

City of Austin



A Report to the
Austin City Council

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Mayor Pro Tem
Sheryl Cole

Council Members
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Office of the City Auditor

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Acting Deputy City Auditor
Jason Hadavi
CPA, CFE

AUDIT REPORT

Short-Term Rental Registration and Tax Compliance Audit

December 2014



REPORT SUMMARY

Three of five short-term rentals (STRs) examined submitted correct tax payments, while errors by the other two had an immaterial impact. While investigations by the Austin Code Department succeed in bringing many unlicensed STRs into compliance, efforts stall when property owners are unresponsive. In addition, the City has not issued citations to STRs that fail to register and STR operators are not fully aware of the tax reporting requirements.

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GOVERNMENT AUDITING STANDARDS COMPLIANCE

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.

AUDIT TEAM

Walton Persons, CPA, CICA, Assistant City Auditor
Robert Elizondo, CIA, CGAP, CICA, CRMA, Auditor-in-Charge

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Audit Report Highlights

Why We Did This Audit

This audit was conducted as part of the Office of the City Auditor's (OCA) FY 2014 Strategic Audit Plan.

What We Recommend

The Controller should collect the tax deficiency and credit or refund the overpayment identified in this audit. The ACD should ensure supervisors review the results of investigator's work, and continue to work with the Law Department to arrive at solution for issuing citations to noncompliant STRs. We also recommend that the Controller review the department's procedures to identify and implement revisions to ensure all STR operators receive reminders to file tax reports.



For more information on this or any of our reports, email oca_auditor@austintexas.gov

SHORT-TERM RENTAL REGISTRATION & TAX COMPLIANCE AUDIT

Mayor and Council,

I am pleased to present this short-term rental registration and tax compliance audit.

BACKGROUND

- In August 2012, the Austin City Council passed an ordinance requiring a license to operate a Short-Term Rental (STR). Council amended the ordinance in September 2013 to include multifamily properties and partial dwelling units.
- The City requires lodging providers to collect a 9% hotel occupancy tax from occupants and remit the tax to the City Controller's Office.
- The Austin Code Department (ACD) issues operating licenses for STRs, while the City Controller's Office (Controller) collects the hotel occupancy tax.

OBJECTIVES AND SCOPE

The objectives of this audit were to:

- determine whether lodging providers comply with City Code requirements regarding STR registration, reporting, and remittance of taxes; and
- determine whether the City provides sufficient guidance and enforcement to ensure compliance with STR regulations.

The scope included STR licensing and reporting activities occurring during the fourth quarter of calendar year (CY) 2013 and the first quarter of CY 2014.

WHAT WE FOUND

Three of five STRs examined submitted correct tax payments to the City.

- One STR operator overpaid due to a miscalculation; the other underpaid due to not collecting tax on cleaning and pet fees charged to occupants.

Although investigations by ACD succeed in bringing many unlicensed STRs into compliance, the City's efforts stall when property owners are unresponsive.

- According to ACD records, of 1,089 investigations conducted through May 2014, 72% led to a lodging provider coming into compliance.
- ACD does not follow up when letters warning of noncompliance do not induce property owners to register. This is because of a concern that ACD's evidence may not be successful in court. While ACD has met with the Law Department, they have not finalized a process for citing noncompliant property owners.
- The documented results of investigations do not undergo a supervisory review.

STRs licensees are not fully aware of tax reporting requirements, which increases the risk they will not pay all hotel taxes owed to the City.

- The Controller sends quarterly notices to registered STR operators reminding them of the quarterly reporting requirements. However, the Controller was unable to locate copies of notices sent to two of the three STR operators we contacted. Those operators reported that they did not receive notices.

We appreciate the cooperation and assistance we received from Controller's Office and Code Compliance staff during this audit.

A handwritten signature in blue ink that reads "Corrie E. Stokes".

Corrie E. Stokes, Acting City Auditor

BACKGROUND

In August 2012, the Austin City Council passed an ordinance requiring a license to operate a Short-Term Rental (STR). Council amended the ordinance in September 2013 to include multifamily properties and partial dwelling units. The City requires lodging providers, including STRs, to collect a 9% hotel occupancy tax on qualified room stays costing more than two dollars per night and remit the tax to the Controller's Office (Controller).

The Austin Code Department (ACD) issues operating licenses for short-term rental (STR) properties, while the Controller collects hotel occupancy taxes from those properties. Exhibit 1 shows the annual revenues from STRs.

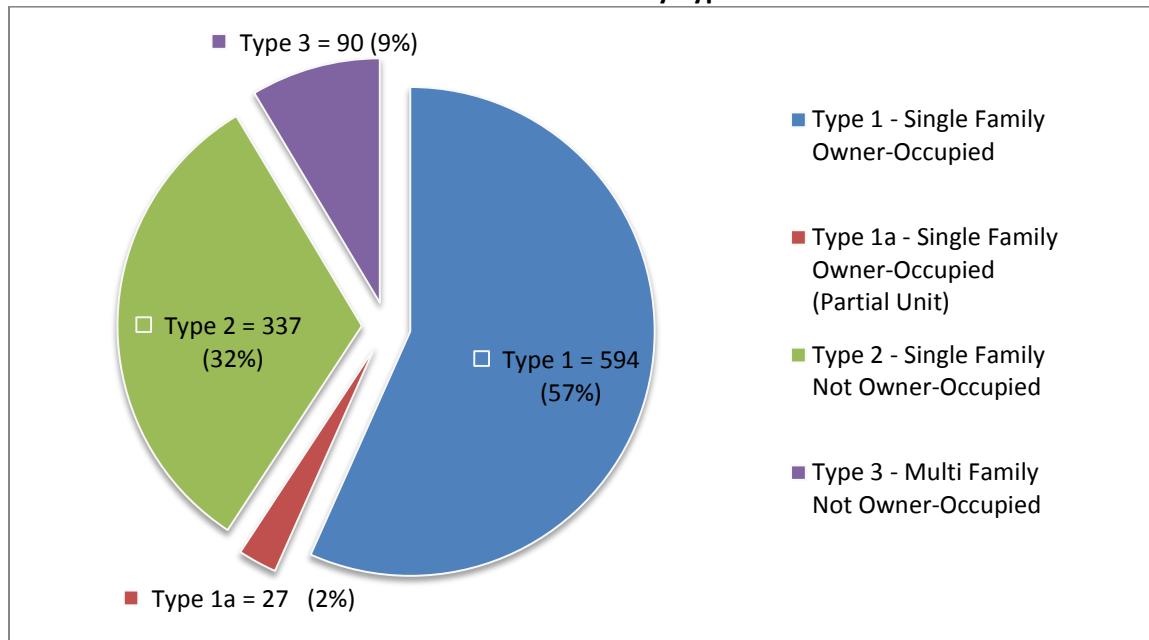
EXHIBIT 1
Analysis of Annual STR Revenue

Fiscal Year	Licensing Fees (\$)	Taxes Remitted (\$)	Totals (\$)
2013	143,485	915,582	1,059,067
2014	295,210	1,716,792	2,012,002

SOURCE: ACD and the Controller, Unaudited, October 2014

As of August 2014, there are 1,048 properties with active STR Operating Licenses. They are broken down as shown in Exhibit 2.

EXHIBIT 2
STR Licenses by Type



SOURCE: ACD and OCA Analysis, August 2014

OBJECTIVES, SCOPE, AND METHODOLOGY

The Short-Term Rental Registration and Tax Compliance Audit was conducted as part of the OCA Fiscal Year (FY) 2014 Strategic Audit Plan, as presented to the City Council Audit and Finance Committee. This audit was included in the Strategic Audit Plan due to interest from Council Members in STR compliance.

Objectives

The objectives of the audit were to:

- determine whether lodging providers comply with City Code requirements regarding STR registration, reporting, and remittance of hotel occupancy taxes; and
- determine whether the City provides sufficient guidance and enforcement to ensure compliance with STR regulations.

Scope

The audit scope included STR licensing activities, and hotel occupancy tax reporting and payment activities occurring during the fourth quarter of CY 2013 and the first quarter of CY 2014.

Methodology

To accomplish our audit objective, we performed the following steps:

- conducted interviews with ACD staff to determine how the department searches for unregistered STRs;
- tested their monitoring for unregistered STRs by reviewing documented complaint and website reviews against the dates those STRs registered;
- obtained and evaluated data from the Controller and ACD to determine if registered STRs submitted quarterly tax reports within the scope period;
- obtained and evaluated data from the Controller to determine whether taxes remitted by STRs were correct, and to determine how the Controller handles overpayments or underpayments;
- tested a random sample of tax quarterly reports received in the scope period by conducting onsite visits with STR owners, which included reviews of supporting documentation; and
- interviewed a random sample of STR owners who had not filed quarterly reports to determine their reasons for not filing.

AUDIT RESULTS

The short-term rentals (STRs) reviewed by the Office of the City Auditor (OCA) either reported their hotel occupancy taxes correctly, or had errors due to a miscalculation or a misunderstanding of how to apply the tax. In addition, investigations by the Austin Code Department (ACD) succeed in bringing many unlicensed STRs into compliance. However, the City's efforts stall when property owners are unresponsive to ACD's efforts and the City has not issued citations to those failing to register. In addition, STR operators are not fully aware of the tax reporting requirements, which increases the risk that these lodging providers will not pay all hotel taxes owed to the City.

Finding 1: Three of five short-term rentals examined submitted correct hotel occupancy tax payments to the City, while errors by the other two had an immaterial impact overall.

City Code requires lodging providers, including STRs, to collect a nine percent hotel occupancy tax on qualified room stays costing more than two dollars per night. In addition, lodging providers must file a written report and remit the tax to the City on a quarterly basis.

As shown in Exhibit 3, OCA reviewed five randomly selected STR properties whose lodging providers had filed quarterly reports for the fourth quarter of calendar year (CY) 2013 and the first quarter of CY 2014. The reviews included an examination of documentation supporting the amount of hotel occupancy taxes submitted with the quarterly reports.

Three of the five STRs collected and submitted the proper amount of tax to the City. Of the other two, one collected the proper tax, but remitted too much to the City for the first quarter of CY 2014 because they included the tax collected as taxable revenue on their report, thereby paying "tax on the tax." This resulted in an overpayment of approximately \$329. The same provider miscalculated their tax resulting in a small underpayment in the fourth quarter of CY 2013. The last STR did not treat cleaning and pet fees as taxable, which resulted in an underpayment of taxes totalling \$109 for the two quarterly reporting periods.

EXHIBIT 3
Results of STR Property Audits

STR #	4 th Quarter CY 2013			1 st Quarter CY 2014				Net Impact
	Tax Owed	Tax Reported & Paid	Balance Due	Tax Owed	Tax Reported & Paid	Balance Due		
1	\$ 649	\$ 649	\$ 0	\$ 731	\$ 731	\$ 0	\$ 0	\$ 0
2	214	214	0	183	183	0	0	0
3	983	983	0	1,010	1,010	0	0	0
4	2,448	2,430	18	2,879	3,208	(329)	(311)	
5	491	432	59	501	451	50	109	

SOURCE: OCA Analysis, October 2014

Finding 2: Although investigations by ACD succeed in bringing many unlicensed STRs into compliance, the City's efforts stall when property owners are unresponsive.

ACD issues licenses to operating STRs and has procedures for identifying and registering properties that operate without a license. For example, ACD conducts website searches to identify unlicensed STRs and contact the owners.

As shown in Exhibit 4 below, ACD's records indicate that they performed 1,089 investigations as of May 31, 2014. Of those 1,089, approximately 72% led to a lodging provider either removing their posting or going through the licensing process. The remaining 28% did not come into compliance with registration requirements per City Code.

EXHIBIT 4
Results of ACD's Proactive Investigations

Outcome of Investigation	Number	Percent
Provider removed website posting	460	42%
Provider obtained a license	291	27%
Providers license application in process	30	3%
Provider still not in compliance	272	25%
Other outcomes ¹	36	3%
TOTAL	1,089	100%

SOURCE: ACD, Unaudited, May 2014

ACD's process includes mailing letters warning property owners that they are in non-compliance. However, there is no follow-up when the letters do not induce the property owner to register. In addition, we found that the documented results of investigations do not undergo a supervisory review, which could help ensure more noncompliant STRs come into compliance with City Code.

According to ACD, not registering an STR property is equivalent to operating without a license and may result in enforcement action, including citations. However, we found that ACD eventually stops the enforcement process because of a concern that its processes may not produce evidence that would be successful in court. While ACD has met with staff from the Law Department's Criminal Prosecution Division, they have not finalized a process for citing non-compliant STR Owners.

Finding 3: STR operators are not fully aware of the tax reporting requirements, which increases the risk that these lodging providers will not pay all hotel taxes owed to the City.

City Code requires every person who collects hotel occupancy taxes, including STR operators, to file a report of hotel occupancy tax with the Controller's Office (Controller). This includes "zero reports," or those where no tax was collected during the reporting period. OCA contacted three operators of licensed STRs who had not submitted any quarterly reports to the City, and each admitted that they were not aware that they must file reports even for properties with no rental activity.

The Controller sends quarterly notices to registered STR operators reminding them of the quarterly reporting requirements. The Controller retains copies of sent notices; however, the Controller was

¹ Other outcomes include (1) property owners operating STRs with an expired license, and (2) property owners who were denied a license.

unable to locate copies of the notices sent to two of the three STR operators we contacted. According to the Controller's staff, they did not send one of the notices because the STR was not yet in business, although the operator had an active license for the property.

If STR operators do not file a report with the City, the Controller does not follow up with a letter of noncompliance unless the operator happens to file a hotel tax report with the State Comptroller's Office, which all lodging providers are required to do. The Controller's staff states that they review data from the State Comptroller each quarter and send letters of noncompliance to lodging providers who have paid the State hotel tax, but not the City tax.

STR operators are responsible for knowing and complying with the code and other applicable requirements. However, not following up with letters of noncompliance when operators do not file their quarterly reports increases the risk that STRs will underpay their hotel taxes to the City.

RECOMMENDATIONS

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. These recommendations provide reasonable approaches to help resolve the issues we identified. However, management is in the best position to understand their operations and may identify more efficient and effective approaches, and we encourage them to do so when providing their responses to our recommendations. As such, we recommend the following:

- 1. The Controller should collect the tax deficiency and credit or refund the overpayment identified in this audit.**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

- 2. ACD should ensure its supervisors review the results of its investigator's work at identifying possible unregistered STRs. In addition, ACD should continue to work with the Law Department's Criminal Prosecution Division to arrive at a solution for issuing citations to STR owners who remain in non-compliance with City Code.**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

- 3. The Controller should review the department's procedures to identify and implement revisions to ensure all STR operators receive reminders to file their quarterly hotel tax reports with the City.**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

APPENDIX A

MANAGEMENT RESPONSE – CITY CONTROLLER’S OFFICE



MEMORANDUM

TO: Cory Stokes, Acting City Auditor
FROM: Diana Thomas, Controller *Diana Thomas*
DATE: December 12, 2014
SUBJECT: Management Response: Short Term Rental Hotel Occupancy Tax Revenue Audit – December 2014

I have reviewed the attached draft audit report. In response to the recommendation below, the Controller's Office provides the following response.

Audit Recommendation #1: The Controller should collect the tax deficiency and credit or refund the overpayment identified in this audit.

Management Response: Management concurs with the recommendation. The Controller's Office has billed the tax deficiency and has refunded the overpayment identified in this revenue audit.

Audit Recommendation #3: The Controller should review the department's procedures to identify and implement revisions to ensure all STR operators receive reminders to file their quarterly hotel tax reports with the City.

Management Response: Management concurs with the recommendation. The Controller's Office reviewed its procedures and put checks in place to ensure that STR operators receive reminders if they request them.

We appreciate the opportunity to provide a response. If you need additional information, please contact me at 512-974-1166.

CC: Elaine Hart, Chief Financial Officer

APPENDIX A

MANAGEMENT RESPONSE – AUSTIN CODE DEPARTMENT



City of Austin

P.O. Box 1088, Austin, TX, 78767

Memo

**AUSTIN CODE
DEPARTMENT**

To: Corne Stokes, Acting City Auditor
From: Marcus Elliott, Assistant Division Manager, Austin Code Department
Date: December 12, 2014 *ME*
Subject: Management Response to STR Registration and Tax Compliance Audit

Austin Code Department (ACD) reviewed the STR Registration and Tax Compliance Audit findings and concurs with the recommendations provided by the city auditors.

As Austin's population continues to grow and as more special events establish roots in our city, the demand for hotel rooms has increased. Austin City Council passed an ordinance requiring a license to operate a Short-Term Rental (STR) in August 2012. Despite the challenges of the current STR Ordinance, our department continues to focus its mission on providing quality education and enforcement of city codes and ordinances to make Austin the most livable city in the country.

Austin Code will incorporate the audit recommendation into our standard operating procedures within the next 45 days.

Concur
Carl J. Smart
Carl Smart, Director, Austin Code Department

*The City of Austin is committed to compliance with the Americans with Disabilities Act.
Reasonable modifications and equal access to programs, services will be provided upon request.*

APPENDIX A

ACTION PLAN – CITY CONTROLLER’S OFFICE

Rec #	Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
01	The Controller should collect the tax deficiency and credit or refund the overpayment identified in this audit.	Concur Refund: Prepare payment document to issue refund to STR owner and mail the check. Collection: Prepare and mail a Notice of Underpayment of Hotel Occupancy Tax to the STR owner.	Refund: Underway Collection: Underway	Refund: 12/31/2014 Collection: 1/31/2015
03	The Controller should review the department’s procedures to identify and implement revisions to ensure all STR operators receive reminders to file their quarterly hotel tax reports with the City.	Concur The Controller’s Office has put in place additional review and verification procedures to ensure that all STR operators receive a quarterly email reminder.	Underway	12/31/2014

ACTION PLAN – AUSTIN CODE DEPARTMENT

Rec #	Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
02	ACD should ensure its supervisors review the results of its investigator’s work at identifying possible unregistered STRs. In addition, ACD should continue to work with the Law Department’s Criminal Prosecution Division to arrive at a solution for issuing citations to STR owners who remain in non-compliance with City Code.	ACD concurs with this recommendation <ul style="list-style-type: none"> • Supervisors will review the results of code officers’ work to help identify unregistered STRs. • Austin Code will continue to work with the Law Department’s Criminal Prosecution Division to develop an enforcement process for identified, unregistered STRs. 	• Process changes and plans are underway.	<ul style="list-style-type: none"> • ACD’s revised review process will begin January 1, 2015. • ACD will contact the Law Department’s Criminal Prosecution Division and schedule a formal meeting to discuss unregistered STRs by January 15, 2015.