LODGINGRevs

CAPTURE EVERY RENTAL

Best Practices in Regulation and Taxation of Short Term Rentals

LODGINGRevs White Paper Series

Best Practices in Regulation and Taxation of Short Term Rentals

The growth of online short term rental listing platforms (Airbnb, VRBO, FlipKey), has simplified the rental process, resulting in significant growth of short term rental properties in almost every community.

This growth is causing many communities to revisit and revise their municipal code ordinances regarding the regulation and taxation of these rental properties.

Our experience in working with municipalities since 2011 has given us a perspective on best practices to achieve the objectives the municipalities establish regarding short term rentals.

The ordinances, fees and taxes, and compliance procedures work together as a tailored package to achieve those objectives. We have found that setting three goals for this package achieves the best long term results for the municipality:

- Make compliance requirements clear and reasonably easy to achieve
- Make it evident to property owners that non-compliance is expensive and futile
- Establish systems and procedures that ensure the cost of monitoring compliance goes down over time

The rest of this paper outlines our experience in achieving these goals.

Taxation

Let's tackle the "easier" subject first – taxation.

We have found that municipalities have generally had the best experience when establishing a "level playing field" - lodging is lodging - and should be subject to equal or neutral tax rates. Local visitors should pick the accommodations that best suit their needs, not the one that avoids lodging taxes.

Some platform providers, especially Airbnb, like to point out that renting out part of your home helps pay the mortgage. True, but it's still a business transaction. Unless you rent for less than 14 days a year, the rental income must be reported on your income tax filing. If municipalities want to support renting out a part of your home (sometimes referred to as "homestays") best practice says that's better accomplished through lower fees or easier regulations than through lower lodging tax rates.

Most municipalities include a penalty (additional percentage) for past due taxes from a late filing property (probably “pulled” into compliance).

We believe the ***Best Practice*** is to make this penalty consistent with late sales tax penalties and to consider waiving it for voluntary compliers during the initial effort/program to bring short term rental properties into compliance.

We have seen a small percentage of municipalities make the listing platforms responsible for filing and paying lodging taxes. We believe that responsibility should be a requirement of the property owner or property management company to ensure complete and transparent compliance.

There is also a major campaign underway by Airbnb to enter into “voluntary” compliance and tax payment agreements with jurisdictions. This can have some benefits and significant drawbacks due to the restrictions on transparency that Airbnb imposes. See our White Paper on the subject for a deeper discussion.

We have found that implementing on-line automated tax filing and payment systems seems to encourage quicker tax compliance, is popular with rental hosts, and helps municipalities control or cap costs associated with compliance.

Regulation

There is not one set of best practices for establishing regulations and ensuring compliance, though certain specific best practices apply to all municipalities.

Best practices must reflect the municipality’s tailored policy concerning short term rentals – what is their impact on the community, and how can that impact be best “managed”.

There is no question that the availability of on-line rental platforms, and their marketing efforts, have made it easier and more profitable for property owners to rent part or all of their property, whether they live there full-time, part-time (second homes) or never (investment property). This has led to a very rapid increase in short term rentals in almost every community across the country. The impact varies.

For many municipalities, local visitors or tourists, are a primary driver of the economy. The municipality wants to ensure that there are an adequate number of rooms, at different price levels, locations, and characteristics to meet the diverse needs of the visitors. Municipalities tend to want to see more short term rentals, especially entire units (homes or condos) made available to house visitors. **Encouraging** is the category name we give this set of regulations appropriate for these municipalities.

For some municipalities the shifting of homes into the short term rental market has removed them from the longer term rental market. This has a significant impact on availability and price of rentals for the workforce and students (if the municipality is home to a college or university). Additional, the increased attractiveness of utilizing homes as investment properties removes them from the market, typically resulting in higher home prices, making it more difficult for residents to afford to buy a home. Additionally, in some communities, the attractiveness and characteristics of specific neighborhoods can lead to larger numbers of short term rentals, and accompanying problems with noise, parking and traffic. When these impacts become significant, municipalities tend to want to limit or tightly control the number (and often the location) of short term rentals. We name the appropriate set of regulations for this category **Restrictive**.

For other communities, the tug between the positive and negative impacts of increased number of short term rentals comes down more in the "middle". While they would like to see more visitors, spending money at local businesses and adding sales tax revenue, they want to protect the livability of their neighborhoods, help foster affordability of workforce and student housing, and provide a level playing field for commercial hotels, motels and B&Bs. The name of the category of the appropriate set regulations for this set of communities, we've named **Balanced.**

Each of these categories **– Restrictive, Balanced, and Encouraging –** will address the specific aspects of regulations and compliance procedures, but will tend to select varying levels. The first step for each community is to develop and articulate the policy stance regarding short term rentals.

There will be certain best practices that are universal – they apply to all municipalities, regardless of the policy stance category.

For instance, in working with one of our first communities in 2011, we determined that requiring the license or permit number be displayed in all advertisements (print and online) would simplify (and lower the cost of) verifying compliance. This has become an industry standard, used around the world, including Paris, Airbnb's largest market.

More recently, we have been encouraging municipalities to have the property hosts use the words Trusted, e.g. Telluride Trusted, before the relevant number, rather than Sales Tax Permit or License number, in the listings. This has a more positive slant for the host, and ensures that only properties within the jurisdiction can use the term and be "certified" as being in the community.

Another best practice is to automate the licensing process. This makes it easier for the property host and controls costs for the municipality. Most municipalities make the online applications and renewals free (include the cost in the license fee) and establish a "surcharge" fee for paper applications. With these practices, our experience is a 97% usage of the automated online option. Property hosts appreciate the ease of filing and paying taxes which the municipality has provided.

Specific Regulation Framework

In this section we detail the individual decisions that each jurisdiction must consider in crafting the ordinance and associated regulations. We list options and ranges that can be selected based on the public policy stance. We also highlight Best Practices that we believe all communities should adopt

1. Define what constitutes a short term rental.

Assuming that commercial hotels, motels and B&Bs are licensed, the focus is on individual units that are rented for a relatively short period of time to different individuals.

- Most municipalities choose **30 days** as the duration cut-off.
- **Restrictive** sometimes choose **60 days**.

Most municipalities do not include properties that are corporate housing – renting to new or visiting employees of a local company.

Must also decide whether to differentiate between rental of entire units (homestays), a separate room within a unit (homeshare) or a bed (roomshare). Encouraging often establish more lenient rules and lower fees for the latter two.

2. Decide what (if any) restrictions will be placed on the general category of short term rentals.

- **Restrictive** often set total allowed, totals by neighborhood and occasionally even totals by city block.

3. Decide what (if any) restrictions will be placed on individual short term rentals.

- **Restrictive** can set limits including:
    - Total number of days rented per year, season or month
    - Total number of “bookings” per year in certain neighborhoods
    - Minimum nights stay for each booking
    - Maximum occupancy
    - Square footage per occupant
    - Maximum units in a multi-unit building or complex
    - Available parking spaces per unit – usually tied to rooms or beds rented
    - Requirement that host must be living in, and be present in, the rental unit, in general or in specific neighborhoods or districts
    - Prohibition on serving alcohol (or even food) to guests
    - Requirement that “duplex neighbor” approve
    - Loss of license or permit due to stipulated number of complaints by neighbors
    - Requirement that if covered by an HOA, the HOA must allow short term rentals
- **Balanced** and **Encouraging** will have fewer individual restrictions.
    - HOA concurrence is typical
    - Loss of license due to neighbor complaints is often included

4. Establish licensing (or permitting) requirements (in addition to general requirements listed above), durations and fees. Ordinances should state that licenses are required prior to advertising the unit for rent.

Requirements could include:

- initial and annual safety inspections by the building department with special focus on safety exits
- smoke and CO monitors, fire extinguishers

- trash and recycling storage areas
- accessibility
- insurance coverage
- availability of a local “owner’s representative”
- specific information to be posted within rental unit including permit and contact info
- requirement to submit a yearly affidavit to rental history (frequency, duration and nightly rate)

These requirements are sometimes lessened for home shares and room shares.

Best Practice: require that every property provide the name and contact information of a local owner’s representative (or designated responsible party, which could be the owner) who can physically be at the property within a set period of time (from immediately to 2 hours), with current information listed on the pertinent license file.

Best Practice**:** application process includes an affidavit signed by owner (or property management company) acknowledging safety, noise, parking, trash and insurance regulations.

License duration (before required renewal) is typically one year, though some municipalities use 2 years and a few as many as 5 years. New licenses should be required with a change of ownership of the dwelling unit.

License (and renewal fees) should be set to a level that at least covers the jurisdiction’s costs and can be much higher for **Restrictive communities**. For example, in Crested Butte, they charge $1,500 for the first year’s license. Many jurisdictions have varying fee levels depending upon occupancy limits (bedrooms or beds) in the rental unit). Home shares and room shares could be a lower level if desired, but often easier to have one standard set of fees.

Most jurisdictions choose to impose a penalty (fine) with interest for licenses that were not acquired prior to (or within a certain period of) the initial advertising or first rental transaction.

Best Practice: develop an “information campaign” highlighting that the jurisdiction is undertaking a thorough process to identify and monitor short term rentals. Include coverage in local newspapers and on the municipality’s website. Include a description of compliance requirements (Factsheet), including necessary steps, and point to an FAQ. Provide a grace period with waiver of penalties for voluntary compliance.

Implementing an automated on-line licensing system, with clear, easy to follow instructions, makes compliance an easier task and controls costs. Such a system should try to tie in all departments involved in the licensing process. Adding short term rentals to the licensing base could result in a very large increase in staff workload if not automated.