

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members

FROM: John Harrington, Management and Program Analyst Supervisor

CC: Brendan Beatty, Director, Department of Revenue
Derek Bell, Administrator, Business and Income Tax Division, Department of Revenue

DATE: April 2022

RE: Performance Audit Follow-Up 21SP-28: Short-Term Lodging and Rental Vehicle Taxes: Keeping Pace With an Evolving Marketplace (orig. 18P-06)

ATTACHMENTS: Original Performance Audit Summary

Introduction

The *Short-Term Lodging and Rental Vehicle Taxes: Keeping Pace With an Evolving Marketplace* (18P-06) report was issued to the Legislative Audit Committee in April 2020. The audit included four recommendations to the Department of Revenue and one to the Montana Legislature. In March 2022, we conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

The initial audit found inconsistencies in the language describing Montana's two taxes on short-term accommodations that led to challenges in administration of the taxes for the department. We further found the department could do more to identify the owners of short-term rental accommodations as required by law, and to ensure accurate distribution of the use tax across the state. The passage of Senate Bill (SB) 52 in the 2021 legislative session addressed both of issues, by standardizing language related to the two taxes and clarifying who is responsible for collection and remittance of the taxes. The bill also removed a requirement that owners of short-term accommodations register with the department.

Background

Overnight guests in Montana are charged a 4 percent lodging facility use tax and a 4 percent sales tax on all short-term (30 days or fewer) accommodation rentals. The use tax is collected for tourism promotion efforts and is divided among many state and regional tourism organizations. The sales tax is deposited in the general fund. The two taxes generated \$97 million in revenue in calendar year 2021, nearly double the amount collected just four years ago. At the time of the audit, we noted that Montana's laws regarding the rental of short-term lodging accommodations had not kept pace with changes in that sector of the economy, due in part to the recent proliferation of third-party online booking platforms facilitating peer-to-peer rentals outside the traditional hospitality industry. This contributed to challenges the department faced in accurately administering and collecting the two taxes.

Audit Follow-Up Results

Through follow-up work we learned that the passage of SB 52 in the 2021 Legislative Session had a significant impact on four of the five the recommendations in the audit, all of which are at various stages of implementation. The fifth recommendation, to the department, has not been implemented. We reviewed changes in Montana Code brought on by the bill; interviewed management and department staff regarding changes to the application and collection of the two taxes as a result of the bill and our original audit work; reviewed documentation and correspondence related to application and collection of the two taxes; obtained the perspective of a statewide hospitality association on how the landscape has changed since the bill was passed; and reviewed data on tax remittances and an ongoing review of the activities of a peer-to-peer vehicle rental platform.

RECOMMENDATION #1

We recommend the Department of Revenue:

- A. Enforce the statutory registration requirement for all individuals engaged in taxable short-term accommodation activity, and**
- B. Enter into future tax aggregation and collection agreements only while maintaining its legal authority to identify and audit individual marketplace participants as necessary to assure compliance with all applicable taxes and statutes.**

Implementation Status – Implemented

We noted during audit work that the department had entered into formal collection agreements with multiple online short-term accommodation platforms to collect and remit lodging taxes on behalf of thousands of property owners who conducted transactions via the platforms. While these agreements streamlined the collection process and administration of the taxes for the department, the agreements also exempted the owners of short-term rental properties sold via the platforms from the statutory requirement that those engaged in such activity must register with the department. Thus, we found that people providing short-term accommodations via the platforms were not treated the same as people selling short-term accommodations directly to consumers or via other platforms that did not have agreements with the department. Further, the lack of registration by individual owners meant the department was not aware of everyone in Montana engaged in short-term accommodation provision, despite the statutory registration requirement.

SB 52 addressed this problem by removing from Montana Code the requirement that people who offer short-term rental accommodations register with the department. With this requirement stricken from state law, the first part of the recommendation is no longer applicable and is considered addressed.

Similarly, the clarity in the application and collection of the two taxes due to SB 52 renders the second part of the recommendation no longer applicable. According to management, the department has not entered into any additional tax aggregation and collection agreements with any online platforms or sellers of short-term accommodations since the audit was complete, and does not anticipate entering into such agreements in the future. If this strategy changes and the department does reach such contractual terms with an online platform, management should ensure the agreements are executed in accordance with applicable laws.

As part of our follow-up work, the department shared communication records with one online platform indicating that the law has changed and the agreement between the platform and the department is no longer needed since the statute is now “clear and unambiguous” regarding which party is responsible for remitting lodging taxes to the department. The department should formalize the dissolution of each of these collection agreements.

RECOMMENDATION #2

We recommend the Department of Revenue:

- A. Amend the Administrative Rules of Montana to define and require updating as circumstances warrant lists of hosts on whose behalf lodging taxes are being remitted by a third party, and**
- B. Develop and implement a process to regularly contact active third-party tax remitters and obtain current lists of hosts on whose behalf the tax is being submitted.**

Implementation Status – Being Implemented

During audit work, we learned that property managers may collect and remit use and sales taxes on behalf of the short-term accommodation owners whose properties they manage. However, we found the department could do more to stay current on which properties were represented by property managers' payments. We recommended better communication and more current list of managed properties to better ensure accurate tax collections.

The department has promulgated administrative rules that implement changes to statute brought on by the passage of SB 52. While these rules are not finalized, they are in the "proposal and adoption" stage and were expected to be submitted by the department to the Secretary of State at the end of the first quarter of 2022. As such, we consider this recommendation in the process of being implemented.

The new administrative rules will require a seller (which could be a property manager, if that is the person who facilitates the sale and collects the money from the consumer) to register with the department information about each of the accommodations for which the tax is being collected and remitted. A single registration may be used to list multiple accommodations, thus providing the department with information about the properties in the state being used for short-term rentals.

RECOMMENDATION #3

We recommend the Department of Revenue develop and implement an oversight process for aggregated regional quarterly tax payments to ensure revenue is appropriately credited to the correct jurisdiction.

Implementation Status –Not Implemented

The 4 percent lodging use tax is collected to support tourism promotion efforts and is distributed according to a formula in statute that provides fixed percentages of the revenue to certain statewide entities (Department of Commerce Office of Tourism Development, among others). Other portions of the revenue are distributed regionally to tourism regions and local convention and visitors bureaus (CVBs), based in part on where in the state the transaction takes place and the tax is paid. During audit work, we reviewed the distribution of lodging facility use taxes to tourism regions and CVBs around the state. Our review of quarterly remittances indicated funds were not being accurately allocated regionally, so we recommended the department develop an oversight process or screening mechanism within its information management system that could flag questionable amounts for individual regions or CVBs, to help ensure proper distribution of the revenue.

During follow-up work, the department acknowledged it has not put in place any type of data screen or measurement tool that would flag certain distribution amounts for further review. Management told us they could not identify a way within their collection and information management system to flag certain remittance amounts for additional review, and that semi-formal visual review of regional distribution remains all that takes place currently. Thus, this recommendation has not been implemented.

With the passage of SB 52, several additional short-term rental platforms are now required to remit taxes separated by region and CVB, increasing the likelihood of errors and making even more important the notion of screening for amounts that seem unlikely or at a significant variation from years past, to ensure local tourism promotion efforts are appropriately funded.

RECOMMENDATION #4

We recommend the Department of Revenue collect vehicle rental sales tax from private vehicle owners by:

- A. Entering tax collection agreements with peer-to-peer vehicle rental platforms, while maintaining both the requirement for vehicle renters to register with the department and the department's ability to identify people engaged in rental activity, or**
- B. Developing and implementing a process for identifying and collecting rental vehicle sales tax from owners who rent their vehicles via peer-to-peer rental platforms.**

Implementation Status – Implemented

During audit work, we learned that as with peer-to-peer platform-based accommodation rentals, a similar marketplace was taking root for personal motor vehicles rented from one individual to another via an online platform. While this nascent economy was nowhere near the size of the accommodation marketplace at the time of the audit, we noted several similar concerns related to the department's ability to identify vehicle owners and collect appropriate tax on peer-to-peer rental transactions.

As it did to enact changes in the accommodation space, the passage of SB 52 rendered unnecessary the execution of collection agreements with peer-to-peer vehicle rental platforms. The onus is now unambiguously on the seller of the rental to remit the rental vehicle sales tax on the full amount collected from the renter. There is no need for the department to enter into collection agreements with these platforms, which now have the responsibility by law of remitting the tax. In addition, vehicle owners are no longer required to register with the department as providers of short-term rental cars, if they are conducting all of their rentals through an online platform that bears the tax remittance responsibility.

During follow-up work, we learned the department is currently analyzing the rental history of an online peer-to-peer vehicle rental platform. We reviewed information provided to the department by the company and noted that the firm offered details of each rental reservation, including date, cost (base rental plus a variety of optional fees), and location, but did not share with the department the identity of the owner of the vehicle being rented. The company is not required to provide this information, and owners who are renting their vehicles through an online seller are also not required to register with the department. While this does raise questions regarding the department's ability to identify individuals who participate in renting vehicles via this platform, the law now clearly does not require those individuals to register.

RECOMMENDATION #5

We recommend the Montana Legislature amend statute to account for the role of online booking platforms in the short-term accommodation industry and to clarify which portion of a customer payment for short-term accommodation is taxable.

Implementation Status – Implemented

SB 52 made consistent the language related to the application of the two taxes on short-term accommodations, and clarified which party is responsible for collecting and remitting the tax on accommodation sales. Previously, one tax was the responsibility of the "seller," and the other was to be

collected and remitted by the “owner/operator.” SB 52 replaced “owner/operator” with “seller” for the use tax, and added a definition of “seller” to make it clear that platforms are considered “sellers” and thus are responsible for both taxes.

Further, SB 52 also clarified that the seller is to collect and remit the use and sales taxes on the total amount paid by the buyer. During the audit, we noted that online platforms were paying only one of the two taxes on the amount retained by the platform as a booking fee for facilitating the transaction.

By passing SB 52, the legislature implemented this recommendation.