

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

# Compliance Audit: Transient Occupancy Tax Operator Collections & Remittances

For the Calendar Year Ended  
December 31, 2018

Engagement No: 3565  
Report Date: January 25, 2022



**Erick Roeser**  
Auditor-Controller-Treasurer-Tax Collector

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Transient Occupancy Tax  
Operator Collections & Remittances  
Audit No. 3565**

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## Executive Summary

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The Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (Internal Audit) has completed a compliance audit of collections and remittances of certain operator entities subject to the Sonoma County (County) Transient Occupancy Tax (TOT) Ordinance.

### Current Year Highlights

For the period January 1, 2018 to December 31, 2018, fifteen (15) operators were selected for audit, as summarized on Appendix A - Schedules of Operators Reviewed, page 9:

- The fifteen (15) operators audited reported a total of \$4,788,211 in taxable receipts and paid \$574,587 in TOT.
- Seven (7) of the fifteen (15) operators audited generally complied with the TOT ordinance during the period covered by our audit.
- Four (4) of the operators audited underpaid TOT tax by a total amount of \$592 and four (4) overpaid by a total of \$4,356 for the period covered by our audit.
- Two (2) of the operators audited claimed Airbnb revenue exemptions totaling \$71,268 on their 2018 returns. Because Airbnb provides aggregated tax reporting data to the County, we are unable to verify that Airbnb collected and remitted that amount to the County on the operators' behalf.
- We noted that a booking service provider (HomeAway/VRBO) charged guests between a 4% and 9% service fee, and no TOT was assessed or collected on these amounts.

### Summary of recommendations:

TOT Administration has engaged an auditor to perform an audit of the Airbnb TOT Tax Return filings to assess Airbnb's compliance to the County of Sonoma TOT ordinances 5823 and 6173. TOT Administration should ensure that the scope of the audit includes verification that TOT exemptions claimed by operators agree with TOT collected and remitted by Airbnb.

TOT Administration should inform operators that the records used to create the quarterly TOT Tax Returns should be maintained by the operator.

ACTTC management should reexamine whether service fees/mark-ups that are required to be paid as part of the room/lodging rental charges are taxable under the TOT ordinance.

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## Introduction and Background

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### Introduction

Internal Audit has completed a compliance audit of the collections and remittances of certain operator entities, (operators), subject to the County TOT Ordinance. The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the results and recommendations contained in our audit report.

The purpose of this audit report is to furnish management independent and objective analyses, recommendations, and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

Occasionally, to fulfill its risk management responsibilities, management requests Internal Audit to perform studies, analysis or audits. In responding to these requests, we ensure that we do not take on any responsibilities for designing, implementing or operating any part of internal control systems so that our independence in regards to those systems is not impaired.

At the request of TOT Administration, we have performed audits of entities subject to TOT and plan on providing such assistance in the future. We do not believe that performing these audits constitute assuming responsibility for the design, implementation, or operation of any part of TOT Administration's internal control system. The TOT Administration selects the entities and agrees to the audit scope proposed by Internal Audit.

### Background

The assessment and collection of TOT is authorized under California State Revenue and Taxation Code Section 7280, as an additional source of non-property tax revenue to local governments. TOT is assessed by operators on transients who occupy lodging facilities (e.g. hotels, motels, campgrounds, or vacation rental homes) in the unincorporated areas of the County for fewer than 30 consecutive calendar days. In Sonoma County, this tax was levied at a rate of 12%, for this audit period. TOT funds are discretionary, in that the Board of Supervisors may direct use of these funds for any legitimate county expense. The tax code does not require any specific use of TOT funds.

Beginning January 1, 2017, the County entered into an agreement with Airbnb for the collection, reporting, and remittance of TOT for booking transactions completed by hosts and guests on the Airbnb internet-based platform for the unincorporated areas of Sonoma County. Airbnb reports aggregate revenue and TOT information on the County's TOT return form.

As of December 31, 2018, there were approximately 2,454 operators, registered with the County, including hotels, motels, bed & breakfasts, inns, recreational parks, campgrounds, vacation rentals, and property management firms. The total collection of TOT for the calendar year 2018 was \$22.69 million, as compared to 2017 which had revenue of approximately \$21.16 million. The TOT Administration is

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## **Policies & Procedures**

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responsible for the administration and enforcement of TOT and works closely with the Permit and Resource Management Department to ensure that all vacation rentals registered by them obtain a TOT certificate.

### **Policies & Procedures**

Each operator is required to report and remit TOT on a quarterly basis. TOT Administration sends a TOT reminder to all active operators four weeks prior to the end of each calendar quarter, and they request the gross rent receipts for the reporting period, less qualified exemptions, in order to calculate the 12% tax due. A qualified exemption is the rents received from a tenant who is a federal, state, or foreign government officer or employee on official business.

Penalties and interest are applied if the returns are not filed timely or the tax is unpaid. For late filings, a penalty of 10% of the base tax is calculated for failure to file on or before the last day of the month following the close of the calendar quarter, an additional 10% penalty is assessed for the second month of delinquency. For late payments, interest of 1.5% per month on the base tax is charged from the delinquent date to the date of payment. If payment is not received in full by the first working day of the second month of delinquency, the account is transferred to the Central Collections section of the Auditor-Controller-Treasurer-Tax Collector's Office. Central Collections assists the TOT Administration with collection. A Certificate of Delinquent TOT Lien is filed with the Sonoma County Recorder's Office by the Revenue Accounting Division when payments from an operator's quarterly filing is late.

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## **Objective, Scope and Procedures**

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### **Objective**

The primary objectives of this audit were to determine:

1. Whether selected entities remitted TOT owed to the County in a timely manner and generally complied with the applicable ordinance.
2. Whether the Operators' financial records supported their filed quarterly TOT returns.

### **Scope**

#### **Current Year Operator Audits**

We audited one year of TOT returns for fifteen (15) of the entities selected by the TOT Administration. TOT Administration agreed in advance to the scope of the audits. The audit covered the period January 1, 2018 to December 31, 2018. The scope of our work encompassed reviewing records of transactions subject to the TOT as well as interviewing the management and staff of operators responsible for the maintenance of financial and guest management systems (Operators).

### **Procedures**

The overall objective of the audits was to determine if the Operators' financial records supported their filed quarterly TOT returns. To accomplish this, we performed a review of the Operators' internal controls over the collection and remittance of TOT, including the entering of guest information in reservation systems, processing and recording of financial transactions and summarizing of financial transactions for the purpose of preparing TOT returns.

Operators are required to maintain records necessary to determine the amount of TOT owed to the County. At a minimum the records deemed necessary for this determination shall be a chronological cash journal showing tax and room rate separately, or other means acceptable to the TOT Administration of summarizing the Operator's monthly or quarterly revenue, supported by room registrations (including the name and address of the transient), a calendar of advance registrations, copies of forms used to claim exemption from the tax, and pre-numbered payment receipts showing payment for occupancy which state the room rate separate from the amount of tax paid and which may, with reasonable effort, be identified with the revenue summary. In instances where the Operator did not maintain records as stated above, all guest transactions within the period under audit were selected and tested. If the Operator maintained records as stated above, a sample of transactions within a specific time period was selected and tested.

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## Results

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For the period January 1, 2018 to December 31, 2018, the fifteen (15) operators audited reported a total of \$4,788,211 in taxable receipts and paid \$574,587 in TOT. Seven (7) of the fifteen (15) audited operators generally complied with the TOT ordinance as summarized on Appendix A. Four (4) of the entities underpaid TOT tax by a total amount of \$592 and four (4) overpaid by a total of \$4,356.

Two (2) of the operators audited claimed Airbnb revenue exemptions totaling \$71,268 in the 2018 year. Reeve Wines claimed Airbnb revenue exemptions of \$59,700 and Steelhead Creek Vineyards claimed Airbnb revenue exemptions of \$11,568. The collection, reporting, and remittance of gross revenues and TOT for the booking transactions completed on the Airbnb internet-based platform is reported and remitted in aggregate by Airbnb to the County. Thus we are unable to verify that TOT applicable to the Airbnb revenue exemptions claimed was accurately assessed, collected and remitted to the County by Airbnb.

As stated above eight (8) operators had records that did not support the revenues stated on the TOT Tax Return. Most variances resulted from transaction processing errors such as a missed adjustment for refunds and data entry errors. No procedural change is warranted, however operators should be directed to retain the detailed records that support their tax returns.

HomeAway/VRBO (booking service provider) charges Sonoma County guests a “service fee” of between 4% and 9% based on agreements with respective operators. The booking service provider collects the entire amount due from the guests, deducts the service fee and remits the balance to the operators.

This service fee appears to meet the criteria for “rent” in the ordinance making it subject to TOT. Service fees are not reported as gross rent on tax returns and TOT is not being collected or remitted on services fees.

Specifics related to the eight (8) operators who had records that did not support the revenues stated on the TOT Tax Return are listed here:

### **Bodega Bay RV Park**

Bodega Bay RV Park did not adjust its gross rent revenue for 2018 for refunds, resulting in overpayment of TOT for the year of \$5,024. Additionally, along with other minor revenue misstatements Bodega Bay RV underreported rent revenue for one of the quarters by \$10,000, resulting in an underpayment of 2018 TOT of \$899. In total for 2018, Bodega Bay RV Park overpaid TOT by \$4,125.

### **Oxfoot Associates, LLC**

TOT was underpaid by \$11 in total for 2018 due to a misstatement of gross revenue on the operators return.

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## Results

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### **Patrick Draeger Residence**

TOT was underpaid by \$332 in total for 2018 due to the operator offsetting credit card fees it paid against the gross rent reported on the tax return. Unless specifically provided in the TOT ordinance, gross rent revenue should not be adjusted for any payments the operator makes prior to assessing TOT. The operator was not able to produce the original supporting documents that tied to the return.

### **R3 Hotel**

TOT was overpaid by \$9 in total for 2018. Quarterly gross rent on the tax return was supported by the operators records, however one room stay was entered incorrectly in the operator's records resulting in an overstatement of revenues in the 3<sup>rd</sup> quarter of \$79, resulting in an overpayment of TOT of \$9 for the quarter.

### **Reeve Wines**

TOT was underpaid by \$106 in total for 2018. The gross revenue reported on the tax returns was lower than the audited operators records by \$883. Although the difference is small, the operator is in violation of the terms of the TOT ordinance that requires operators to maintain records supporting all amounts reported on their tax returns.

Beginning July 1, 2018 Airbnb took over one of the rental management agencies used for reservations and began remitting Transient Occupancy Tax to the County for those reservations. Airbnb may not have included cleaning fees as gross rent revenue for purposes of calculating TOT, potentially resulting in underpayment of TOT by \$240. Additionally, due to the aggregated tax remittance data by Airbnb, the County is unable to determine whether Airbnb remitted TOT due.

### **Safari West**

TOT was underpaid by \$143 in total for 2018. Revenue reported on the tax return varied in each quarter from what was supported in the records reviewed during the audit. Returns were prepared from the accounting system quarterly profit and loss statements. According to Safari West the underpaid TOT was due to changes made in the reservation system not being correctly communicated to the Bookkeeper for correct entry in to the accounting system.

### **Steelhead Creek Vineyards**

TOT was overpaid by \$198 in total for 2018. Quarterly gross rent receipts on the tax return were supported by the operators records, however one stay in the 3<sup>rd</sup> quarter had a partial refund of \$1,650 that was not reflected in the operator's records supporting the tax return and not reflected in tax reporting, resulting in a \$198 over payment of TOT for the year.

### **Weed Farms**

TOT was overpaid by \$24 in total for 2018. Quarterly gross rents on the tax return were supported by the operators records. However, one stay in the 3<sup>rd</sup> quarter had a partial refund of \$200 for a broken pool heater that was not reflected in the operator's records and not reflected in tax reporting, resulting in a \$24 over payment of TOT.

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## Recommendations

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### **Recommendation No. 1:**

TOT Administration has engaged an auditor to perform an audit of the Airbnb TOT Tax Return filings to assess Airbnb's compliance with the County of Sonoma TOT ordinances 5823 and 6173. The scope of the audit should also include procedures to determine whether TOT from operators claiming Airbnb TOT exemptions is remitted to the County in accordance with the Airbnb Agreement.

### **Management Response:**

Pisenti & Brinker LLP (P&B) has been engaged by the County to perform an audit of the Airbnb TOT Tax Return filings to assess Airbnb's compliance to the County of Sonoma TOT ordinances 5823 and 6173. TOT Administration has requested P&B include procedures to determine whether TOT from operators claiming Airbnb TOT exemptions is remitted to the County.

### **Recommendation No. 2:**

TOT Administration should inform operators that the records used to create the quarterly TOT Tax Returns should be maintained by the operator.

### **Management Response:**

Management agrees and will remind operators that the records used to create the quarterly TOT Tax Returns should be maintained by the operator in accordance with the TOT Ordinance Sec. 12-18.1. Additionally, TOT Administration includes record retention requirements in the Frequently Asked Questions posted on the Auditor-Controller-Treasurer-Tax Collector's TOT webpage.

### **Recommendation No. 3:**

In consultation with County Counsel, ACTTC management reexamined online travel company (OTC) service fees that are required to be paid by transients as part of short-term rental charges and concluded these fees are taxable under the TOT Ordinance. TOT Administration should inform operators and their agents that OTC service fees are taxable and should be included as part of gross rent reported on TOT returns and when computing the TOT amount due.

### **Management Response:**

Management agrees and will inform operators that OTC service fees are taxable and should be included as part of gross rent reported on TOT returns and when computing the TOT amount due. Management will implement procedures to assist in enforcement of services fees being collected on OTC service fees.

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## **Staff Acknowledgement**

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### **Staff Acknowledgement**

We would like to thank management and staff for their time, information, and cooperation throughout the audit.

## Appendix A: Schedule of Operators Reviewed

County of Sonoma  
 Transient Occupancy Tax  
 For the period of January 1, 2018 to December 31, 2018

<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	Tax Paid	Tax Per Review	Over (Under) Paid
9028 Sonoma Highway	\$ 176,219	176,221	21,146	21,146	\$ -
Bodega Bay RV Park	774,487	740,115	92,939	88,814	4,125
Brambleberry	-	-	-	-	-
Matheson Partners, LLC	33,923	33,923	4,071	4,071	-
Michael and Kristin Ray	78,703	78,703	9,444	9,444	-
Oxfoot Associates, LLC	77,090	77,180	9,251	9,262	(11)
Patrick Draeger Residence	131,768	134,535	15,812	16,144	(332)
R3 Hotel	451,714	451,636	54,206	54,197	9
Reeve Wines	214,382	215,266	25,726	25,832	(106)
Safari West	2,375,686	2,376,885	285,083	285,226	(143)
Steelhead Creek Vineyards	92,230	90,580	11,068	10,870	198
The Estate at Chalk Hill	-	-	-	-	-
Valley Lane Vacation-Reunion Retreat	125,483	125,483	15,058	15,058	-
Villa in the Vines	122,868	122,868	14,744	14,744	-
Weed Farms	133,658	133,458	16,039	16,015	24
<b>Total</b>	<b>\$ 4,788,211</b>	<b>\$ 4,756,853</b>	<b>\$ 574,587</b>	<b>\$ 570,823</b>	<b>\$ 3,764</b>

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## **Appendix B: Prior Year Results and Recommendations**

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### **Recommendation No. 1:**

Over and under payments, as identified in Appendix A, should be settled with respective operators as appropriate.

**Status: Implemented**