# LONG-TERM LODGING EXEMPTION

EVALUATION SUMMARY

SEPTEMBER 2018
2018-TE8

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

| | |
|---|---|
| YEAR ENACTED | 1959 |
| REPEAL/EXPIRATION DATE | None |
| REVENUE IMPACT | $12.3 million (CALENDAR YEAR 2017) |
| NUMBER OF TAXPAYERS | Could not determine |
| AVERAGE TAXPAYER BENEFIT | Could not determine |
| IS IT MEETING ITS PURPOSE? | Yes, but it may not be applied consistently |

## WHAT DOES THIS TAX EXPENDITURE DO?

The Long-Term Lodging Exemption excludes tax stays of 30 days or more at lodgings, such as hotels, home shares, and campgrounds from state sales.

## WHAT DID THE EVALUATION FIND?

We determined that this exemption is likely accomplishing its purpose for a substantial portion of long-term stays; however, some lodging providers may not consistently apply the exemption.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider amending statute to clarify the exemption's eligibility requirements and clarify its applicability to third-party payers.

## WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Because it was created at the same time that the State established a sales tax on lodgings, we inferred that the purpose was to establish the maximum length of stay for which lodging sales would be subject to the tax and ensure that individuals who purchase long-term housing from lodging providers, such as hotels or home shares, are treated the same as individuals who purchase long-term housing through traditional apartment or home lease agreements since these types of agreements are also not subject to state sales tax.

# LONG-TERM LODGING EXEMPTION

## EVALUATION RESULTS

### WHAT IS THE TAX EXPENDITURE?

In 1959, the General Assembly established a sales tax on temporary lodgings and created the Long-Term Lodging Exemption at the same time. The exemption has remained substantially unchanged since that time. According to Section 39-26-104(1)(f), C.R.S., sales of lodgings that are typically used for short-term stays, such as hotels, home shares, guesthouses, and trailer parks, are generally subject to state sales tax. However, under the Long-Term Lodging Exemption [Section 39-26-704(3), C.R.S.], sales of lodgings for stays of 30 consecutive days or more are tax exempt. In addition, eligible lodging purchases are exempt from local sales taxes, including lodging taxes, in cities and counties that have their local sales taxes collected by the State on their behalf. This is because statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Long-Term Lodging Exemption. Home-rule cities established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to set their own tax policies independent from the State and are not required to exempt long-term lodging from their local sales tax, although many choose to do so.

For a sale to be eligible for the exemption, there must be a written agreement for occupancy between the purchaser and lodging provider, which can include a receipt or a hotel registration, and the same payee must pay for the duration of the stay, which must be at least 30 consecutive days. If the price of the stay is not paid in full up-front, or is paid up-front but is refundable, Department of Revenue guidance indicates that lodging providers can either not collect the sales tax, in which case they would be liable for the sales tax if the customer does not complete at least a 30-day stay, or collect the tax and then refund it after the customer has stayed at least 30 days. In some cases, the customer may have to apply to the Department of Revenue for a refund if they stay for at least 30 days, but the lodging provider collects the sales tax and does not refund it. Lodging providers must have a sales tax license and report the value of the Long-Term Lodging Exemption on the Department of Revenue's Retail Sales Tax Return (Form DR 0100) using the "other exemptions" line of the form's exemptions schedule. This line aggregates several exemptions that do not have a separate reporting line on the form.

## WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. Based on the statutory language of the exemption, we inferred that the intended beneficiaries of this exemption are individuals and businesses who purchase long-term stays in lodgings, such as hotels, corporate housing, home shares (including online platforms such as Airbnb, Vacation Rentals by Owners (VRBO), and HomeAway), recreational vehicle parks, and campgrounds, which are typically subject to state sales tax. According to a 2006 study conducted by the U.S. Census Bureau, individuals who occupy hotels on a long-term basis do so for a variety of reasons, including, financial hardship that results in the loss of permanent housing, relocation by an employer on a temporary or permanent basis, loss of a home to fire or natural disaster, or a decision to live in high-end hotels to have access to luxury services. Some of these individuals choose hotels specifically designed and marketed for extended stays, but others stay in traditional hotels, some of which may offer low rates and flexible payment terms (e.g., discounted weekly rates, day-to-day payments) targeted to individuals experiencing financial hardship.

## WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Because it was enacted in 1959, concurrently with the state sales tax on lodging, we inferred that the purpose was to limit the state sales tax on lodging to individuals making short-term stays (less than 30 days) and provide parity in tax treatment between people who enter into residential leases for 30 days or more (which are not subject to sales tax) and people making long-term stays at lodging establishments which are more typically used for short-term stays by travelers.

## IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that this exemption is accomplishing its purpose for many long-term occupants of lodgings, but some lodging providers may not consistently apply it. Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its inferred purpose.

**PERFORMANCE MEASURE:** *To what extent are the amounts paid for long-term lodgings being exempted from sales tax?*

**RESULT:** Although we lacked adequate data to quantify the extent to which customers who make stays of 30 days or more in otherwise taxable lodgings are properly exempted from state and local sales tax, we determined that the exemption is likely applied to a substantial portion of lodging sales. Specifically, based on our analysis of Department of Revenue data and information from lodging providers, we estimate that the exemption was applied to $423 million (10 percent) of about $4.3 billion in total retail lodging sales in the state (see discussion below on how we arrived at our revenue estimates), which indicates that the exemption is frequently used. However, we did not have information on what percentage of stays were for 30 consecutive days or more, and therefore eligible for the exemption.

Despite evidence that the exemption is frequently used, we also found that lodging providers may not consistently apply the Long-Term

Lodging Exemption, which could reduce the extent to which long-term stays are exempted from sales tax. Specifically, we found the following based on our review of several types of lodging providers:

- **TRADITIONAL HOTELS.** We called a non-statistical sample of 20 Colorado hotels, including several large hotel chains, and customer service representatives at eight of the hotels indicated that they would not charge sales tax for a planned stay of 30 or more days (40 percent). Of the remaining 12 hotels that indicated that they would charge the sales tax, two stated that they would only apply the exemption for stays of 31 days or more and the other 10 did not seem to be aware of the exemption.

- **EXTENDED STAY HOTELS.** We reviewed the online booking systems of five extended stay hotels and found that three did not include sales taxes in their quoted price for a planned stay of 30 or more days, the other two included the sales tax in the quoted price. We contacted each hotel and staff at all five indicated that the tax would be refunded or credited to a guest's account after 30 days.

- **CORPORATE HOUSING.** We interviewed representatives from two corporate housing providers that specialize in providing accommodations, such as furnished apartments, for long-term business travelers, and both indicated that they apply the exemption to stays of 30 or more days.

- **HOME SHARES.** We reviewed the websites of Airbnb, VRBO, and HomeAway, the three largest home share platforms. We found that as of March 2018, Airbnb's website applies the exemption correctly to the quoted price of most long-term stays, although it appears to require a stay of 31 or more days before removing sales taxes. VRBO and HomeAway typically place the responsibility of sales tax collection and remittance on the lodging owners and there was no data available to determine the extent to which they apply the exemption.

Though our assessment of the practices of lodging providers suggests that some may improperly collect sales tax from customers making long-term stays, we did not inform the providers that we contacted that we would expect them to exempt long-term stays from sales tax. Thus, it is possible that if a customer knew that the exemption should apply and asked the lodging providers' customer service representatives to remove or refund the sales tax, the providers would do so. However, based on our limited survey of hotels in the state, it appears that lodging customers who are unaware of the exemption may be charged sales tax by some lodging providers.

## WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

We estimate that about $12.3 million in state revenue was forgone in Calendar Year 2017 as a result of the Long-Term Lodging Exemption. As shown in EXHIBIT 1.1, we calculated the revenue impact estimate separately for the hotel and corporate housing industry sectors due to different data sources for each sector.

EXHIBIT 1.1.
ESTIMATED REVENUE IMPACT OF THE LONG-TERM LODGING EXEMPTION
BY LODGING INDUSTRY SECTOR
CALENDAR YEAR 2017

| | Sales Attributable to Long-Term Stays (30 days or more) | State Revenue Impact | Local Government Revenue Impact | Total Revenue Impact |
|---|---|---|---|---|
| Hotels and Home Shares[1] | $356 million | $10.3 million | $6.6 million | $16.9 million |
| Corporate Housing[2] | $67.3 million | $2 million | $1.3 million | $3.3 million |
| TOTAL | $423.3 million | $12.3 million | $7.9 million | $20.2 million |

SOURCE: Office of the State Auditor analysis of data from the 2015 Department of Revenue reports, State Demographer data, Bureau of Economic Analysis data, and information published by industry associations.
[1] Data provided in the Department of Revenue 2015 Retail Sales Tax Reports.
[2] Data provided by Corporate Housing Providers Association. Assumes that all corporate housing stays are 30 days or longer.

To arrive at the revenue impacts, we first estimated the total taxable revenue associated with long-term lodging stays of 30 days or more. We used data from the Department of Revenue's 2015 Retail Sales Tax Reports to determine that hotels and other types of accommodations, such as home shares, reported $450.6 million in tax exempt sales (the difference between net sales and taxable sales on their Retail Sales Tax Returns) in Calendar Year 2015 (the most recent year available), which includes exempt sales for lodging and other items, such as food. Although the Department of Revenue does not collect data specifically for the Long-Term Lodging Exemption on its Retail Sales Tax Return (Form DR 0100), our review of the State's sales tax exemptions indicates that this exemption is likely the most common exemption that would apply to sales of lodging. There are no other sales tax exemptions specifically targeted to the lodging industry and only a few other exemptions appear to potentially apply to the lodging providers, such as exemptions on food sold through vending machines (Section 39-26-714(2), C.R.S.), and food provided to restaurant staff (Section 39-26-707(2)(a), C.R.S). We attributed a factor of 25 percent to these nominal other exemptions. Therefore, we assumed that 75 percent of the tax exempt sales reported by lodging providers were due to the Long-Term Lodging Exemption. We multiplied this figure by the $450.6 million in reported exempt sales, to estimate $337.9 million in Long-Term Lodging Exemptions for Calendar Year 2015. We then increased this amount by 5.3 percent to account for growth in the hotel industry from Calendar Year 2015 to 2017, as reported by the U.S. Bureau of Economic Analysis, to arrive at our estimate of $356 million in exempted sales for the hotel and home share sector.

Because corporate housing providers may not be included with hotels and other types of accommodations in the Department of Revenue's retail sales tax reports, we obtained sales revenue data from the Corporate Housing Providers Association, which showed total U.S. corporate housing revenues of $3.2 billion in Calendar Year 2016. We multiplied this figure by 2.1 percent, which is the share of U.S. hotel sales that occurred in Colorado in 2012, which is the most recent year available, to estimate $65.9 million in Colorado corporate housing sales. We then increased this amount by 2 percent to account for industry growth and inflation from Calendar Year 2016 to 2017, as reported by the U.S. Bureau of Economic Analysis, to arrive at our estimate of $67.3 million in Colorado corporate housing sales for Calendar Year 2017. We assumed that all of these sales were exempt under the Long-Term Lodging Exemption because according to the stakeholders we contacted, it is uncommon for corporate housing units to be used for shorter-term stays, though a few shorter term stays could be included in our estimate and cause a slight overestimate.

To estimate revenue impacts, we then applied the State's 2.9 percent sales tax rate and the Colorado population-weighted average local tax rate (including lodging taxes, if applicable) of 1.95 percent, which excludes self-collected home-rule cities, to our revenue estimates discussed above.

It is important to note that our estimated revenue impacts could double count the impact associated with corporate housing providers to some degree because we could not determine how corporate housing providers are typically categorized in the Department of Revenue's Retail Sales Tax Reports. Specifically, these reports rely on self-reported information from taxpayers based on the North American Industry Classification system. It is possible that some corporate housing providers could have selected industry categories that would have included them within the "Hotels and Other Accommodation Services" category in the Department of Revenue reports, the category we used to estimate the revenue impact from hotels and home shares, as opposed to other categories, such as the "Real Estate, Rental and Leasing." In this case, our estimate would likely double count the revenue impact.

The savings provided by the exemption may provide a significant benefit to some individuals, but likely has only a small impact on the lodging industry in general. Specifically, for some individuals, the combined state and local tax savings, which averages 4.85 percent and $20.2 million in total, or about $146 on a 30-day $100 per night hotel stay, may be significant enough to drive choices about where they make overnight stays. In particular, individuals who are staying in hotels due to economic hardship may choose or only be able to afford to stay in a hotel because of the cost savings provided by the exemption. Further, in some local jurisdictions with higher tax rates on lodging, which can range up to 9.5 percent, the exemption may be more important to price-sensitive customers. In addition, for many individuals who choose to make long-term stays in hotels and other lodging establishments, other forms of housing, such as apartment or home leases, which are typically less expensive on a monthly basis, are impractical. This can be the case when individuals do not wish to enter into typical 6-month or 1-year lease terms, require hotel services and amenities, cannot pay the required up-front deposits that are often required for leases, or have poor credit.

For the lodging industry, the $20.2 million in estimated total cost savings to consumers represents about 0.5 percent of the $4.3 billion in total lodging sales in Calendar Year 2017. Therefore, the exemption likely has a relatively small impact on the lodging industry as a whole, since even if consumers used all of their cost savings on longer or more expensive hotel stays, it would represent a small increase in industry sales. However, the exemption may be more significant for businesses that specialize in long-term lodging, such as corporate housing providers, or extended stay hotels. In particular, because most states have a similar exemption, the Long-Term Lodging Exemption could also help keep long-term lodging providers in Colorado competitive for individuals who have the flexibility to choose which state to stay in.

## WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the exemption could increase the cost of long-term lodging, result in unequal tax treatment of people depending on the type of long-term lodging they purchase, and negatively impact lodging providers who specialize in long-term accommodations. Specifically, without the exemption, the after-tax cost of long-term stays in non-home rule jurisdictions would increase, on average, by 4.85 percent due to state and local taxes. However, some lodging establishments could choose to offset part of this increase by reducing prices to remain competitive with establishments that are subject to lower taxes, since local tax rates for lodging vary considerably across the state. In addition, individuals who reside in lodgings, such as hotels, corporate housing, and home shares, on a long-term basis would pay sales taxes that do not apply to individuals who enter into traditional residential leases. This could create a hardship for some individuals who cannot enter into traditional leases and could cause some businesses to choose alternative means of housing, such as renting apartments, for employees that need to make stays of over 30 days.

Several industry representatives we interviewed stated that the Long-Term Lodging Exemption is important to their businesses and to Colorado's lodging industry. Corporate housing providers reported that they are able to remain competitive with similar businesses and the hotel industry as a result of the exemption, and the same may be true for other lodging providers that rely on long-term occupants. Members of a lodging providers association predicted that eliminating the exemption would be damaging to their businesses and may have other adverse effects, such as driving up housing costs or causing some low-income residents to move to states where their dollar would stretch further.

## ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

At least 46 states assess a sales or lodging tax on the price of temporary lodgings and at least 41 of these states provide an exemption for long-term lodgings. However, the minimum length of occupancy required to qualify for a "long-term" lodging exemption varies by state, and can be anywhere from 28 days to 185 days. The most common time period was 30 days, which is the requirement in Colorado.

## ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We did not identify any similar tax expenditures or programs in Colorado.

## WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue does not track the amount of Long-Term Lodging Exemptions claimed by lodging providers. Specifically, the Department of Revenue's Retail Sales Tax Return (Form DR 0100), does not contain a specific line for long-term lodging sales, and lodging providers report the sales that qualify for this exemption as part of the "other exemptions" line on the form, which combines any exemption not specifically addressed elsewhere on the form. Since this line can encompass several different exemptions, the Department of Revenue does not capture this data point in GenTax, its tax reporting system. If the General Assembly wants to know the amount of the exemption claimed with a higher degree of reliability than the estimates provided in this evaluation, it could require the Department of Revenue to add a specific line to the DR 0100 where lodging providers are required to report this information and direct the Department of Revenue to capture these data in GenTax. However, this change could increase the administrative burden on lodging providers who would be required to separately track long-term lodging sales and the amount exempted. It would also require resources for the Department of Revenue to update the form, provide new instructions, and make programming changes in GenTax to capture the information (see the Tax Expenditures Overview section of thisCompilation Report for details on limitations of Department of Revenue data and potential costs for addressing them).

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

**THE GENERAL ASSEMBLY COULD CONSIDER CLARIFYING WHETHER THE EXEMPTION SHOULD BE AVAILABLE TO THIRD-PARTY PAYERS.** Statute specifies that the Long-Term Lodging Exemption is for sales that are made "to any occupant who is a permanent resident" of the lodgings [Section 39-26-704(3), C.R.S.]. Statute does not indicate whether this should apply to third-party payer situations, such as when a business pays for a room that is occupied by multiple employees over the length of stay. However, the current Department of Revenue policy is to allow the exemption under such circumstances so long as the lodgings are paid for by the same payer for at least 30 consecutive days, regardless of whether the lodgings are actually occupied by the same person for that length of time. The Department of Revenue's policy likely decreases the administrative burden on lodging providers and taxpayers, but also allows for a broader application of the exemption than may have been intended and likely increases its revenue impact.

**THE GENERAL ASSEMBLY COULD CONSIDER CLARIFYING WHETHER HOME-SHARES AND SIMILAR FORMS OF LODGING SHOULD QUALIFY FOR THE EXEMPTION.** With the expansion of the home sharing industry, non-traditional temporary lodging options are growing. Although we found that, in practice, some home-share sales are being exempted from sales tax under the Long-Term Lodging Exemption, statute [Section 39-26-704(3), C.R.S.] does not specifically list "home-shares" or "private homes" as an exempted category of lodgings. Such sales could be interpreted as falling under categories that are listed, such as "guesthouse" or "lodging house," though it may not be clear to some taxpayers how to interpret these terms.

More broadly, while Airbnb collects Colorado sales tax on behalf of home-share hosts, hosts operating through other platforms may not be clear about whether or not they are liable for sales tax for any sales, even those under 30 days. Specifically, statute [Section 39-26-102(11), C.R.S.] does not include accommodation sales of "home-shares" or "private homes" in the list of lodging types which are subject to sales tax. Similar to the language in the Long-Term Lodging Exemption, "guesthouse" and "lodging house" are included as applicable lodging types and could be interpreted as including such sales; however, the General Assembly could consider clarifying the types of lodging sales that are subject to sales tax.