeline, this option was not pursued further, and costing was not explored.

Collection by the Greater Toronto Hotel Association

The GTHA currently collects the Destination Marketing Program (DMP) fees from its participating member hotels under a voluntary agreement. The GTHA therefore has an existing database of hotels and contacts, financial systems and reporting/remittance forms, protocols and electronic reporting systems that could be easily modified within a short timeframe (2-3 months) to allow the GTHA to begin collecting the MAT-Hotel Tax by April 1, 2018.

Additionally, the GTHA has existing audit functions that provide both auditing of the GTHA's financial and accounting systems, and regular compliance auditing of remittances by participating member hotels that would be made available to the City under a fee for service contract.

In terms of costing, the GTHA's preliminary pricing to provide this service was stated as $265,050 annually, one-time start-up/set-up fees of $25,900, and additional costing for individual hotel compliance audits of $1,200 - $1,500 per hotel (all figures net of applicable taxes). The annual costing includes a year-end audit of the GTHA's financial and collection systems.

In addition to the GTHA's fees, this option would require expenditures totalling approximately $300,000 annually, for City staff resources (1.5 full-time staff positions), office and administrative expenditures, and external audit costs.

The service agreement with the GTHA contemplated an initial term of 2 years, with a right to renew annually, for a further two (2) one-year periods, with the right provided to both parties to terminate the service agreement without cause on 60 days notice.

Collection by the City using in-house resources

City staff developed detailed costing estimates, and the staffing, I&T and administrative implications for the option of collecting the Hotel Tax portion of the MAT using in-house resources administered by the City's Revenue Services Division.

Using the in-house model would require:

- hiring 7 full-time staff positions, with total salaries and benefit costs of $660,000;
- expenditures of $85,000 for materials, equipment and overhead, including office accommodations, and printing/mailing costs;
- Contracting of external audit services to perform compliance and financial auditing, with annual costs of $125,000;
- One-time program development and set-up costs of $160,000, for I&T development and programming, notifications/communications and mailings, and costs to compile and maintain database of hotel properties.

The anticipated timeline for implementation using in-house City resources is estimated to be approximately 4 months, i.e., by June 1, 2018, reflecting the time required to post and fill new positions, acquire and program new financial systems to collect the hotel tax or to make modifications to the City's existing billing systems, development of communications materials and notifications, and the compilation of a billing database of hotel properties and contacts from scratch.

Table 1 below, provides a comparison of the advantages and disadvantages of each of these potential options.

Table 1: Comparison of Alternate Collection Options for Hotel Tax

Collection Option	**Disadvantages**	**Advantages**	**Costs**
Competitive bid process to engage an external collection agent	- Lead time to develop RFP, and evaluate and award contract could be 6-8 months, and 2-3 months for implementation, delaying start of collection of tax to 2019. - New firms would need to develop database of hotels and devise collection methodology.	- Traditional competitive bid process can identify capable firms, at lowest cost	Unknown (not evaluated)
Collection by the Canada Revenue Agency	- Hotel tax collection must be kept separate from HST system due to legislative reasons - cost relatively high due to lack of economies of scale - up to 2-year timeline (2020) for implementation - not possible to use HST remittances to verify against hotel tax remittances (no efficiencies gained)	- Could use CRA's expertise in the areas of registration, forms preparation, assessing, accounting, and notification	Unknown (not evaluated)

Collection Option	Disadvantages	Advantages	Costs
Collection by the Greater Toronto Hotel Association	- no direct control by City over collection methodology and processes - reliance on once-annual audit of financial controls	- implementation by April 1, 2018 - efficiencies gained from existing member database and collection pathways - reduced set-up costs	- Annual: $265,000/yr - one time set-up: $26,000. - City costs: $296,000/yr. **Total: $587,000.**
Collection by the City using in-house resources	- implementation by June 1, 2018 - delay in collecting tax revenue - need to develop collection methodology and protocols - time, cost and resources required to compile/maintain billing database from scratch - time and resources required to acquire new financial systems or re-program existing billing systems	- direct control over collection processes - full control over compliance audits - efficiencies from combining Hotel & Short term rental accounting and reporting functions	- Annual: $870,000/yr - one time set-up: $160,000. **Total: $1,030,000.**

Financial Implications of Opting for In-House Collection using City Resources

Table 1 above identifies that the costs (annual + one-time set-up) to have the GTHA act as the City's collection agent totals approximately $587,000, compared to costs of $1,030,000 if collections were provided using City resources. This represents a total difference in costs of $443,000 for the first full year of operations (factoring in start-up costs), and an annual difference of $309,000 in each subsequent year. If, in future years, the City's collections costs are reduced (i.e., fewer positions required or efficiencies achieved), these savings would be reflected in future year operating budgets.

Additionally, the 2018 budget estimate for hotel tax revenues in Item EX30.4 identifies projected gross revenues of $16.1 million, based on an April 1, 2018 implementation date as proposed by the GTHA. Under an in-house collection model using City resources, the projected start date is June 1, 2018. Delaying the start date from April 1 to June 1 would result in a loss of potential tax revenue of $3.8 million over the current 2018 budgeted amount.

The total financial impact on current 2018 budget estimates of electing to utilize an in-house collection model vs. using the GTHA as the City's collection agent is therefore a revenue loss of approximately $4.0 million, reflecting the reduction in potential hotel tax revenue from a June 1 start date, and the additional costs associated with using an in-house collection model.

CONTACT

Rob Hatton, Acting Executive Director, Corporate Finance
Tel.: (416) 392-9149; E-mail: robert.hatton@toronto.ca

Casey Brendon, Director, Revenue Services
Tel.: (416) 392-8065; E-mail: casey.brendon@toronto.ca

SIGNATURE

Joe Farag
Acting Chief Financial Officer