

TO: Local Accommodations Tax Subcommittee of the
South Carolina Taxation Realignment Commission

FROM: South Carolina Association of Counties

RE: “Changes Proposed by Tourism Industry to the Tax Realignment Commission
Local Accommodations & Hospitality Tax Sub-Committee”

For ease of use, the “Changes Proposed by Tourism Industry to the Tax Realignment Commission Local Accommodations & Hospitality Tax Sub-Committee” dated September 8, 2010, will be the document referenced and will be referred to as “the Proposal.”

I. The Proposal is primarily focused on the statutory appropriations set by the General Assembly and is beyond the scope of TRAC.

The Proposal suggests wholesale revisions of the General Assembly’s statutory appropriation system and changes the objectives of the program the General Assembly has adopted. As is noted in the September minutes, Chairman Maybank observed that TRAC is charged with reviewing the tax structure, not the General Assembly's appropriations decisions. The great majority of the Proposal is focused on changing the General Assembly's statutory appropriation of state accommodations tax, state admissions tax and the local accommodations and hospitality tax revenue. As such, the Proposal is not a proper subject for TRAC to consider.

In particular, the Proposal recommends the following changes to the statutory appropriations:

- Increases the portion of state accommodations tax taken off the top of the revenue stream for administrations and earmarked programs from 3% of revenue to 11%.
- Increases the percentage of state accommodations tax revenue going to the regional tourism groups from 2% to 5%.
- Creates a new funding source for PRT from state accommodations tax revenue which has been funded with state general fund revenue in the appropriation process.
- Creates a new funding source for PRT from state admissions tax revenue which has been funded with state general fund revenue in the appropriation process.
- Redistributes the portion and changes the purposes of the appropriations to local communities for tourism projects and programs.
- Eliminates currently permitted arts and cultural projects from the possibility of funding with state accommodations tax revenue distributed to local communities.
- Alters the permitted uses of local accommodations and hospitality tax revenue by eliminating five of the six currently permitted uses.

These elements of the Proposal are the very definition of an appropriation process which the General Assembly has set in statute.

II. The Proposed Changes in the Local Accommodations & Hospitality Taxes Reverse the Intent of the General Assembly Evidenced in the Original Act and Subsequent Amendments

The Proposal's prohibition on the use of local accommodations and hospitality taxes for long term debt (bonds) is directly counter to all evidence of the General Assembly's intent in adopting the local accommodations and hospitality taxes.

Local accommodations and hospitality taxes (hereafter referred to as "A&H taxes") were authorized in SC Code §§ 6-1-500 through 6-1-770 by the General Assembly in 1997. The original provisions regarding permitted uses of these revenues read:

Section 6-1-530. Use of revenue from local accommodations tax.

(A) The revenue generated by the local accommodations tax must be used exclusively for the following purposes:

- (1) tourism-related buildings, including, but not limited to, civic centers, coliseums, and aquariums;
- (2) cultural, recreational, or historic facilities;
- (3) beach access and renourishment;
- (4) highways, roads, streets, and bridges providing access to tourist destinations;
- (5) advertisements and promotions related to tourism development; or
- (6) water and sewer infrastructure to serve tourism-related demand.

(B) In a county in which at least nine hundred thousand dollars in accommodations taxes is collected annually pursuant to Section 12-36-920, the revenues of the local accommodations tax authorized in this article may also be used for the operation and maintenance of those items provided in (A)(1) through (6) including police, fire protection, emergency medical services, and emergency-preparedness operations directly attendant to those facilities.

A similar provision was adopted in Section 6-1-730 for local hospitality taxes.

The language of Sections 6-1-530 and 6-1-730 are clearly intended to create a funding source for tourism relating buildings, facilities and infrastructure. Five of the six permitted uses of the A&H taxes are capital projects which require either the issuance of debt or accumulation of revenue until the project can be paid for.

Further evidence of the General Assembly's intent is found in Section 6-1-760 of the original 1997 act, which authorizes the use of accommodations fee and other non-tax revenue, which included hospitality fees, to repay debt issued for the tourism related projects in the earlier Code provisions.

In 2010 Act No. 284, Section 6-1-760 was amended to more explicitly authorize the use of the A&H taxes for bonded debt.

The Proposal to eliminate the use of A&H tax revenue for debt service is also contrary to the provision in Section 6-4-15 allowing state accommodations tax revenue to be used to repay debt for projects permitted under Chapter 4 of Title 6.

The Proposal seeks to eliminate five of the six uses of the A&H taxes which were the original intent of the General Assembly and clarified by legislative act as recently as 2010.

III. Deleting the Ability to Issue Bonds Repaid by A&H Taxes Will Take Away an Economic Development Tool.

The General Assembly codified the bond issuance provision in the A&H tax statutes. Removing that authorization would prevent counties and cities from developing facilities and infrastructure to service and attract the local tourism. Many of the current projects were designed to take advantage of niche opportunities which would not be of as much interest to coastal areas typically thought of as tourism hubs, but these projects fill the restaurants and hotels in those locations and serve the tourism industry in those locations.

IV. The Department of Revenue (DOR) is Ill-equipped to Handle the Additional Workload Which the Proposal Shifts to Them

The Proposal seeks to place the administrative duties for the collection and handling of the A&H taxes under DOR.

A. DOR Does Not Have Sufficient Staff for the Task.

DOR is staffed at levels equivalent to levels they had in 2001. That staffing level is after the General Assembly adopted a 2010 proviso to increase the audit and collections staff by approximately 94 employees to increase state general fund revenue.

The General Assembly expected the focus of the efforts of this additional appropriation for auditors and collection agents to be increased general fund revenue and not earmarked revenue streams such as the state accommodations tax, much less A&H taxes.

To add to this concern is the fact that the money for additional auditors is non-recurring money which may not be renewed for FY 2011-12.

B. “Coding” errors would become a significant problem.

Local administration helps avoid common coding mistakes. A typical example might be a business with an Irmo mailing address. It is sometimes difficult for the person completing or reviewing the tax return to know whether the store location is in either Lexington or Richland county, and because the Irmo mailing address does not conform to city limits, whether the store is in the Town of Irmo or the unincorporated area of either county.

Coding errors are frequently a problem in the local option sales tax, especially with large chain stores. For the local option sales tax, there is a separate fund which consists of revenue for which the originating jurisdiction cannot be determined and it is placed into the fund which is shared among many jurisdictions. Thus it is likely that some payers of A&H taxes will not pay into the project the tax was intended to fund.

C. Administration of A&H taxes in Columbia would be more complex and very difficult because of the non-uniformity of A&H taxes.

By definition, A&H taxes are not uniform. These ordinances are fashioned locally, within the statutory authorization to meet local needs.

The authorizing statutes grandfather local accommodations and hospitality fees which pre-date the 1997 enactment.

In a particular county area, there is typically a difference in rates of these taxes under the statute among the jurisdictions. For example, the county may have one rate in the unincorporated areas of the county, another rate for municipalities which do not have a tax of their own, and a third rate in other municipalities which do have a tax of their own. This is a result of the statute setting caps on the combined rates of counties and cities.

In some jurisdictions there is also a different tax base than the statewide tax base. In at least one jurisdiction, there are two different hospitality tax rates, depending upon whether the restaurant serves alcohol or not.

Even assuming there were no “coding” errors such as in the Irmo example discussed above, the staff in Columbia will have to learn and administer ordinances where the tax base and the combined tax distribution is more complex than what they are currently equipped to do. Local officials currently doing this work have put a great deal into education for these businesses and are better positioned to help avoid errors than someone not in the community.

V. The Current Local Administration of A&H Taxes is More Accurate and Cost Effective than the Proposal

A. Cost of personnel efficiencies are lost under the Proposal.

Currently, local jurisdictions have a number of people who collect and enforce these A&H taxes. Frequently, both business license officials and assessors work on local accommodations and hospitality taxes. Many counties and cities have an agreement whereby one entity does the collection of both taxes to make it easier for the businesses. This multiple use of personnel also carries over to auditing and enforcement efforts and is not typically funded with A&H tax revenue.

These local administrative costs are typically not taken from the revenue for the tourism project, but are general fund expenditures. Under the Proposal, DOR would receive 1% of the revenue for administrative costs and the result would be a lower level of service at a greater expense to the project concerned.

B. Local communities already have education and training in place.

Local officials currently doing this work have put a great deal into education for these businesses and are better positioned to help avoid errors than someone not in the community. Not only would existing efforts be lost, but the state personnel would have to learn the intricacies of the existing A&H ordinances, causing additional cost.

C. Level of expertise and institutional knowledge is lost under the Proposal.

These people are on the streets and can more easily identify non-compliant businesses. From anecdotal evidence, the local workers in this area forward more useful information to the state workers than vice versa. The Proposal would move the opportunity to get the benefit of current knowledge from local officials later in the process of collecting and administering the revenue, perhaps to a point in the process when it is too late to determine the origin of the revenue.

VI. Tourism Expenditure Review Committee (TERC) Review of A&H Tax Expenditures is Neither More Transparent Nor More Accountable than Current Practice

The Proposal would have TERC review expenditures of A&H tax revenue. Currently, TERC reviews only local expenditures of state accommodations tax revenue for statutory compliance.

A. Requiring TERC review of local tax expenditures makes citizen input much more difficult.

When a local A&H tax is adopted, it is typically for a specific project or program. There is a requirement for a public hearing and there is notice to the community of the meeting (See §4-9-130). If there is any question about how the revenue is spent or accounted for, a citizen can make a local call or just show up at a council meeting to ask questions. Many local council meetings are also televised on local cable television channels.

TERC is composed of eleven members from across the state and any citizen who has a question about a TERC decision will have a difficult time finding TERC and have very little chance of meeting with them to discuss any question about either the original ordinance imposing the tax or TERC's decision on the spending of the revenue. TERC does not meet every month and some of their meetings are via conference call to add to the accessibility problem.

If the local governing body is not responsive, they can be defeated at the ballot box and they are readily accessible to the members of the community. If a citizen can manage to find TERC, there is no recourse when a citizen is aggrieved by a TERC decision.

TERC's minutes document a violation of the Freedom of Information Act's open meeting provisions during its December, 2005 meeting. TERC took a vote while in executive session and

there is no evidence that TERC remedied that violation or took a ratifying vote in a public session. This is a fundamental or black letter law violation of the Freedom of Information Act.

Assuming the public could determine who reviews local expenditures of state accommodations tax revenue, it would have been impossible for the public to observe TERC's deliberations and actions taken.

B. TERC Has a Checkered History of Fulfilling Their Current Duties and Additional Duties Are Not Warranted

1. TERC is inconsistent in its interpretation guidelines on the state accommodations tax expenditures.

DOR's Revenue Ruling 98-22 is the wide ranging interpretational document on state accommodations tax expenditures and was widely regarded as the best available interpretational aid. In July, 2006, TERC decided it was not bound by Revenue Ruling 98-22. This decision was not reflected in their newsletter and no mention was made of what guideline, if any, they would adhere to. Subsequent to that meeting, Revenue Ruling 98-22 has been used in discussions of expenditures and it is even posted to the TERC web page now.

Strictly speaking, revenue rulings issued by DOR are not binding legal authority. However, TERC and its predecessor, the Accommodations Tax Oversight Committee had by custom and practice used it as a basis for eight years. When TERC decided Revenue Ruling 98-22 was not binding upon them, it left any entity which had to go through TERC without a guideline for what TERC would base any decision upon.

In subsequent TERC minutes and on their current web postings, Revenue Ruling 98-22 was used as a basis for decisions. Although no decision to follow it was announced or formally decided.

2. TERC has on several occasions added requirements to those found in the state accommodations tax statutes.

One example that illustrates two such points is the 2006 TERC decision to withhold money from Florence County. The expenditure in question was to give money to the Darlington Raceway to advertise one of the races held there. TERC voted to withhold funds from Florence County for two reasons: (1) the Darlington Raceway was a for profit organization and (2) the money was being dispersed outside the county.

Nowhere in the statutes does it say that the promotion has to be directed to a non-profit organization. The only reference to non-profit organization in the state accommodations tax is in the section addressing the entity selected to manage and direct use of the 30% funds for tourism promotion. The words non-profit do not appear anywhere in the statute in the portions which direct the use of the 65% money, which is the revenue stream TERC reviews from local governments.

This issue was also heard by the Administrative Law Court (ALC) in an appeal of a 2004 TERC decision to disallow an expenditure for a biker rally in Myrtle Beach. The ALC reversed TERC's decision finding no provision in the statute restricting appropriations to non-profit groups, so long as it met the tourism related purposes otherwise required in the statute. A circuit court has upheld this ALC decision. TERC has appealed the ruling to the Court of Appeals.

The appropriate criteria is not the nature of the recipient, but whether a public purpose is being met. This is the criteria which underpins economic development incentives through which tax breaks and gifts of land are made to for profit corporations are made.

Regarding the location of the recipient, Section 6-4-10(4)(d) reads: "In the expenditure of these funds, counties and municipalities are required to promote tourism and make tourism-related expenditures primarily in the geographical areas of the county or municipality in which the proceeds of the tax are collected where it is practical. " The underlined phrase, especially using the word "primarily" clearly means something other than exclusively in the boundaries of the recipient county. In the case of NASCAR races at Darlington, there are very few hotel rooms in Darlington County and many race fans go to Florence to find accommodations.

This strict geographic interpretation is despite the holding in the 1987 case of Horry v. Thompson, where the Court of Appeals stated that "[t]he dispositive question on appeal is: does the Act require all revenues which are allocated to the (C) fund to be returned to the geographic area from which they are collected?" and reversed the circuit court stating that "[n]o such prohibition appears in the statute, however."

3. TERC adopted a definition of "tourism" which was not in the statutes and counter to the definition which is in the statute.

The statutory definition of "tourism" adopted in 2001 Act No. 74 is "the action and activities of people taking trips outside their home communities for any purpose, except daily commuting to and from work." TERC decided in 2003 to adopt the definition of tourism put forth by a national trade group to impose a 50-mile radius requirement. That action disregarded the statutory definition adopted by the General Assembly.

Currently, TERC has posted to its website a "Frequently Asked Questions" page and a memo on the definition of "tourist" and how far a visitor must travel to be treated as a tourist. Both state that 50 miles is the general rule but will TERC will treat a visitor from less than 50 miles away if a significant economic impact can be shown. This interpretation is contrary to the statutory definition of "tourism" found in Section 6-4-5(4). That position is also not sustainable given another definition of "tourist" adopted in Act 284 of 2010 for the Local Hospitality Tax Act Section 6-1-760(A) which reads as follows:

"With respect to capital projects and as used in this section, 'tourist' means a person who does not reside in but rather enters temporarily, for reasons of recreation or leisure, the jurisdictional boundaries of a municipality for a municipal project or the immediate area of the project for a county project."

There is no 50 mile distance requirement adopted by the General Assembly, but TERC persists in applying additional requirements.

4. TERC appears to search for ways to disallow expenditures.

In August, 2003, the City of Beaufort asked TERC whether they could appropriate \$40,000 over eight years for the USC Beaufort performing arts center. TERC questioned whether the expenditure had been reviewed by the advisory committee required by the statute. The minutes state “[i]f not, it could be rejected on that basis, considering the law states that if a local a-tax committee is in place the county or municipality must run it through them first(Section 6-4-25). [TERC] asked [its staff] to obtain more information and ask in more detail how it provides for tourism and the procedure in which council funded it.”

The September, 2003 minutes reflect receipt of details from the city and state that TERC had asked for an Attorney General’s opinion “as to the appropriateness of committing funds up front or whether it should be done on an annual basis. [TERC] stated that they believed the city had mishandled the situation by committing future funds and the project should be reviewed on an annual basis.” TERC then waited for the Attorney General’s opinion. The opinion issued was dated September 23, 2003.

The Attorney General opined that the City of Beaufort’s expenditure was permitted under Section 6-4-10 and did not contravene Section 6-4-15 relating to bond issuance. They did not reach the question of whether the multiple year payback of the original \$40,000.00 expenditure was binding on later city councils.

In the October, 2003 minutes TERC stated that “[t]he representative from the state Attorney General’s office told the Committee that in order to address reimbursements and other issues such as this, there needed to be a change in the law and clarifying language. A letter will be drafted telling them such.”

It is not clear from the minutes whether TERC approved the expenditure or not. What is clear is that the city could have spent all \$40,000.00 in one year and been approved, but that TERC did not like this particular expenditure and went to great lengths to find a reason to deny the request.

5. TERC frequently attempts to substitute its preference as to expenditures instead of determining whether local expenditures comply with the statutory requirements.

There are numerous occasions in the TERC minutes where TERC has approved an expense and then sent a letter questioning whether the expenditure decided upon by the local advisory council and governing body of the city or county are the most effective or in accord with TERC’s preferences from among the permitted uses of state accommodations tax revenue. However, nothing illustrates this point more clearly than the minutes of the January, 2009 TERC meeting minutes which read:

“... asked that a letter be sent to Hilton Head Island regarding TERC expenditures relating to museums, concerts and symphonies, and not on promotion and

advertising. While funding for these events is allowable, it goes against the true stance of what TERC money should be spent on. The Committee agreed and approved the request to send a letter to Hilton Head regarding this issue.”

6. TERC has attempted to extend its jurisdiction into the general fund expenditures of cities, which is far beyond it’s statutory authority.

TERC had in years prior to FY 2008-09 allowed the City of Myrtle Beach to use “65%” funds from the state accommodations tax to defray operational expenses associated with the tourists who impact local services such as police, fire and parks personnel. Myrtle Beach is a high concentration tourism area and this is permitted by Section 6-4-10(4)(b).

In 2010, TERC ordered \$312,545.00 be withheld from the City of Myrtle Beach’s state accommodations tax disbursement, because of expenditures made by Myrtle Beach in FY 2008-09. The difference being that Myrtle Beach appropriated all of the state accommodations tax revenue to defray tourist related operational expenditures as permitted in Section 6-4-10(4)(b). The city also made other expenditures from its general fund to groups and events which had previously received portions of the state accommodations tax funds.

TERC requested all of Myrtle Beach’s budgetary documentation for the years in question and the \$312, 545.00 equates to the general fund expenditures which Myrtle Beach made to those groups. TERC now claims that the city should not be allowed to make general fund expenditures without submitting them to TERC for approval because they relate to tourism.

Section 6-4-10(4)(b) does not limit the amount which can be used for operational expenses associated with tourism. No provision of the state accommodations tax statutes prohibits the use of general fund money to support tourism related expenses. No provision of the state accommodations tax statutes require expenditures other than those made from state accommodations tax revenue to be submitted to TERC.

This case is currently pending before both the Administrative Law Court and the circuit court.

VII. There are very few abuses of state accommodations tax revenue by cities and counties.

For all the complaints by members of TERC, there is very little evidence of state accommodations tax revenue being spent by cities and counties in a manner not permitted by statute.

There are hundreds expenditures reviewed by TERC each year. This is because a county or city may fund four different expenditures or projects with state accommodations tax revenue in a given year and each expenditure is reviewed independently.

In FY 2008-09, there were 4 withholdings ordered by TERC in the total amount of \$35,151.00.

- One of the expenditures in that group was \$27,500.00
- The 3 remaining withholdings were \$5,000.00 or less and total \$7,651.00.

According to the State Treasurer's Office there was \$40 million in state accommodations tax that year and that equates to 0.08% or less than one-tenth of one percent of the revenue.

In FY 2009-10, there were eight withholdings ordered by TERC in the total amount of \$376,512.00.

- One of the withholdings is the City of Myrtle Beach case which is currently in court in the amount of \$312,545.00.
- One of the withholdings for \$10,000.00 TERC has reversed and reinstated the money.
- The remaining 6 withholdings total \$63,967 and one of those was for \$50,000.00.

According to the State Treasurer's Office there was \$38.5 million in state accommodations tax that year and that equates to just under 1% of the revenue if the City of Myrtle Beach is not successful in its appeal and 0.16% or sixteen one-hundredths of one percent of the revenue if Myrtle Beach is successful.

Then there is the cost of this oversight mechanism. The expenses of TERC are taken from the state accommodations tax revenue - member mileage and per diem, staff expense, website costs, and legal fees. In FY2008-09 those costs amounted to \$91,343.00. The expenditures which disallowed in that same year amounted to only \$35,151.00.

In FY 2009-10, assuming that expenditures remained constant, TERC expenses are 50% higher than the amounts ordered withheld once the Myrtle Beach general fund expenditures case discussed above is eliminated from the withholdings total.

Added to the direct cost of TERC is the cost of reporting by the counties and cities and on numerous occasions the costs to appear before TERC to provide additional information and legal costs to appeal decisions. Clearly in a tight fiscal environment, there is a balancing between cost and benefit of this mechanism which must be performed.

TERC's has no budget approved by the General Assembly and there is no disclosure of the amount expends each year on its website. The efficiency of this oversight mechanism is questionable at best given that expenses of reviewing the expenditures were more than two and half times the amount of expenditures not approved for the year that TERC expenditures are available.

IX. The Proposal's recommended changes to the General Assembly's statutory appropriations of the state accommodations tax revenue are detrimental to local tourism projects and programs.

The Proposal seeks to change the General Assembly's statutory appropriations and the net result is a reduction in funds available for local tourism projects and programs. First, the percentage of revenue devoted to administration and earmarked programs is increased from 3% to 11% - more than triple the current appropriation for this portion of the revenue stream.

Next, the Proposal freezes the portion of the state accommodations tax revenue being distributed to the two groups of local communities which generate the least amount of state accommodations

tax revenue. This is particularly tough because state accommodations tax revenue is at a much lower level than recent years because of the economic downturn and the level of revenue will not increase when state accommodations tax revenues return to more customary levels of recent years.

For the group of local communities in the highest generating state accommodations tax areas, their revenue will be cut for the short term because of the overall lower revenue level. Even after state accommodations tax collections return to previous levels, it will take several more years of growth before the amount of revenue reaching these communities reaches recent revenue levels because the percentage of revenue taken off the top for administration and earmarked programs is increased from 3% to 11%.

The Proposal purports to make these appropriations changes revenue neutral by including timeshare units in the state accommodations tax base. However, there is no BEA estimate of the revenue which might be gained by making that change and in speaking with BEA staff, it is unclear that there is sufficient data to make a reasonably reliable estimate.

The SC Association of Counties has heard from none of the forty-six counties, regardless of location or amount of state accommodations tax revenue received, which supports the Proposal.