



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

LEGISLATIVE AUDIT  
DIVISION

18P-06

PERFORMANCE AUDIT

# *Short-Term Lodging and Rental Vehicle Taxes: Keeping Pace With an Evolving Marketplace*

*Department of Revenue*

APRIL 2020

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**PERFORMANCE AUDITS**

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee, which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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April 2020

The Legislative Audit Committee  
of the Montana State Legislature:

This is our performance audit of Lodging and Rental Vehicle Taxes managed by the Business and Income Tax Division of the Montana Department of Revenue.

This report provides the legislature information about the use and sales taxes Montana collects on short-term accommodation rentals as well as the sales tax on vehicle rentals. This report includes recommendations for improving oversight of taxable short-term lodging activities, as well as a recommendation to the legislature related to Montana statute and the recognition of the role of online booking platforms for short-term accommodation rentals. A written response from the department is included at the end of the report.

We wish to express our appreciation to department personnel for their cooperation and assistance during the audit.

Respectfully submitted,

*/s/ Angus Maciver*

Angus Maciver  
Legislative Auditor



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## PERFORMANCE AUDIT

## Short-Term Lodging and Rental Vehicle Taxes: Keeping Pace With an Evolving Marketplace

Department of Revenue

APRIL 2020

18P-06

REPORT SUMMARY

The Department of Revenue (department) has taken active steps to collect lodging facility use and sales taxes in an effort to keep up with the evolving landscape of the industry. However, in doing so it has circumvented state law and is unable to verify if the correct taxes are remitted. The two lodging taxes combined for nearly \$58 million in revenue in fiscal year 2018. While other states have statutorily addressed this evolving industry, Montana statute has not kept pace.

## Context

The department administers and collects two taxes on short-term (fewer than 30 days) accommodations: a 4 percent lodging facility use tax that is dedicated to tourism promotion, and a 4 percent sales tax that is deposited in the general fund. Together these taxes amount to more than \$50 million per year. The department also administers a similar 4 percent sales tax on rental vehicles, which provides an additional \$5 million per year to the general fund.

We found the department has entered into tax collection agreements with major online travel companies in an effort to more efficiently and thoroughly collect the two accommodation taxes. While there is evidence the agreements may be working due to an increase in tax collections, provisions in the agreements run counter to state law, and limit the department's access to the identity of certain individuals engaged in short-term rental activity. Because of this anonymity, we identified \$26 million in gross lodging revenue in 2018 that the department cannot trace to any individual and cannot verify is being correctly claimed and taxed as income.

We also found opportunities for the department to improve both Administrative Rules and its internal processes to more accurately collect

lodging taxes remitted by property managers on behalf of multiple other property owners.

Compared to the online travel industry, the online market for rental cars is relatively small. Nonetheless, a growing amount of peer-to-peer vehicle rental activity is going untaxed, and the department should ensure proper taxes are collected and remitted.

Other states have done more to amend statutes to better reflect the changing short-term lodging economy and to accommodate certain participants in the marketplace who may not have had a role when our laws were first passed. Updating Montana Code would help the department in its effort to accurately and efficiently administer and collect these taxes.

## Results

Our work resulted in five recommendations, including four to the department and one to the legislature. Recommendations were related to:

- ◆ Meeting a requirement that people engaged in short-term rental activity register with the department,
- ◆ Improving the identification of and tax collection from individuals

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who utilize the services of property managers to manage and rent their properties,

- ◆ Improving its review of aggregated tax payments to ensure use tax is distributed accurately to regional entities across Montana,
- ◆ Collecting all required sales tax from people engaged in short-term vehicle rental, and
- ◆ Updating statute to better reflect the short-term lodging economy and the roles of various participants in it.

Recommendation Concurrence	
Concur	1
Partially Concur	3
Do Not Concur	0
<b>Source: Agency audit response included in final report.</b>	

For a complete copy of the report (18P-06) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto:lad@mt.gov); or check the web site at <https://leg.mt.gov/lad/audit-reports>  
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# Chapter I – Introduction

## **Introduction**

Montana is among many states that assess one or more taxes on the rental of short-term accommodations. Terms and definitions vary across the country, but these are generally identified as lodging, hotel, short-term rental, transient rental, or vacation rental taxes, among other terms. These taxes are typically aimed at travelers and tourists, as opposed to people renting places to call home. In Montana, the taxes are applicable on rentals of 30 days or fewer. Montana also assesses a 4 percent sales tax on vehicle rentals. Each of these taxes is administered by the Department of Revenue (department). The department registers individuals engaged in rental accommodation and rental vehicle activity, and collects and processes quarterly payments through its primary taxpayer information system, Gentax. It also audits the accounts of taxpayers to ensure accuracy and compliance with the law.

The department requested a performance audit of the lodging facility use and sales taxes and the vehicle sales tax. In its request, the department cited recent technological developments in the lodging industry as well as court decisions that affect these current tax programs in Montana. The department noted that evolution of market models used by third parties that communicate, coordinate, lease, or rent lodging facilities in the state call into question whether the current tax system is or can be administered in a fair and equitable manner. Based on the department's request as well as legislative interest in the topic, the Legislative Audit Committee prioritized a performance audit to examine the statutory construct of the sales and use taxes and the department's role in collecting the taxes.

## **Background**

Montana assesses two taxes on short-term accommodation rentals: a 4 percent use tax, and a 4 percent (as of January 1, 2020; 3 percent prior to that) sales tax. A similar 4 percent sales tax is also assessed on vehicle rentals, which made up a smaller portion of our audit work. The taxes are overseen and collected by the department's Miscellaneous Tax Unit within its Business and Income Tax Division. The unit is also responsible for the collection of tobacco taxes, the retail telecom tax, the contractor gross receipt tax, and several other miscellaneous taxes.

According to the department's most recent biennial report, in fiscal year 2018, the lodging facility use tax generated \$32.8 million in revenue, while the lodging sales tax generated \$24.1 million. The use tax is dedicated to tourism promotion and is shared among several statewide and regional entities. The sales tax is deposited in the

general fund. The rental vehicle sales tax, also deposited in the general fund, generated \$5.0 million for that same period.

The following two tables illustrate the amount of lodging facility use tax, lodging facility sales tax, and rental vehicle sales tax collected by the department for the four most recent reported fiscal years. The combined lodging taxes provide approximately 10 times the revenue of the vehicle sales tax. From fiscal years 2015 to 2018, the amount of lodging taxes collected increased by 22 percent, while the amount of rental vehicle taxes collected increased by 28 percent in the same period.

Table 1  
**Lodging Use and Sales Tax Revenue**  
2015-2018

Fiscal Year	Lodging Use Tax	Lodging Sales Tax	Total Lodging Taxes
2015	\$27,127,478	\$19,696,526	\$46,824,004
2016	\$27,910,664	\$21,492,606	\$49,403,270
2017	\$29,539,381	\$21,780,133	\$51,319,514
2018	\$32,805,856	\$24,091,089	\$56,896,945

Table 2  
**Rental Vehicle Sales Tax Revenue**  
2015-2018

Fiscal Year	Vehicle Rental Sales Tax
2015	\$3,906,745
2016	\$4,269,438
2017	\$4,536,234
2018	\$4,958,598

**Source: Compiled by the Legislative Audit Division from department records.**

Over the past several years, the short-term accommodation industry, and particularly how individuals arrange to rent short-term accommodations, has changed. Today the marketplace is dominated by online travel companies (OTCs), which are Web sites that list short-term accommodation rentals in multiple locations. A subset of the online travel market provides non-traditional or peer-to-peer short-term accommodations, often offered for rent by individuals and not hotel or motel companies. The influence of online travel reservations on the marketplace and on Montana's current tax structure, as well as how the department has responded to changes in the industry, were a focus of our work.

Short-term lodging transactions work in different ways. In some cases, an OTC will purchase a block of rooms from a hotel, then re-sell the rooms. In others, an OTC will link a customer to the renter's own website to complete the transaction. In other models, particularly in the peer-to-peer space, the platform advertises rentals and collects payment from the customer, then passes a share of the revenue on to the property owner.

## **Audit Scope**

Work for this audit largely reviewed information contained in and accessed via the department's information system used for collecting and tracking these and other taxes. Generally, our audit work addressed two main areas: the identification and collection of sales and use taxes in the short-term accommodation and vehicle rental markets. We also examined the fairness and equity of state law related to the taxing of short-term accommodation rentals. The following paragraphs provide additional detail on each of our primary scope areas. Most of our work focused on calendar years 2016 through 2018, to account for certain changes in collection practices made by the department during that time. However, the statutes governing the taxes date back to 1987 and 2003, so our statutory review dated back that far. The following sections outline the two main areas of our review work in more detail.

## **Identification and Collection of Sales and Use Taxes**

We evaluated the department's ability to accurately identify and collect use and sales taxes from owners of short-term accommodations. One focus was on websites that serve as peer-to-peer platforms for individuals looking to rent what would historically be considered private lodging. An examination of three years' worth of quarterly tax submissions (2016-2018) allowed us to identify trends in revenue collections as well as in the number of individual filers of the three taxes. We also assessed the impact of tax aggregation and remission agreements negotiated with major online peer-to-peer rental platforms. As part of this work, we reviewed a sample of individual renters on one of the major platforms, to determine whether those individuals were properly collecting and remitting the lodging taxes. We also examined the terms of agreements the department has executed with major online peer-to-peer platforms to determine if the agreements comply with state law and if taxes are being accurately remitted and distributed to appropriate parties.

We similarly examined the peer-to-peer market for vehicle rental. This included work like the work conducted for accommodation rentals. We evaluated if individuals engaged in vehicle rental activity could be identified as remitters of the vehicle rental sales tax, and what steps the department is taking to ensure taxes are collected when vehicles are rented.

## Statutory Fairness and Equity

We evaluated a distinction in statutory language between Montana's two short-term accommodation taxes (use and sales) as well as a 2015 Montana Supreme Court opinion that settled which participants in the short-term accommodation marketplace are responsible for the collection and remission of either or both taxes.

We evaluated department data to determine whether and to what extent the difference in language is affecting lodging tax collections by the department. We reviewed numerous bills from the last three legislative sessions to gain an understanding of the types of changes the legislature has contemplated in recent years. We studied other states around the country for evidence of how lawmakers have addressed the evolving short-term accommodation industry and the proliferation of online travel companies and peer-to-peer booking platforms. Our focus was on identifying innovative or effective strategies for applying tax policy. We did not limit our work to states in geographic proximity to Montana.

## Audit Objectives and Methodologies

Based on risk assessment work completed as part of our audit, we developed the following two audit objectives:

1. Does the Department of Revenue accurately identify and collect sales and lodging facility use taxes from Montana businesses and individuals participating in the short-term accommodation and vehicle rental markets?
2. Is Montana state law related to the application of the sales and use taxes on short-term accommodation rentals consistent and equitable to all participants in the market?

To address these objectives, we performed the following methodologies:

- ◆ Conducted an analysis of the reliability and integrity of data in the department's taxpayer database used to administer short-term accommodation and vehicle rental taxes.
- ◆ Reviewed Montana Code, Administrative Rules, and department policies to identify how the department identifies and collects use and sales taxes.
- ◆ Reviewed the 2015 Montana Supreme Court decision regarding the application and collection of sales and use taxes for lodging accommodations.
- ◆ Obtained and reviewed department goals and objectives related to equity and fairness in taxation.
- ◆ Acquired and analyzed tax aggregation and remission agreements with online peer-to-peer rental platforms to determine whether the department could legally enter the agreements.

- ◆ Requested the department ask the company for the identity of its individual Montana hosts, and also asked the company directly for this information, to determine whether the department could access the information necessary to ensure all appropriate taxes are being collected.
- ◆ Analyzed information provided by the company to determine if the information allowed for identification of individual hosts around the state.
- ◆ Accessed the department's taxpayer database for three years' worth of individual lodging tax returns (calendar years 2016-2018) to analyze trends over time; evidence of property managers remitting taxes for multiple addresses; and changes in revenue and number of taxpayers when platform agreements took effect.
- ◆ Interviewed department staff regarding lodging sales and use taxes and vehicle sales tax collections and audits.
- ◆ Reviewed a sample of one platform's 36 peer-to-peer rental offerings on a selected date in the Helena area to attempt to identify the owners and determine whether each appeared as a lodging tax account in the department's database.
- ◆ Reviewed a sample of vehicles available for peer-to-peer rental on the leading platform for these transactions to measure how much taxable activity is taking place on this platform.
- ◆ Interviewed department staff regarding processes to facilitate tax collection from individuals engaged in peer-to-peer vehicle rental.
- ◆ Reviewed bills from recent legislative sessions to determine what efforts the legislature has made to amend either or both short-term lodging taxes.
- ◆ Interviewed stakeholders to obtain their perspective on the current laws and the process to collect lodging taxes.
- ◆ Reviewed a selection of other states to learn whether and how they have amended statute to better reflect the evolving short-term accommodation marketplace.

## **Report Contents**

This report contains two additional chapters:

- ◆ Chapter II describes the department's current tax collection practices for short-term accommodation rentals and vehicle rentals. This chapter offers recommendations to improve identification of and equity among participants in these markets; ensure increased accuracy of third-party tax remission; and improve the accuracy of accommodation use tax distribution.
- ◆ Chapter III provides an analysis of Montana Code and how current use and sales taxes are defined, described, and implemented. The chapter also includes a review of lodging tax statutes and collection practices in other states. This chapter discusses potential changes to Montana Code that may more accurately reflect and regulate the current environment for short-term accommodation rentals.



## Chapter II – New Models for Accommodation and Vehicle Rentals

### Introduction

Our first objective examined how the Department of Revenue (department) identifies and collects sales and use taxes for short-term lodging accommodations (defined in Montana as 30 days or fewer) and a sales tax on vehicle rentals. Montana collects two taxes on short-term accommodations, a 4 percent use tax and a 4 percent (3 percent prior to January 1, 2020) sales tax. These taxes were enacted at different times and for different purposes.

Sections 15-65-101 through 15-65-131, MCA, were passed in 1987 and require collection of a 4 percent lodging facility use tax. This revenue is to be used for tourism promotion activities, and the tax is divided up among several regional and statewide entities in the tourism industry. According to statute, the tax is to be collected and paid to the department by the owner or operator of a facility. The law does not define the terms “owner” or “operator,” but they are generally understood to be people who own or are charged with running short-term lodging facilities.

A short-term lodging sales tax was implemented 16 years later, in 2003, through passage of §15-68-101 through §15-68-820, MCA. The sales tax was 3 percent when first implemented, and increased to 4 percent on January 1, 2020. Revenue from the sales tax is deposited in the general fund. Statute mandates that the sales tax be collected by the seller and paid to the department by the seller. Per the law, the seller is defined as “a person that makes sales, leases, or rentals of personal property or services.” A similar sales tax is collected on vehicle rentals, also now 4 percent, also collected by the seller, and revenue is deposited in the general fund.

In the years since these taxes were codified, changes have taken place in the short-term lodging industry, particularly in the way consumers shop for, identify, and purchase short-term accommodations. Our audit work sought to determine how the department identifies and collects these taxes in the face of an evolving industry. To do this we reviewed individual hosts offering accommodations on peer-to-peer rental platforms and tax aggregation and remission agreements between the department and certain short-term lodging platforms. We also examined the peer-to-peer vehicle rental market in Montana to assess what steps the department is taking to address this growing market.

We found opportunities for the department to improve the collection agreements it makes with online platforms, and to strengthen rules and practices related to third-party tax remissions. We made recommendations to the department in these and other areas.

### **More People Using Third Parties to Book Accommodations**

The proliferation of the Internet into everyday life over the past two-plus decades has led to sweeping changes in scores of industries, and the short-term accommodation rental marketplace is no exception. A generation ago, Americans would reserve accommodations by calling a hotel directly, or perhaps by calling a hotel chain's toll-free number. Today, the Internet is used to facilitate most bookings. One industry publication reported that online travel companies (OTCs), or websites offering customers a variety of lodging options, facilitate two of every five lodging bookings, in addition to those accommodations booked directly with hotel websites. These OTCs did not exist when Montana's lodging facility use tax was first implemented.

In addition to OTCs comprising a significant share of booking transactions, another subset of the online short-term accommodation market has grown substantially in recent years. Specifically, websites through which individuals can rent accommodations (homes, cabins, apartments, etc.) to other individuals, called peer-to-peer rentals, have grown in popularity. There is comparatively less activity in a similarly structured peer-to-peer vehicle rental space. However, we found this segment of the vehicle rental market is growing in Montana.

### **Small Peer-to-Peer Hosts Historically Difficult to Identify**

From the department's perspective, trying to ensure appropriate taxes are collected and remitted and identifying individuals engaged in the peer-to-peer accommodation rental business is more of a challenge than doing so for traditional lodging businesses (hotels, etc.). The peer-to-peer platforms do not require individual hosts to identify themselves to prospective customers or the public. Even though state law requires people engaged in short-term accommodation rental activity to register with the department, department staff believed many peer-to-peer lodging providers may not have been aware of this requirement when they entered the market, and thus are not registered.

In interviews, department staff described earlier efforts to identify all the individuals in Montana engaged in peer-to-peer rental activity. This involved using the limited information provided on each platform listing. This may or may not include a first or last name, a locator map with varying degrees of specificity, exterior photos of the property available to rent, etc. Department staff would cross-reference available

information with sources such as web-based maps, the Montana Cadastral Mapping Project, the department's taxpayer information system, and other available sources.

Ultimately, department staff told us they believed they identified most short-term rental providers. However, they also told us the process was time-intensive and the return in tax revenue from any individual host was thought to be limited. Nonetheless, this is a tax that is required to be collected and remitted by people engaged in this activity, and ensuring compliance is the department's responsibility.

To replicate this method of identifying individual peer-to-peer lodging renters, we undertook a similar exercise, on a more limited scale. Using one popular peer-to-peer platform and a randomly selected date for a lodging reservation, we attempted to discern the identity of the owner and the tax status of the 36 properties available to rent in and around Helena on the date we selected. While this peer-to-peer platform has listings across the state, we selected Helena due to audit staff familiarity with the area, which would aid in the identification of properties and owners.

Our sample of 36 rentals included nine traditional hotels in Helena, all of which we identified in the taxpayer database. The 27 remaining rentals were owned by 20 unique owners.

Among the 20 unique owners in our sample:

- ◆ We positively identified 17 owners, and three could not be identified.
- ◆ Of the 17 owners we identified, we confirmed that six were in the taxpayer database as registered lodging taxpayers.
- ◆ Of the 11 owners we did not find as lodging taxpayers in the database, eight were new accounts on the platform as of 2019 and thus may not have yet registered with the department at the time of our review.

We were able to identify and confirm the tax status of many of the hosts in our sample. However, there were properties for which we could not identify the owner, and others for which we could confirm ownership but not the status of lodging tax submissions.

## **Tax Collection and Remittance Agreements With Peer-to-Peer Platforms**

In an effort to more effectively collect short-term accommodation taxes, the department has entered into tax collection and remission agreements with two major peer-to-peer lodging platform companies, one in early 2018 and one in late 2019. In these agreements, the companies agree to collect and remit all use and sales taxes due on all bookings facilitated through their online platforms, on behalf of thousands of

individual property owners across the state. Rather than each individual host remitting the taxes, the company aggregates the taxes on behalf of all property owners on the site. The company “assumes the duty” of the seller for the purposes of collecting and remitting the proper lodging taxes.

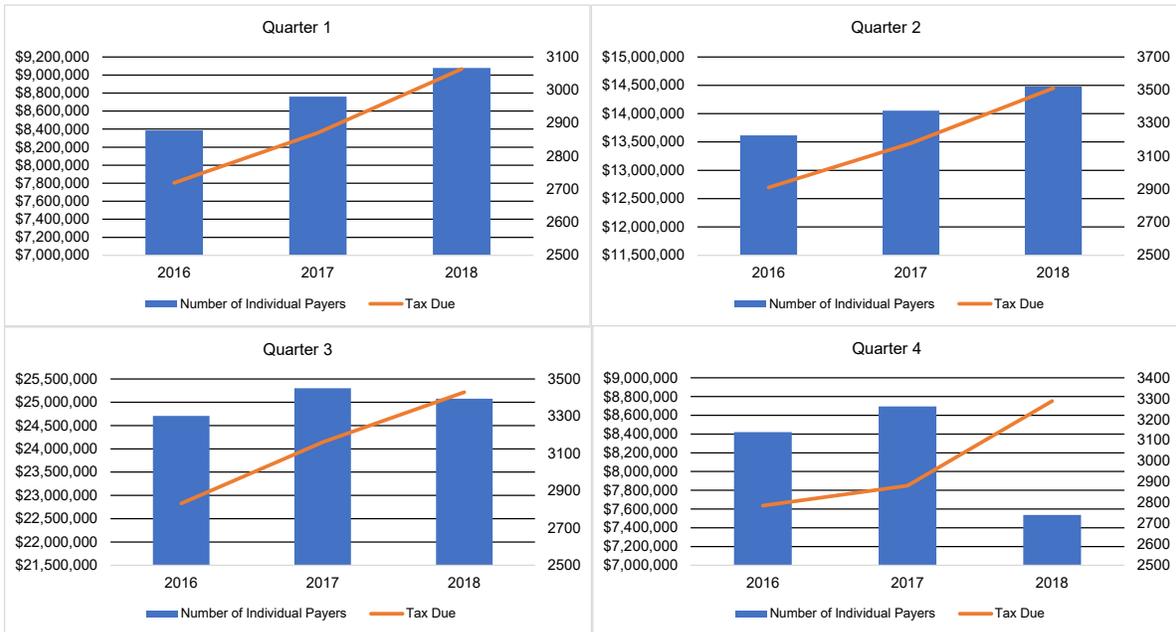
The department believes these agreements are helpful because they require the platform companies to collect and remit aggregated use and sales taxes for thousands of accommodation renters whom the department would otherwise need to account for individually. Indeed, in the first full quarter that the initial agreement was in effect (Q3 of 2018), the platform company remitted \$718,266 on behalf of 3,904 properties in the state that were rented via the platform that quarter.

The department believes these agreements increase both tax collection efficiency and taxpayer compliance because the company is expected to collect and remit tax for every rental facilitated through its platform. Without these agreements, it would have to process thousands of smaller lodging tax returns each quarter, and would need to do more detailed compliance work to ensure the correct taxes were being collected and remitted. The department suggested additional staff maybe necessary for this work.

We reviewed cumulative lodging tax collections for the quarters immediately before and after the first agreement was implemented and found evidence that the agreement may be improving compliance and thus increasing revenue. As illustrated in Figure 1 (see page 11), we generally observed that the total number of individual filers of lodging tax returns decreased after the agreement took effect. This would be expected if owners who had previously filed individually were now being aggregated into payments by the company and no longer had to file for themselves. For example, in a year-over-year comparison, the number of filers in the fourth quarter of 2019 was 16 percent below the number of individual filers in the fourth quarter of 2018. At the same time, the amount of tax revenue collected went up by 11.5 percent in the same time frame. While factors such as a strong tourism economy may contribute to this, it may also suggest compliance may have improved with the collection agreement.

Figure 1 (see page 11), the blue bar represents the total number of individual rental tax filers, while the orange line represents the amount of quarterly tax due. The figures illustrate the seasonality of the short-term lodging industry in Montana, with the majority of activity taking place April through September. The figures (Q4 in particular) also show a decrease in the number of individual filers after an aggregation agreement was reached with a peer-to peer platform. In addition to illustrating the seasonality of the short-term lodging industry in Montana, the figures show the decrease in the number of individual filers after an aggregation agreement was reached with a peer-to-peer platform.

**Figure 1**  
**Number of Tax Filers and Total Amount Due by Quarter**  
**2016-2018**



Source: Compiled by the Legislative Audit Division from department records.

## Tax Collection and Remittance Agreements Exempt Certain Renters From Registration Requirements

While there are benefits to the agreements, we reviewed the text of agreements and found they contain provisions that are contrary to state law. Specifically, each agreement says property owners renting via the respective platforms are exempted from having to register individually with the department. This is counter to statute for the use tax, which mandates “the owner or operator of a facility shall apply to the department of revenue for a registration number” (§15-65-114(1), MCA). Similarly, the sales tax statute mandates that “a person engaging in business within this state shall ... obtain a seller’s permit” (§15-68-110(1), MCA).

The result of this provision in the agreements exempting hosts from registering is participants in the short-term rental marketplace are not treated equally. Property owners conducting short-term rentals in Montana are subject to different rules depending upon the venue they use to offer their accommodations and acquire customer bookings. Those on the platforms covered by the two agreements are inappropriately exempted from the statutory requirement to register with the department, while those on other platforms or acting independently still must register.

Further, the agreements stipulate that the companies will not provide to the department the names and addresses of the property owners at which the short-term rental activity is taking place. This anonymity effectively means the department is unable to accurately identify and collect sales and use tax from individuals engaged in the rental of short-term accommodations and subject to the lodging sales and use taxes and other statutory requirements. Department staff could not identify another tax for which the identity of the individuals engaged in the taxable activity is not known by the department.

Our research showed that peer-to-peer platforms have entered into similar agreements with many states and municipalities around the country, and that protecting the identity of individual hosts is something the platforms typically insist upon. In that sense, the agreements the department entered are not unique. Nonetheless, the terms of the agreements circumvent existing statutory requirements for individuals engaged in short-term lodging activity.

### **Income Generated by Rental Activity Cannot Be Verified**

The lack of individual registration coupled with other provisions in the agreements designed to protect the identity of individual property owners makes it difficult, if not impossible, for the department to audit the platforms' activity to ensure proper tax is collected. According to the audit provisions in each agreement, the department agrees to audit the companies "on an anonymized transaction basis," and the companies are not required to produce any personally identifiable information relating to any host or guest without binding legal process served after the completion of an audit. These audit provisions are untested by the department, and we have concerns the department will be unable to confirm or prove that the appropriate tax is paid.

Further, the department's inability to identify individual participants in the market means the department has no way to verify if personal or business income from rental activity is claimed and the appropriate income tax paid. In the first seven months of its agreement with the state, one peer-to-peer platform remitted sales and use taxes on \$22.5 million in gross receipts. The department has no way of verifying if rental income is being appropriately claimed and taxed by individual property owners.

In interviews, department staff told us that when negotiating the first of the two agreements, the company said denying the identity of its hosts to the department was of substantial importance. While not entirely comfortable with not knowing the identity of individual hosts, the department ultimately believed it was more important to increase efficiency in collecting the tax revenue generated by accommodation rental activity on the platform.

## The Department's Tax Collection and Remittance Agreement Audit Provisions Remain Untested

The department maintains it will audit the records of the first platform within three years of execution of the agreement, once there is sufficient tax remission history to make an audit worthwhile. The department believes the audit provisions in the agreements will ultimately allow for personal identification of individual hosts. But again, these provisions remain yet untested.

We asked one platform to provide the identities and addresses of the individuals on whose behalf it is collecting and remitting the lodging taxes, and the company refused our request. The company did provide anonymized transaction data that purported to show every rental on its platform in Montana for the quarter in question, but with no identifiable information included. This is the same information the company is willing to provide to the department as the first step of an audit.

Table 3  
**Lodging Tax Due, Q3 and Q4**  
2018

	Taxable Lodging Receipts, Statewide	Total Tax Due Statewide	Taxable Lodging Receipts, Platform	Tax Due Via Platform Agreement
2018Q3	\$369,196,345	\$25,215,853	\$11,007,239	\$718,267
2018Q4	\$128,994,596	\$8,751,871	\$8,800,012	\$567,490

**Source: Compiled by Legislative Audit Division from department and company records.**

The department has circumvented state law by entering into agreements allowing certain participants in the short-term rental market to avoid registering or otherwise identifying themselves to the department. This law requires everyone engaged in this activity and remitting either sales or use tax register or obtain a permit from the department. Taken together, the peer-to-peer renters on one platform to reach an agreement with the state represent around 2.5 percent of all taxable lodging activity in the state, which according to the department makes the platform the single largest filer of accommodation use and sales tax returns.

## Agreements a Useful Tool if Properly Designed

Through interviews with department staff and our audit work, we came to recognize the value of such tax collection and remission agreements from the department's perspective. As the peer-to-peer economy continues to grow, such agreements may become more prevalent, and may become appropriate in industries beyond short-term

lodging rentals. The department took steps to identify a way to more efficiently and thoroughly collect sales and use taxes from thousands of small marketplace participants. However, these agreements should not be executed in circumvention of existing state law. Department staff said the first platform company refused to yield on providing personal information or requiring its users to register. Ultimately the department determined developing what they believed was a more efficient and thorough collection process was more important than knowing the identities of individual renters. By not knowing the identities of individual renters, the department is essentially taking it on faith that it is receiving the correct amount of sales and use taxes owed by a segment of short-term accommodations owners in the state.

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**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.*
- 

## **Property Managers Can Also Collect and Remit Taxes for Short-Term Lodging Rentals**

The tax aggregation and remission agreements with peer-to-peer platforms are not the only examples of people collecting and remitting sales and use taxes on behalf of other property owners. Administrative Rule 42.14.106 says that “a seller who is registering multiple locations and who has elected to file a combined return may file one application listing separately each location.” This allows an individual to collect and submit use and sales tax for multiple short-term rental properties on a single tax return, whether the properties are owned by the filers themselves or by one or more third parties. This rule applies to people acting as property managers, who may, for example, administratively manage several rentals for different owners in a resort condo development.

Property managers paying taxes for multiple rental properties are required by rule to provide a list of the properties they will be paying for when registering with the department. There is, however, no requirement that this list of properties be updated or edited to reflect additions or subtractions as the portfolio of properties under

the registrant's management changes. This limits the effectiveness of the rule, as it diminishes the department's ability to identify the individuals on whose behalf the use and sales taxes are being remitted each quarter.

### **Not All Property Managers Are Submitting Lists of Properties**

We examined the department's taxpayer information system to determine if the required lists are being provided by property managers upon registration. We found the taxpayer information system cannot readily identify individuals, such as property managers, who are remitting taxes for multiple rental properties or on behalf of properties owned by someone else.

We judgmentally selected 16 individuals who remit lodging taxes on behalf of multiple addresses. Of the 16 property managers we identified, eight had at one time provided the requisite lists of properties to the department, listing from three to 84 properties. Of those eight, five had most recently provided a list in 2014, the last time the department sent letters to people it identified as likely property managers reminding them of the rule and urging compliance. It is likely that over time, the number and identity of properties under a given manager's oversight would change. Currently, the department does not have an accurate accounting of short-term accommodations managed by property managers.

### **Updating of Property Lists Would Help With Compliance Efforts**

With no formal process in place, the department has neither consistently nor actively pursued property managers to update lists of properties for which they are remitting taxes. However, updating this information is not required by rule. Because the administrative rule does not require lists to be updated as properties are added or removed from a third-party manager's tax responsibilities, the department cannot stay current on whose properties are being used for short-term rental activity. In addition to hampering the department's ability to ensure the proper tax is collected, this also limits the department's ability to ensure the income from these rentals is being appropriately claimed and taxed.

We found this rule to be evidence that the department is prepared to accept tax payments from third parties. This rule also shows that in the case of third-party tax remitters, the department wants to know the identity of the property owners who are being represented by those third-party property managers. Amending the rule to require updated or current lists of properties represented by single filers would help the department with compliance efforts for short-term rental taxes. It would help the

department confirm that such rental income was being appropriately claimed and the proper income tax paid.

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***RECOMMENDATION #2***

*We recommend the Department of Revenue:*

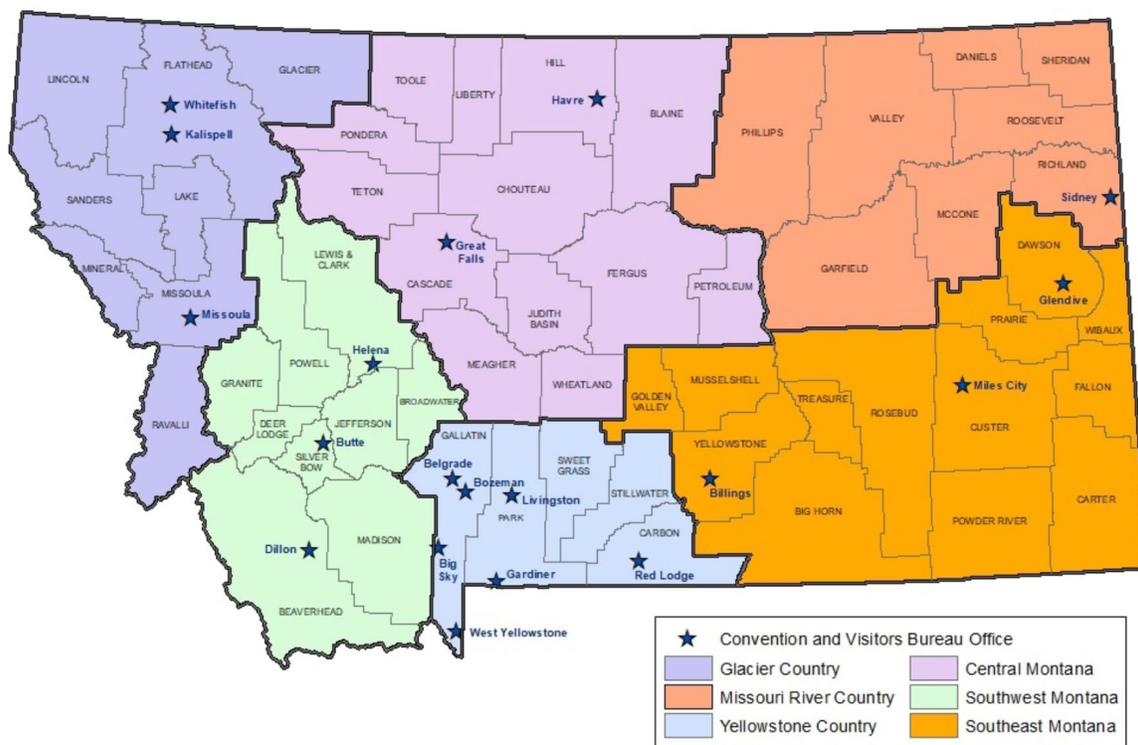
- A. *Amend the Administrative Rules of Montana to define and require updating as circumstances warrant lists of hosts on whose behalf lodging taxes are being remitted by a third party, and*
  - B. *Develop and implement a process to regularly contact active third-party tax remitters and obtain current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

## **Distribution of Lodging Facility Use Tax Among Tourism Regions and CVBs**

The 4 percent lodging facility use tax, put in place in 1987 to fund tourism promotion efforts, is distributed according to a formula that provides fixed percentages to certain statewide entities. These include the Department of Commerce Office of Tourism and Business Development, Montana State Parks, and the Montana Historical Society. A percentage of the tax also supports regional entities, namely tourism regions and convention and visitors bureaus (CVB), and is distributed in part to where the tax was generated according to a statutory formula.

The following map illustrates the six tourism regions in Montana, as well as the 19 CVBs throughout the state. Each of these receive a proportional share of the lodging facility use tax.

Figure 2  
2019 Montana Tourism Regions and Convention & Visitors Bureaus Locations



Source: Compiled by the Legislative Audit Division.

Because of this regional distribution component of the use tax, anyone filing the tax for locations in multiple counties or CVBs must submit a separate tax return for properties in each geographic location. Accordingly, the agreements with the peer-to-peer platforms call for the companies to submit separate quarterly tax returns for each county and CVB, so a portion of use tax can be properly credited and distributed to the appropriate region/CVB. (Each tourism region is comprised of several counties, and the county payments are aggregated accordingly.)

### Errors Identified in Several Tax Returns Where Gross Revenues Were Mis-Allocated

We analyzed aggregated quarterly tax returns from one company in the department's tax database for the first three quarters that the tax aggregation agreement was in place (Q2 through Q4 of 2018). We found errors in how gross rental revenue was being credited geographically. Specifically, we identified several months for which the company was claiming no gross rental revenue in CVBs where it is impossible that there would be even a single month without rental activity.

For example, as shown in the table below, one quarterly return showed no gross rental income in the Big Sky CVB for the last three months of 2018. In addition to one month earlier in the year. Other returns showed no rental activity for one month in both Red Lodge and West Yellowstone. Big Sky, Red Lodge, and West Yellowstone are distinct CVBs, and thus should be receiving a commensurate percentage of the lodging facility use tax. It is highly unlikely there would be no peer-to-peer rental activity for an entire month or more in any of these visitor-heavy resort areas.

Table 4  
**Mis-Allocated Lodging Revenue in Three Convention and Visitors Bureaus**

CVB	Months for Which No Gross Revenue Shown	Mis-Allocated Gross Revenue for Those Months
Big Sky	4	\$1,280,438.47
Red Lodge	1	\$79,065.64
West Yellowstone	1	\$255,426.03

**Source:** Compiled by Legislative Audit Division staff from department records.

Based on staff interviews, we found the department did not notice the errors or take steps to correct them prior to our bringing the errors to the department's attention. When we pointed out the errors, staff contacted the tax filer to determine what had happened. The department determined that the correct amount of tax was paid in total, but gross rental revenue that should have been attributed to each identified CVB was instead credited to the county in which the CVB is located.

### **Tourism Dollars Should Be Distributed Based Upon Where Rental Activity Takes Place**

In the Big Sky example from above, the result of this error was the incorrect allocation of \$1.28 million in gross lodging receipts for the three months in question. These funds were mistakenly credited to Gallatin County (and thus the Yellowstone Country tourism region) and not to the Big Sky CVB. Had the department not corrected this error when we pointed it out, \$5,700 in tourism promotion funding would have been incorrectly provided to Yellowstone Country (which includes Gallatin County) rather than to the Big Sky CVB.

Tourism promotion entities across the state depend upon the use tax proceeds for a significant portion of their promotional activities, and even a few thousand dollars can be significant in a single CVB. If tax filers do not claim gross lodging receipts in the correct county or CVB, and the error goes uncorrected, tourism promotion dollars will not be accurately distributed.

## **Lack of Review Process Makes Errors More Likely**

Presently, the department does not have an oversight process to review county and CVB gross revenue numbers to ensure tax revenue is correctly allocated to the tourism regions and CVBs. Department officials said it is not practical with current resources to examine every aggregated regional tax return. However, we believe the department can establish a process to review a sample of returns based on highest risk, particularly in the case of aggregated returns on which errors of this nature would likely be multiplied by a significant number of individual renters. This could include reviewing major tourism areas, or flagging substantial variation in lodging revenue year over year within a county or CVB.

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### **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.*

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## **Peer-to-Peer Auto Rental Taxes Not Collected Despite Industry Growth**

Like the peer-to-peer lodging platforms, there are peer-to-peer platforms that facilitate the rental of private vehicles from one individual to another. This vehicle market is much smaller than its short-term accommodation counterpart, but is showing signs of growth. We found the department is not taking steps to identify and collect the sales tax (vehicle rentals are not subject to the use tax) from people renting out their vehicles via peer-to-peer online platforms. According to the department, the last time staff examined the leading online peer-to-peer vehicle rental platform, around two years ago, fewer than two dozen cars were offered for rent statewide. Department staff indicated any effort to identify such a small number of car owners and a correspondingly small amount of taxable rental revenue was not deemed an efficient use of staff time.

## **Large Growth in Peer-to-Peer Auto Rental Activity**

We wanted to determine whether the level of activity on the leading peer-to-peer vehicle rental platform has grown since the department reviewed it two years ago. We found the volume of activity on the platform has grown significantly since that time. To illustrate this growth, we searched for a car to rent from the Bozeman airport at a random date in March 2020. On this date we identified 28 vehicles available for rent. These vehicles had been rented nearly 400 times previously, according to the website,

and generated more than \$120,000 in revenue, based upon list daily rental price. This represents activity that should have yielded \$3,634 in sales tax revenue, had the department been aware of it. In addition, this activity generated income for the owners of the cars. This is income the department is unable to verify is accurately claimed and taxed. Further, another Bozeman car owner was found to have four vehicles available for rent, with a total rental history of 189 rentals since joining the platform in 2016. This owner's rentals alone appeared to account for \$9,680 in gross rental income and almost \$300 in sales tax liability.

## **Identifying Peer-to-Peer Vehicle Renters Particularly Challenging**

As we did with peer-to-peer accommodation providers, we attempted to identify a small sample of individuals engaged in peer-to-peer vehicle rental activity. We found this challenging, if not impossible, because vehicles do not have a fixed address or photos and maps to help identify them. We identified two vehicle rental providers in the Helena area, but we found no indication in the department's tax information system that either was registered with the department or was remitting vehicle rental tax.

As the volume of vehicle rental business on peer-to-peer platforms increases, the department is not collecting an increasing amount of tax revenue because it does not have a process to monitor activity in this market. Given the challenges associated with identifying marketplace participants on an individual basis based upon available information, an agreement with peer-to-peer vehicle platforms for the collection and remission of sales tax would likely be more thorough and efficient from the department's perspective. However, any agreement with the platform must be constructed so as not to circumvent state law, particularly the statute requiring those who participate in vehicle rental business to register with the department prior to remitting quarterly taxes as required in §15-68-110(2), MCA. If such an agreement cannot be reached to the satisfaction of both parties, the department should find another means to identify participants in the vehicle rental market and ensure the appropriate tax is collected and remitted.

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**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.*
-



## Chapter III – Keeping Pace With an Evolving Industry

### **Introduction**

Our second objective asked whether Montana state law related to the application of the sales and use taxes on short-term accommodation rentals is consistent and equitable to all participants in the market. Montana collects two taxes on short-term accommodations, a 4 percent lodging facility use tax and a 4 percent (as of January 1, 2020, 3 percent during fieldwork prior to that) sales tax.

The lodging facility use tax was passed by the legislature in 1987, with the direction that the proceeds would be used primarily for tourism promotion, on both a statewide and regional basis. A formula guides the distribution of the tax. Fixed percentages of the amount collected are provided to certain statewide entities, including the Office of Tourism and Business Development, Montana State Parks, and the Montana Historical Society. Concurrently, a percentage of the tax collected is distributed geographically, to one of the state's tourism regions or convention and visitors bureaus (CVB), also to be used for tourism promotion and allocated based upon how much tax was generated in the region/CVB. The accommodation sales tax was created in 2003. The proceeds from this tax are deposited in the general fund.

As part of our work, we examined the history of Montana's two accommodation taxes, in both the legislature and the court system. We reviewed multiple legislative attempts at amending the tax statutes, and assessed whether Montana's accommodation tax structure is appropriate given the way the industry is structured and the way most people acquire such accommodations. We also examined several other states that have amended their tax statutes in recent years to address the evolving nature of the short-term accommodation marketplace. Through our work we determined other states have updated their statutes as the short-term accommodation model has evolved. This chapter includes a review of updated statutes in other states and a recommendation to the legislature to amend Montana statute to reflect the current state of the industry.

### **A Brief History of Short-Term Accommodation Taxes in Montana**

Montana's two short-term accommodation taxes were enacted at different times more than a decade apart, and the language describing who is responsible for collecting and remitting the two taxes is not identical.

Further, the use tax was codified in 1987, long before the buildout of the Internet and the proliferation of online travel companies (OTCs). The sales tax was passed in 2003, and was also not written to account for the role of the emerging OTC industry model. Online travel companies operate websites that typically provide multiple options for potential purchasers of short-term accommodation rentals, based on where and when an individual is looking for a place to stay.

Despite being written into two separate chapters of Title 15, MCA, certain aspects of the two taxes overlap. For example, those who must collect and remit both taxes submit the taxes quarterly on the same calendar schedule and using the same tax return.

The language implementing the two taxes, however, is not identical. The use tax is charged to the customer and remitted by the “owner or operator” of a facility, while the sales tax is to be collected and paid to the Department of Revenue (department) by the “seller.” The following table illustrates some key distinctions between the two taxes collected on short-term accommodation rentals.

Table 5  
**Comparing Lodging Facility Use and Sales Taxes**

Tax	Enacted	Statute	Rate	Supports	Responsible for Collecting
Lodging Facility Use Tax	1987	§15-65-101	4 percent	Tourism promotion	“Owner or operator”
Lodging Sales Tax	2003	§15-68-101	4 percent*	General Fund	“Seller”

**Source: Compiled by Legislative Audit Division Staff from Montana Code Annotated.**

\*3 Percent prior to January 1, 2020.

This question of who is responsible landed in district court in 2010, when the department sought sales and use tax collections on the fees that online travel companies charge on bookings on their platforms. The OTCs claimed because they are not the “owner or operator” of the properties for which accommodations are booked on their platforms, they should not be subject to the 4 percent use tax. They similarly claimed to not be the “seller” of the accommodation, and thus should also not collect nor remit the 3 percent sales tax. The department disagreed.

Ultimately the Montana Supreme Court in 2015 split the difference, ruling that the OTCs must collect and remit the 3 percent sales tax on the fees they charge as the “seller” of the accommodation. However, because the OTCs do not own or operate the accommodations, the Supreme Court ruled OTCs are exempt from collecting and remitting the 4 percent use tax on their share of the price paid by the consumer.

## Consumers Pay Different Tax for Identical Transactions

As the result of the inconsistent assessment of these short-term accommodation taxes, the execution of the same transaction at the same price results in varying amount of tax paid by the consumer and ultimately remitted to the department, depending upon how the transaction is consummated. The state does not receive the same amount of tax if a consumer books a room directly by telephone or using a hotel's own website versus using an OTC or peer-to-peer booking platform, even if the base price paid and the accommodation received are the same.

To illustrate this, we sought a reservation at a hotel on three different Internet platforms, including the hotel's own platform and two OTC sites. As the following table illustrates, the advertised price for the room was the same on all three platforms, but the final amount paid by the consumer was different on all three. The amount of tax collected by the department would also vary for the three bookings, based upon how much of the customer payment was received by the accommodation and how much was received by the OTC. This illustrates the average consumer experience and shows that the same item (hotel room) purchased for the same price (\$118) via the same method (Internet) will not have the same final cost, due in part to the tax structure. The consumer is unable to discern how much of the additional payment is taxes and how much is other fees.

Table 6  
**Same Purchase, Different Taxes, Different Total Cost**

Reservation Source	Advertised Room Rate	Implied Tax (8%)	Actual Additional Costs	Additional Costs Shown As	Total Rental Cost
Hotel Web Site	\$118.00	\$9.44	\$10.26	Tax/fees	<b>\$128.26</b>
Room Re-Seller	\$118.00	\$9.44	\$9.26	Taxes and fees	<b>\$127.26</b>
Peer-to-Peer Platform	\$118.00	\$9.44	\$11.44	Tax recovery charge/service fee (\$6.72), Tax (\$4.72)	<b>\$129.44</b>

**Source: Compiled by the Legislative Audit Division.**

As the table illustrates, the expected tax on the room in each case would be \$9.44, based on the identical advertised room rate of \$118. However, the actual additional costs vary from this amount in each instance, with one reservation actually showing taxes and fees less than the expected amount of tax alone. Thus, it is impossible for the customer—and for the department—to know exactly how much tax is due and how much should be collected for each rental.

In addition to this uncertainty, the department is concerned that exempting the third-party booking sites and peer-to-peer platforms from a measure of tax liability has led to participants suggesting that other components of the total cost of a booking should perhaps also be free of tax liability.

## Financial Impacts of the Tax Language Inconsistency

Tourism promotion entities in Montana would be receiving more funding if the total cost paid by a consumer was subject to the 4 percent use tax not currently collected by OTCs. As the following table illustrates, tourism promotion across Montana would have benefitted from \$669,808 in additional funding (minus a vendor allowance) if the consumers' entire payments were subject to both sales and use taxes from 2016-2018. Table 7 shows the amount of sales tax collected by the OTCs on their portion of the consumer payments, as well as the amount of use tax that would have been collected if the OTC fees were subject to the lodging facility use tax in addition to the sales tax.

Conversely, if the fees collected by OTCs for facilitating bookings were not subject to either

tax, the general fund would have received \$502,356 less than it did over the period illustrated above, as no sales tax would have been applied to the OTC fees.

Amount of Sales Tax Remitted by Platforms (3%):	\$502,355.90
Amount of Use Tax Not Owed by Platforms (4%):	\$669,807.87

**Source: Compiled by Legislative Audit Division from department records.**

## Legislative Efforts to Change Language of Lodging Taxes

Since the 2015 Supreme Court decision determined who is responsible for collecting and remitting which of the use and sales taxes, several legislative efforts have been made to alter the statutory language of the two statutes to make more clear and consistent the tax remission responsibility.

A 2017 bill that would have required the platforms to collect and remit the use tax and would have made public the names of owners or businesses engaged in short-term accommodation rentals passed the Senate but died in a House committee. A similar bill in the same session that would have made the use tax the responsibility of the "seller" (as opposed to owner or operator) also died in committee. Similar legislation was proposed and tabled in the 2017 Special Session. In 2019, a bill that would have combined the sales and use taxes, but not raised the overall tax rate, died in its first committee.

In some regards, the question of whether and how Montana should tax the various transactions that make up the short-term lodging economy has been asked and answered. The Supreme Court has weighed in on the law as it is currently written, and the legislature has declined several opportunities to make changes to existing statute. However, significant changes have occurred to Montana’s short-term lodging industry in the decades since the current taxes were enacted. Other states have experienced similar changes in their lodging industries as well. Therefore, we reviewed how other states have approached taxation on short-term accommodations and responded to these changes, including how they changed their state laws and if similar changes could potentially be beneficial in Montana.

### **Other States Have Updated Statute to Reflect Current Marketplace**

Montana’s two short-term accommodation taxes were each enacted before the widespread proliferation of third-party online booking providers. We focused our audit work on how other states have amended statute to account for the prevalence of third-party platforms used for booking both hotels and peer-to-peer rentals.

Questions regarding existing Montana Code are what led the department to request our review. We worked with the department and Montana’s hospitality stakeholders to identify other states to include in our review. We also used information from industry papers and publications. Because tourism is a national industry, we did not limit our research to states in Montana’s region. We also looked to identify states whose tax statutes acknowledge the role of third-party booking or peer-to-peer platforms within the short-term accommodation industry.

Montana has two accommodation taxes and does not specifically address third parties that now participate in a significant number of transactions. Several other states have clarified tax responsibility and collection in the short-term accommodation marketplace, reflecting the evolving landscape of online bookings and peer-to-peer rentals. These changes in other states acknowledge the evolving landscape of the short-term lodging industry in ways that Montana Code currently does not.

States we identified where statute addresses the role of third-party participants in short-term lodging bookings are discussed below:

- ◆ **Oregon** has amended its statute multiple times in the past decade to keep pace with the changing nature of the industry. It defines a “transient lodging intermediary” to include people who facilitate lodging bookings, regardless of whether they have any ownership or other interest in the facility being booked. Oregon further specifies the lodging tax due “must be computed on the total retail price, including all charges ... paid by a person for occupancy

of the transient lodging.” This would more specifically include the fees charged by booking platforms for facilitating a booking that are currently exempt from Montana’s use tax.

- ◆ **Rhode Island** changed its law to describe both lodging facilities and “hosting platforms.” Rhode Island requires accommodation taxes be collected and remitted by whichever party is paid by the consumer, and tax is due on the total amount the consumer pays, regardless of how that payment may be divided up between the lodging facility provider and any involved third parties. The state specified that platforms are responsible for the applicable lodging taxes. If a lodging provider sells accommodations both via a platform and directly to the consumer, it is responsible for the tax collection and remission on the direct sale, but not on the platform booking, provided the consumer pays the platform and not the property owner.
- ◆ **Idaho** defines a “short-term rental marketplace” as a “person that provides a platform through which a lodging operator ... offers a short-term rental or vacation rental to an occupant.” The state mandates that short-term rental marketplaces register with the state tax commission for the collection, reporting, and payment of sales and use and travel and convention taxes.
- ◆ **North Carolina** defines a “facilitator” as a “person who ... contracts with a provider of an accommodation to market the accommodation and to accept payment from the consumer for the accommodation.” North Carolina further stipulates that the tax is applied to the “gross receipts” from an accommodation rental; that gross receipts include the “sales price” of the rental; and that “the sales price of the rental of an accommodation marketed by a facilitator includes charges designated as facilitation fees and any other charges necessary to complete the rental.” In North Carolina, facilitators send the sales price and associated tax to the retailer, who then remits the tax to the state.

In each of these states, no distinction is drawn between “seller” and “owner,” as is the case in Montana. The prevailing policy we identified in many other states is that tax is owed on the entire amount paid by the consumer, no matter how that payment is subsequently divided between lodging operators and booking services or platforms.

### **Montana Law Has Not Kept Pace With Evolving Industry**

Other state legislatures have acted to acknowledge in statute the role played by third-party booking websites and platforms. This includes sites dealing primarily with commercial rental properties, like hotels, or providing for peer-to-peer rentals, such as apartments or guest homes from private owners on an internet platform. Montana state law could benefit from updated language that acknowledges the means by which the majority of business in this segment of the economy is conducted. The department has supported statutory change in multiple sessions, to no avail, and has done what it can to collect lodging use and sales taxes within the current statutory environment. Updating Montana Code to better reflect the current workings of the short-term

accommodation industry would help the department in its efforts to equitably fulfill its role as the revenue authority for the state.

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***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 consumer payment for short-term accommodation is taxable.*

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DEPARTMENT OF REVENUE

DEPARTMENT RESPONSE



April 17, 2020

Angus Maciver  
Legislative Auditor  
Performance and Information Systems Audits  
Montana Legislative Audit Division

RECEIVED  
April 17, 2020  
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

This correspondence is in response to the April 2020 legislative performance audit on *Short-Term Lodging and Rental Vehicle Taxes: Keeping Pace With an Evolving Marketplace*.

In May 2018, the Department of Revenue (department) asked the Legislative Audit Division (LAD) to review the current lodging taxes. The department requested the audit, in part, concerned that Montana Supreme Court and Montana district court decisions conflict with the current statutory language and court decisions have made the administration of the lodging facility use taxes potentially inequitable. The department thanks the Legislative Audit Division for agreeing to conduct this audit.

Below is the department's response to the legislative audit recommendations.

**Recommendation #1:**

- A. Enforce the statutory registration requirement for all individuals engaged in taxable short-term accommodation activity, and**
- B. Enter into future 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.**

**Partially concur.** While the department's main concern is the administration of the taxes in a fair and equitable fashion, the department's first priority is compliance. It is imperative that those responsible for collection of taxes for remittance to the department comply with the collection provisions. In the case of the trust taxes in Title 15, chapters 65 and 68, the Montana court decisions and the volatility of the different types of rental platforms has made it difficult for the department to enforce compliance under a strict reading of both those chapters.

Additionally, the department has engaged in protracted litigation to enforce compliance of all platform types, even though some ambiguity may exist as to how each platform fits within the chapter 65 and 68 definitions. Therefore, when a new platform is willing to enter into compliance agreements with the department for collection of the extensive taxes without resorting to litigation, the department has engaged in these agreements in the best interest of the state. And, as part of those agreements, the department retained its audit authority in a fashion that both enhances compliance and allows for efficient use of department resources.

The department enters into agreements that meet the statutory registration requirements. In the case of the two agreements at issue, the provisions allow for collection and remittance by the company without disclosure of the hosts. As LAD has acknowledged at pp.12-13 of its report, the department will audit the Company within 3 years of the execution of the agreement. At that time, if there are anomalies in the taxes collected and remitted, the department has the discretion to audit an individual host and require registration. However, if similar agreements in the same format become available and the identity of hosts is a determinable factor in reaching these agreements, the department will enter into these agreements and use other tools to identify host and other tax information.

Section 15-1-201(1(a), MCA states, in part:

The department has general supervision over the administration of the assessment and tax laws of the state, except Title 15, chapters 70 and 71, and over any officers of municipal corporations having any duties to perform under the laws of this state relating to taxation to the end that all assessments of property are made relatively just and equal, at true value, and in substantial compliance with law. The department may make rules to supervise the administration of all revenue laws of the state and assist in their enforcement.

The department believes the previous statutory language allows for agreements between short-term lodging reservation platform companies and the department. Two agreements have produced almost \$6 million in tax collections in a small number of consolidated filings rather than the possibility of receiving almost 4,000 separate small returns from each separate host location. The agreements have been successful in tax collections and remittance that would have been difficult at best to collect, in an efficient and easy filing format for both the taxpayers and the department.

The department recognizes the need to use the agreements as a tool to register and identify the short-term lodging hosts. However, as LAD acknowledged in its report at pp. 12-13, the short-term lodging reservation platform companies would not enter into the agreements that would provide the host information. To avoid litigation that would forgo tax collection and remittance for several years, the department used its statutory authority to enter into the agreements to effect compliance, knowing that it would have to use other means such as audit and research to obtain the names of the hosts.

**Recommendation #2:**

- 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.***

**Partially concur.** The department does not necessarily disagree with the recommendation but has determined that amending the rules to require real-time lists of hosts to be an ineffective use of resources and an undue burden for the lodging industry.

Montana is fortunate to have many areas where visitors are likely to request accommodations from properties owned by citizens managed by third parties. However, due to the nature of this industry, many citizens periodically or seasonally change or discontinue the availability of their properties. Maintaining constant contact for real-time changes would require extensive effort and resources. The department believes that a robust audit program will produce the same results in a more efficient manner than constantly updating ever-changing lists of hosts maintained by property managers.

The department will continue to use its audit authority to identify the hosts under third-party management while at the same time verifying the proper tax payments.

**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.***

**Concur.** The department will consistently review the revenue distributions in order to identify any discrepancies or errors. This process will be in place by the end of December 2020.

**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.***

**Partially concur.** The department will continue to review peer-to-peer rental vehicle platforms and contact these platform companies to enter into tax collection agreements. The department is hopeful the current discussions with the vehicle rental platform companies will produce tax collection agreements. In addition, the department will negotiate vigorously for the identification and registration of the vehicle hosts.

However, if in the negotiations the vehicle rental platform companies will enter into tax collection agreements only if they are not required to provide the identification of the vehicle hosts, the department may still enter into the agreements to substantially comply with the code provisions to require compliance of tax collection, while avoiding litigation, as discussed above. The success of the lodging agreements has proven the worth of agreements of this nature. In these situations, the department will identify the platform hosts by other means such as audit and research.

**Recommendation #5:**

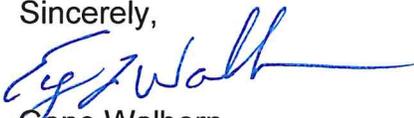
***We recommend the Montana Legislature amend the statute to account for the role the online booking platforms in the short-term accommodation industry and to clarify which portion of a consumer payment for short-term accommodation is taxable.***

**Concur.** The department believes that updating the statutory language for the accommodation taxes would improve the equity and efficiency, and simplify the administration of the taxes for both taxpayers and the department. The department has supported these statutory changes in previous legislative sessions.

On behalf of the department, thank you for allowing us to respond to the performance audit report. I would also like to express my gratitude for your staff and their professionalism throughout the audit.

Please let me know if you have additional questions.

Sincerely,

  
Gene Walborn  
Director