



## THE HOTEL TAX "TWO-STEP"

By **Bill Longley**, TML Legislative Counsel

In the grand scheme of things, city hotel occupancy taxes account for just a small amount of city revenue. Property taxes and sales taxes are far more important to most cities. Why does it seem, then, that hotel taxes generate so much confusion and controversy?

The answer is this: hotel taxes, unlike most other taxes, are levied on a specific category of businesses – hotels. As a result, these businesses tend to pay close attention to how cities expend these funds. Spend city sales taxes in a controversial way, and no particular category of business feels singled out enough to raise a fuss. Perceived misuses of hotel taxes, on the other hand, are a different story.

Fortunately, it's very easy for a city official to remember how to legally spend hotel taxes. A city simply needs to remind itself to always follow the "two-part test." The key element of a two-part test is – surprise – that it has two parts! Cities frequently remember to meet one element of the test, but then entirely forget the other part. This article will succinctly describe the two-part test, and then describe some common situations to which we can apply the test.

### Part One: Heads in Beds

The first element of the two-part test is this: every expenditure of hotel taxes must generally put "heads in beds." State law requires local hotel tax expenditures to "promote tourism and the convention and hotel industry." What this means is that every funded project must attract overnight tourists to the city's hotels and motels or have some other direct economic impact at an area hotel, thus promoting the city's hotel industry.

For example, how about a weekend-long arts and crafts show? There's a very good chance that out-of-town guests might come to visit such an event, so expenditure of hotel tax money on that event would likely qualify.

On the other hand, what about a quilting bee at a local retirement home? While a worthy cause, the quilting bee is unlikely to attract overnight tourists and, therefore, probably wouldn't qualify to receive hotel tax funds.

### Part Two: The Nine Categories

Once a project has cleared the first part of the test, it's time for – you guessed it – the second part of the test. Here it is: every expenditure of local hotel taxes must *also* fit into one of nine statutorily authorized categories. These are the nine categories: (1) convention and visitor centers; (2) convention delegate registration; (3) advertising and promotional programs to attract tourists and visitors to the city; (4) promotion of the arts; (5) historical restoration and preservation; (6) sporting events in a county under one million in population; (7) enhancing or upgrading existing sports facilities or sports fields (only in certain cities); (8) tourist transportation systems; and (9) signage directing the public to sights and attractions that are frequently visited by hotel guests in the city.

Thus, even if an event puts heads in beds or otherwise economically benefits area hotels, it cannot receive hotel tax money unless it also fits into one of the nine categories. For instance, what about a livestock auction that will attract attendees from surrounding counties? While that event is likely to attract overnight tourists, it doesn't fit neatly into one of the nine categories. Therefore, it's likely not a valid recipient of hotel tax money.

It's not enough to meet one of the two prongs of the two-part test. A city must meet both! The following are some real-life examples that have been the focus of inquiries received by the Texas Municipal League (TML) legal department.

### Fireworks, Anyone?

The prototype hotel tax controversy is an event like a fireworks show or a parade. Cities frequently ask if they can fund a fireworks show with hotel tax money.

Let's subject a fireworks show to the two-part test. Does a fireworks show put heads in beds? The answer is "probably not," unless it is a truly spectacular event. But let's give it the benefit of the doubt. Suppose the Town of Pyrotechnic, Texas, truly does put on a fireworks extravaganza that attracts tourists from around the state. So far, so good.

But what about the second part of the test – the nine categories? Do fireworks shows fit neatly into any of the nine? Not really. Some may argue that such shows “advertise” the city, but this is likely not what that category means. Advertising the city literally means some sort of print or other media that explicitly promotes the city. Otherwise, a city could simply say that any popular event “advertises” the city that holds it. Direct funding of fireworks displays and the like are usually not a very good fit.

### **Signs of the Times?**

Another frequent question concerns highway signs promoting the city. May a city fund a billboard touting the city’s attractions, restaurants, and hotels? Let’s put it to the two-part test. Heads in beds? Well, why not? If a billboard encourages motorists to stop in town, those motorists might stay the night, whereas without the sign they would have driven on to the next city. This is exactly what the statute intends. The nine categories? How about advertising? Prior to 2009, a convincing argument could be made that because a billboard literally advertises the city it refers to, that it would fit within the advertising category. All doubt was erased in 2009, when the Texas legislature added the ninth category – signage directing the public to sights and attractions. Wayfinding signs for tourist attractions are a perfect fit for hotel occupancy tax expenditures.

### **Chambers of Commerce?**

Cities frequently wonder if they can fund the local chamber of commerce using hotel tax money. Do chambers put heads in beds? Maybe, but maybe not. Chambers of commerce are typically charged with promoting economic development, not tourism. Even assuming a chamber does promote tourism though, how about the nine categories? Funding a chamber doesn’t, in itself, fall into any of the nine categories.

Fortunately, there is an easy solution. The laws governing hotel tax expenditures permit the city to delegate expenditure of hotel tax money to another entity, typically a chamber or convention and visitor bureau. As long as the chamber spends the money on projects that otherwise meet the two-part test mentioned above, it’s fine to delegate some funds to them. There must be a written contract laying out the duties of the chamber, though. Also, the chamber must keep the hotel funds in an account separate from its general operating fund.

### **Arts Organizations**

City arts organization proposals are a common source of questions on hotel tax expenditures. Arts councils throughout the state know that promotion of the arts is one of the nine categories on which city hotel taxes may be expended. Cities know this because these arts groups frequently seek local hotel tax funding.

Cities should encourage arts groups to seek funding for their festivals and shows that attract overnight tourists to the city or otherwise have a financial impact on area hotels. By limiting arts expenditures to such costs, a city can ensure its expenditure meets both parts of the test.

### **Don’t Forget to Report**

Legislation passed in 2017 requires cities to annually report hotel occupancy tax information to the comptroller, including information on how the funds are spent. Not later than February 20 of each year, a city that imposes a hotel occupancy tax must submit to the comptroller information that includes the city’s hotel occupancy tax rate, the amount of revenue generated by the tax, and the amount and percentage of the revenue spent for each of the following purposes:

- Convention or information centers
- Convention delegates registration
- Advertising to attract tourists
- Arts promotion and improvement
- Historical restoration and preservation projects
- Signage directing the public to sights and attractions

Cities must comply with the annual reporting requirements by either submitting the report to the comptroller on a form prescribed by the comptroller, or alternatively providing the comptroller a direct link to, or a clear statement describing the location of, the information required to be reported that is posted on the city’s website. City reporting data can be accessed at <https://comptroller.texas.gov/transparency/local/hotel-receipts>.

### **What Else?**

There are numerous other technical details about how to legally expend hotel tax funds. In truth, by simply learning and remembering the two-part test, city officials are 99 percent of the way toward full compliance with hotel tax laws. City officials with questions about the hotel occupancy tax should call the TML legal department at 512-231-7400. ★