



Tourist Development and Convention Development Taxes Audit - #813 Executive Summary

Why CAO Did This Review

Pursuant to Section 5.10 of the Charter of the City of Jacksonville and Chapter 102 of the Municipal Code, we conducted an audit of Tourist Development Taxes and Convention Development Taxes. These taxes are 4% and 2%, respectively, on the total rental amount charged by every dealer (person that rents out any living quarters or accommodations for a term of six months or less). These taxes are paid by guests on top of the amount charged for all accommodations subject to the Tourist Development and Convention Development Taxes in addition to the State Sales Tax. The State Sales Tax is remitted to the Department of Revenue of the State of Florida. In Duval County, the Tourist Development Taxes and Convention Development Taxes are self-reported and remitted to the Tax Collector. The Finance and Administration Department is charged with enforcing payment of these taxes.

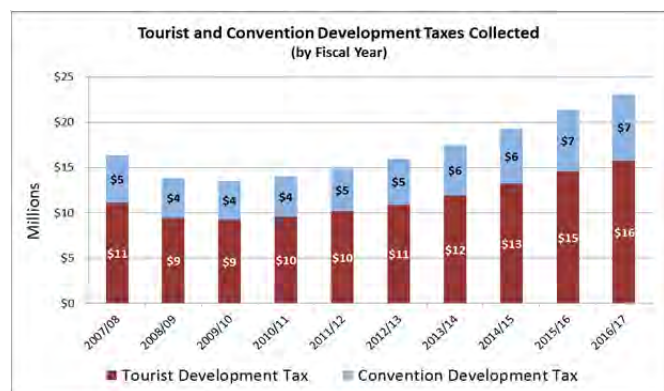
What CAO Recommends

The Finance and Administration Department should establish auditing procedures to ensure that taxes are collected and that collected taxes are accurate. We also recommend that the Finance and Administration Department create procedures to regularly search for rental properties that are not registered with the City and that do not remit taxes.

What CAO Found

While it appears that the City had sufficient internal controls to ensure that Tourist Development and Convention Development taxes were remitted timely to the City, there were not sufficient controls in place to ensure that taxes were remitted by all dealers and that the amounts remitted were accurate. In particular, we found the following issues:

- There were no on-site audits being performed by the Finance and Administration Department to ensure that Tourist Development and Convention Development Taxes were collected and that collected taxes were accurate. The Finance and Administration Department is the only area authorized to conduct this work based on Municipal Code Sections 666.106(d) and 764.102(c) and guidance we received from the Office of General Counsel. Many counties perform such audits and often find that gross amounts are not calculated accurately or that exemption documentation is not complete.
- Airbnb and other similar “peer-to-peer property rental” companies currently do not submit Tourist Development and Convention Development Taxes to the City. If these taxes are remitted, it is by the home owner directly.





Council Auditor's Office

Tourist Development and Convention Development Taxes Audit

May 15, 2018

Report #813

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EXECUTIVE SUMMARY

AUDIT REPORT #813

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OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building



May 15, 2018

Report #813

Honorable Members of the City Council
City of Jacksonville

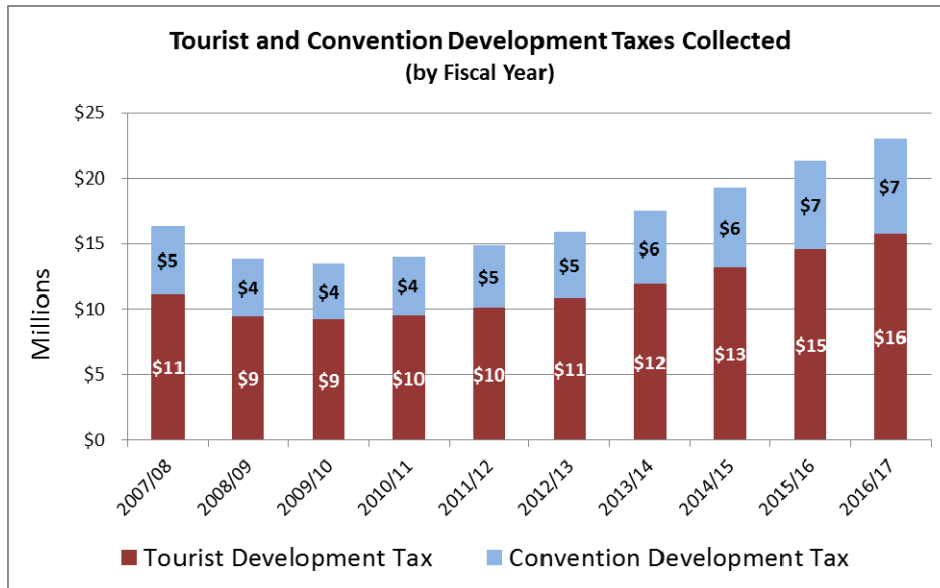
INTRODUCTION

Pursuant to Section 5.10 of the Charter of the City of Jacksonville, Chapter 102 of the Municipal Code, Section 666.106(d) of the Municipal Code, and Section 764.102(c) of the Municipal Code, we conducted an audit of the Tourist Development and Convention Development Taxes.

The Tourist Development and Convention Development Taxes are 4% and 2%, respectively, on the total amount charged by every person (usually called “dealer”) who rents, leases or lets for consideration any living quarters or accommodations in any hotel, apartment hotel, motel, resort motel, apartment, apartment motel, rooming house, mobile home park, recreational vehicle park, condominium, or timeshare resort for a term of six months or less. The tax payments are due within 20 days from the last day of the reporting period. If a payment is not received by that day, a penalty of 10% is applied for each month that payment is late, but it shall not exceed 50% in the aggregate and should not be less than \$50. In addition, 8% annual interest is currently charged for all late payments.

These taxes are paid by guests on top of the amount charged for all accommodations subject to the Tourist Development and Convention Development Taxes in addition to the State and Local Discretionary Sales Tax. The State and Local Discretionary Sales Tax is remitted to the Department of Revenue of the State of Florida. In Duval County, the Tourist Development and Convention Development Taxes are self-reported and remitted to the Tax Collector. While the Tax Collector is charged with the collection of these taxes, the Finance and Administration Department is charged with enforcing payment of these taxes, as explained below.

Examples of what these taxes can be used for include costs to construct and maintain convention centers and sports facilities, to finance beach park facilities and beach improvements, and to promote and advertise tourism. For the past ten (10) years, the City has collected on average almost \$17 million in Tourist Development and Convention Development Taxes with an upward trend. The City collected over \$23 million for Fiscal Year 2016/17:



Originally, we planned to conduct on-site audits where we would visit hotels and audit their records in order to determine if the City is receiving the correct amount. However, Section 666.106 (d) of the Municipal Code states:

The Director of Finance and Administration of the City of Jacksonville may use any power granted by F.S. § 125.0104 to the State Department of Revenue to determine the amount of tax, penalties, and interest to be paid by each dealer and to enforce payment of such tax, penalties, and interest.

Section 764.102(c) contains the same language with a reference to Florida Statutes Chapter 212 Part I instead of Florida Statutes 125.0104. Each of the two Sections of the Municipal Code goes on to state:

The Council Auditor is hereby authorized to audit all such collection and administration transactions.

Based on the language in the Municipal Code, we thought it was unclear whether we were authorized to conduct on-site audits, so we requested a legal opinion from the Office of General Counsel. The legal opinion stated that the Council Auditor’s Office does not have the authority to perform an on-site tax audit as it related to the Tourist Development and Convention Development Taxes. It goes on to state “... the Council Auditor’s Office is authorized to audit the collection and administrative transactions resulting from the exercise by the Director of Finance and Administration of such official’s power to perform dealer tax audits.” Based on the legal opinion, we focused our audit on the City’s side of the process (collections and enforcement).

STATEMENT OF OBJECTIVE

To determine if the City has sufficient internal controls in place to ensure that the correct amount of Tourist Development and Convention Development Taxes are remitted to the City in a timely manner.

STATEMENT OF SCOPE AND METHODOLOGY

The audit period covered the control structure surrounding Tourist Development and Convention Development Taxes from January 1, 2018 through March 31, 2018. We examined Jacksonville's Municipal Code and Florida Statutes on this subject. We interviewed Tax Collector and Finance and Administration Department employees and directly observed some of the employees performing their duties related to this area to obtain an understanding of the processes. We contacted several Florida counties to survey their collection and enforcement processes to get an understanding of common practices. We also performed a review of information system controls for the Tax Collector's system relevant to the audit objective and conducted testing of the internal controls to determine if Tourist Development and Convention Development Taxes are submitted to and collected by the City in a timely and accurate manner.

REPORT FORMAT

Our report is structured to identify Internal Control Weaknesses, Audit Findings, and Opportunities for Improvement as they relate to our audit objective. Internal control is a process implemented by management to provide reasonable assurance that they achieve their objectives in relation to the effectiveness and efficiency of operations and compliance with applicable laws and regulations. An Internal Control Weakness is therefore defined as either a defect in the design or operation of the internal controls or is an area in which there are currently no internal controls in place to ensure that management's objectives are met. An Audit Finding is an instance where management has established internal controls and procedures, but responsible parties are not operating in compliance with the established controls and procedures. An Opportunity for Improvement is a suggestion that we believe could enhance operations.

SUGGESTED ADDITIONAL AUDIT WORK

As discussed in the Introduction section, the Municipal Code grants the authority to perform on-site audits to the Finance and Administration Department, not the Council Auditor's Office. Therefore, we did not pursue the following areas, and as such, they should be considered for future audit work by the area in charge of the enforcement process:

- Identifying short-term rentals that are not registered with the City.
- Appropriateness of exclusion of various fees from gross revenues by dealers (cleaning fees, early/late check-in fees, pet fees, etc.).
- Usage and appropriateness of exemptions honored by dealers.
- Treatment of rewards used for booking by dealers.

STATEMENT OF AUDITING STANDARDS

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on our audit objective.

AUDITEE RESPONSES

Responses from the auditee have been inserted after the respective finding and recommendation. We received these responses from the City via Sam E. Mousa, Chief Administrator Officer, in a memorandum dated July 16, 2018 and from the Tax Collector's Office via Sherry Hall, Chief Deputy Tax Collector, in a memorandum dated July 24, 2018.

AUDIT CONCLUSION

While it appears that the Tax Collector's Office had sufficient internal controls to ensure that Tourist Development and Convention Development taxes were submitted timely to the City, the Finance and Administration Department did not establish sufficient controls to ensure that taxes were submitted by all dealers and that the amounts submitted were accurate.

AUDIT OBJECTIVE

To determine if the City has sufficient internal controls in place to ensure that the correct amount of Tourist Development and Convention Development Taxes are remitted to the City in a timely manner.

Finding 1 *System Calculations Issue*

We found a calculation error made by the computer program used by the Tax Collector to keep track of Tourist Development and Convention Development Taxes. Due to this system issue, a dealer's Tourist Development and Convention Development Taxes amount due was understated in limited circumstances. It appears that the error occurred when a combination of the following transpired:

1. The payment sent to the Tax Collector was short of the actual amount due.
2. The payment was submitted late by the dealer.

Since the payment was short, the Tax Collector would have to send an invoice for the remaining amount. We found this issue while observing Tax Collector staff sending delinquent notices. One of the notices stated that the outstanding amount was less than expected. The amount originally paid by the dealer was \$1,007.27, but the amount owed was \$1,203.01. Therefore, the dealer owed an additional amount of \$195.74. However, the system calculated that the dealer only

owed \$148.98 (i.e. \$46.76 less than what was owed). At our request, the Tax Collector's Office processed a test payment of \$148.98 to confirm that the account balance would become zero. After we confirmed that the balance was cleared, the test transaction was reversed.

Recommendation to Finding 1

We recommend the Tax Collector review and correct the system setup so the outstanding amount is calculated accurately in all instances.

Tax Collector Response to Finding 1

Agree Disagree Partially Agree

We are in the process of replacing the system and will require the contracted vendor to provide an accurate system calculator.

Internal Control Weakness 1 * Tourist Development and Convention Development Taxes Not Being Audited*

Per Municipal Code Section 666.106(d) and Municipal Code Section 764.102(c), the Finance and Administration Department is charged with the enforcement of the Tourist Development and Convention Development Taxes payments, penalties and interest. However, there was no evidence that any audits or any other enforcement activities (except for occasional review and approval of payment plans where there is a waiver of a portion of the outstanding balance being requested, which does not appear to have occurred since 2015) have been performed by the Finance and Administration Department to ensure the Tourist Development and Convention Development Taxes were collected from all potential dealers or that the amounts collected were accurate.

On the other hand, the Tax Collector does perform some enforcement activity. For example, when a payment is late, a registered dealer is contacted by mail and later by phone. If there is no response, the compliance inspector would pay a visit and inform the dealer about the legal ramifications of not filing tax returns and not making tax payments. In addition, if a complaint is filed with the Tax Collector about a property that appears to be a short-term rental but is not registered with the Tax Collector to pay taxes, the compliance inspector would research the complaint, contact the property owner or manager, and pay a visit to the property, if needed.

We contacted several Florida counties regarding the collection and audit process for these taxes. We found that most with comparable collections actively audit submitted Tourist Development and Convention Development Taxes whether it be performing the audit on-site or remotely. Those counties often also actively search for rental properties that are not registered with the county and do not remit their Tourist Development and Convention Development Taxes.

Currently, only 1% of taxes collected is retained for the cost of administration although the Municipal Code could be amended to increase the amount up to 2% of the Convention Development Tax and 3% of the Tourist Development Tax to offset additional audit and

enforcement costs. Ideally, these enforcement and audit activities would increase revenues and not result in less funds being available. Without anyone in the City enforcing the accuracy of the amounts collected from the Tourist Development and Convention Development Taxes, there is no assurance that the City is receiving the correct amount of the taxes.

Recommendation to Internal Control Weakness 1

We recommend that the Finance and Administration Department establish ongoing auditing and enforcement procedures to ensure that taxes are collected in the correct amount or seek an amendment to the City’s Municipal Code to transfer the on-going audit and enforcement authority to the Tax Collector.

These procedures should include continuous searching for rental properties that are not registered with the City and that do not remit the Tourist Development and Convention Development Taxes, and procedures for conducting on-site audits.

Regardless of whether the authority remains with the Finance and Administration Department or is transferred in part or completely to the Tax Collector, we recommend that the Council Auditor’s Office be granted authority to perform periodic on-site audits.

Finance and Administration Department Response to Internal Control Weakness 1

Agree Disagree Partially Agree

The Department of Finance and Administration will work with the new Tax Collector when he is elected to determine the proper division of audit and enforcement efforts among our operations and request legislation if necessary.

We agree the Council Auditor should have audit authority regarding tourist taxes.

Internal Control Weakness 2 *Access Rights Issues*

We reviewed the access rights of all users that have access to the Tourist Development and Convention Development Taxes module of the Tax Collector computer system. We found that 8 out of the 86 (or 9.3%) users tested had excessive access rights related to the Tourist Development and Convention Development Taxes.

Recommendation to Internal Control Weakness 2

We recommend that the Tax Collector review and modify the access rights to the Tourist Development and Convention Development Taxes module to ensure that users have the proper level of access.

Tax Collector Response to Internal Control Weakness 2

Agree Disagree Partially Agree

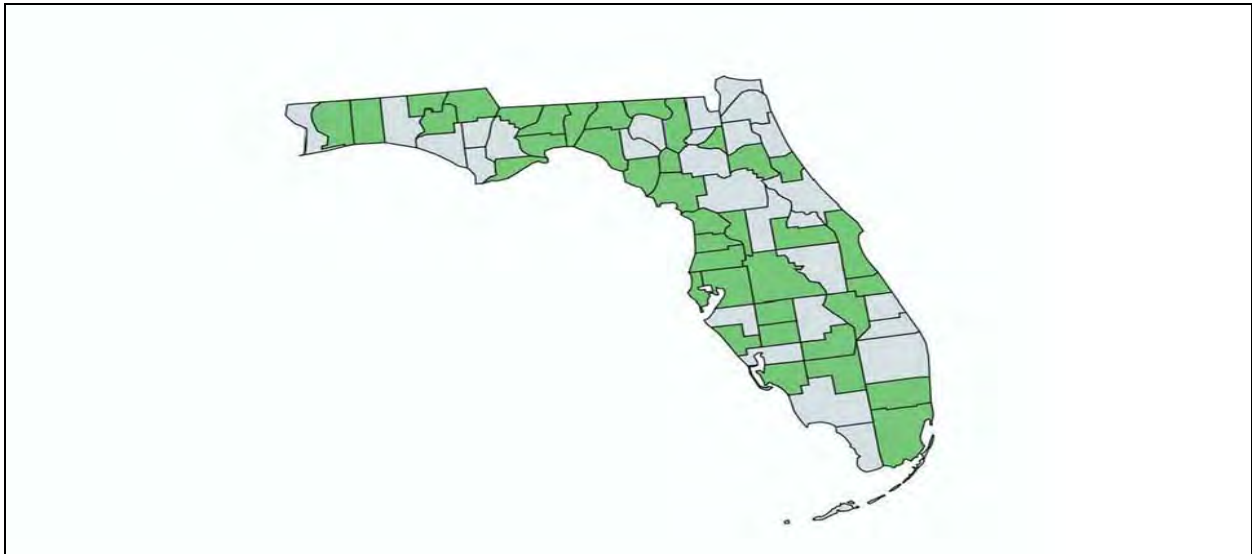
We concur.

Opportunity for Improvement 1 *Not Collecting Taxes from “Peer-to-Peer Property Rental” Companies*

“Peer-to-peer property rental” companies (e.g. Airbnb) currently do not submit Tourist Development and Convention Development Taxes to the City. While individuals who rent their properties via those platforms could charge and submit those taxes themselves, there are likely to be issues due to persons that rent out their properties possibly not being aware of the requirement to collect those taxes and due to a lack of enforcement by the City.

Airbnb offered to enter into an agreement with the City on February 12, 2016, but no agreement was signed. Various aspects have to be considered before such an agreement could be signed. For example, the proposed agreement would only apply to Airbnb while there are other “peer-to-peer property rental” companies. Another issue would be how to treat taxes owed from past years. Finally, it is difficult to find a solution for the auditing rights aspect since the City would likely want to retain audit rights, and it is not clear if the “peer-to-peer property rental” companies would be open to allowing the City’s auditing rights requirements.

As of March 2018, 39 of 63 (or 62%) counties in Florida that assess the Tourist Development and Convention Development Taxes have an agreement with Airbnb, one of the largest companies in this industry. Counties that have an agreement with Airbnb are shaded (or in green, if color version) in the map below.

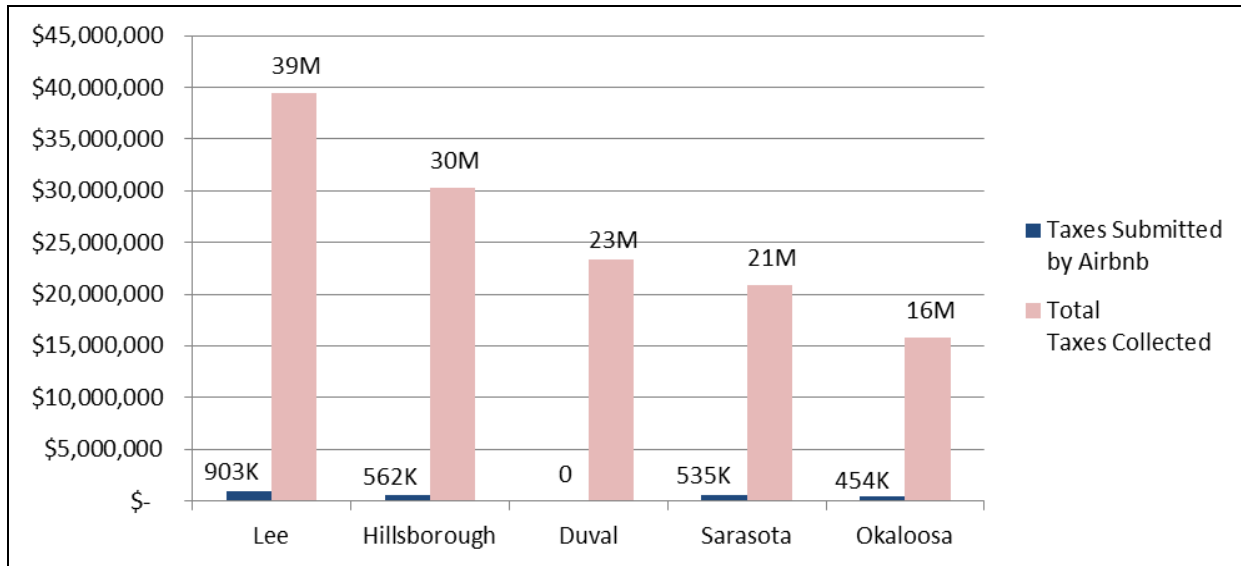


Source: <https://www.airnbcitizen.com/2017-florida-tax-report/>

To estimate the potential lost revenue, we compared Duval County to other counties:

- 1) that receive similar amounts of Tourist Development and Convention Development Taxes per the State of Florida; and
- 2) that have an agreement with Airbnb.

Below is a graph that shows the total Tourist Development and Convention Development Taxes collected by Duval County and those counties in 2017 along with the taxes Airbnb states it submitted to each county in calendar year 2017:



Sources: <https://www.airbnbucitizen.com/2017-florida-tax-report/> & <http://floridarevenue.com/taxes/tables/f3fy2017.xlsx>

In a different report from the same source (<https://www.airbnbucitizen.com/florida-2017-report/>), Airbnb estimated that there were 42,600 guest arrivals in Duval County, which resulted in total income of \$6.1 million for the hosts in 2017. If the \$6.1 million amount were accurate and assuming no owner directly submitted taxes, the City would have failed to collect \$366,000 in Tourist Development and Convention Development Taxes just from Airbnb in calendar year 2017 alone.

Recommendation to Opportunity for Improvement 1

We recommend that the Administration work with the applicable parties to make a decision on how to proceed with this issue including whether to sign an agreement with Airbnb and other similar companies or to pursue other alternatives that would ensure the City is collecting the accurate amount of Tourist Development and Convention Development Taxes.

Administration Response to Opportunity for Improvement 1

Agree Disagree Partially Agree

This matter not only includes collection of tourist development tax funds but will also entail significant zoning code changes to allow Airbnb and other similar entities to operate in the County. The administration has recommended to various council leadership in the past to create

a special committee on short term rental matters to decide if and/or where short term rental companies should be allowed to operate in the county. Upon such conclusion an agreement may then be executed and tourist development taxes collected.

Opportunity for Improvement 2 *Creating SOP for Delinquent Accounts Process*

At the time of our audit, when a registered dealer was late with their monthly payment, the Tax Collector’s Office would send a letter to the dealer. If no payment was received, the dealer would then be contacted by the compliance inspector from the Tax Collector. If a payment was still not received, the inspector might give another call to the dealer or meet with the property’s owner or manager. In some cases, payment plans were established.

However, the Tax Collector had no written standard operating procedures (SOPs) that described steps and the associated timing of each step to be taken on delinquent accounts. Such SOPs should include in detail instructions on:

- a) When and how to contact the dealers if there was no payment received.
- b) When and how to contact them again if no payment is received after the first contact is made.
- c) What to do if there is no response.
- d) What kind of payment plan to offer and what approval is needed.
- e) What portions could be waived and what the process is to obtain approval for the waiver.

Having formal SOPs for this process would help to ensure that all dealers are treated equally and would assist with training of new Tax Collector personnel in the future.

Recommendation to Opportunity for Improvement 2

We recommend that the Tax Collector create a formal standard operating procedure on the process of handling delinquent accounts for Tourist Development and Convention Development Taxes.

Tax Collector Department Response to Opportunity for Improvement 2

Agree Disagree Partially Agree

We concur.

We appreciate the assistance and cooperation we received from the Tax Collector and the Finance and Administration Department throughout the course of this audit.

Respectfully submitted,

Kyle S. Billy

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Council Auditor

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