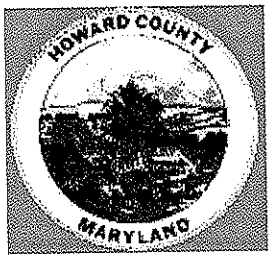
Internal Audit Report

DEPARTMENT OF FINANCE
ROOM RENTAL TAX
APRIL 2009

Office of the County Auditor



OFFICE OF THE COUNTY AUDITOR

Haskell N. Arnold, CPA
County Auditor

April 2009

The County Council and County Executive
Of Howard County, Maryland

Pursuant to Section 212 of the Howard County Charter and Council Resolution 22-1985, we have conducted a review of selected activities of the

DEPARTMENT OF FINANCE
ROOM RENTAL TAX

and our report is submitted herewith. The scope of our examination related specifically to a follow-up review of the recommendations made in our December 2004 report and a review of current operations. The body of our report presents our findings and recommendations.

The contents of this report have been reviewed with the Chief Administrative Officer and the Director of Finance. We wish to express our gratitude to the Department of Finance for the cooperation and assistance extended to us during the course of this engagement.

Haskell N. Arnold, C.P.A.
County Auditor

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BACKGROUND AND SUMMARY

In August 1992, Howard County, in accordance with section 20.401 of the Howard County Code, began imposing a room rental tax of 5% on hotels and motels located in the County. This tax is imposed on revenues collected from guests staying 30 or fewer consecutive days (visitors), those who are not employed with federal, state or local government, or whose charges are not paid through a tax-exempt agency. The room rental taxes that were collected during the prior month must be paid to the County on or before the last day of each month. To ensure that the proper amount of tax was being collected in accordance with County laws, we performed audits of these revenues in 1995, 2000 and 2004. We visited 24 different hotels and motels within the County in those previous audits. We have completed a follow-up of previous reports and have repeated three of the recommendations from prior reports in our current report because there are recurring errors being made by the hotels and motels related to those recommendations and we believe they need to be recommended again.

As part of our continuing review of the room rental tax collection process, we examined the records of eight hotels/motels for adherence to County tax laws. These establishments were selected from those that had not previously been audited. Of those selected, one was found not to have maintained the required records relating to exemptions from the tax. Another was refunding the local tax to guests after 30 days instead of 31 days. Two others did not include all of their room rental income in the computation of tax. One hotel incorrectly included a reduction to income as an exemption and in an amount higher than the room rental charges pertaining to that reduction. One hotel failed to reduce their taxable income by the amount of a guest's room rental charges for the first 30 days of a stay that exceeded 31 days. We have recommended that the Department of Finance request repayment of the amounts we determined to be outstanding and to issue a credit for the overpayment of taxes.

We have also recommended that the Department of Finance communicate, in detail, its expectations from the hotels and motels on an annual basis.

INTRODUCTION AND SCOPE

The Office of the County Auditor has issued reports on the room rental tax collection process in 1995, 2000 and 2004. The scope of each of these audits related specifically to review of the records of a total of twenty-four hotels and motels in Howard County and their adherence to County room rental tax laws. As part of the audit process, we performed follow-up reviews on completed audits to determine the current status of the original report recommendations. We have reviewed the records of an additional eight hotels or motels as they relate to the collection and payment to Howard County of the room rental tax.

At each location, we reviewed the daily summaries or, if those were not available, the room rental cards to compare to the monthly recap sheets which were then compared to the monthly room rental tax reports. Our conclusions are based on a review of these documents.

FOLLOW-UP OF RECOMMENDATIONS

We performed follow-up audits of the hotel and motel room rental tax and issued reports in 2000 and 2004. The scope of this follow-up included examining the status of implementation of previous recommendations. Based upon our current review, we believe that it is appropriate to repeat certain recommendations made in the 2004 audit. These recommendations are as follows:

1. ***The Department of Finance inform all hotels/motels in writing that the length of stay required for exemptions is 31 days or more.***

Administration's Response:

The Administration concurs with this recommendation. This information will be included in the annual letter to the management of the hotels.

Current Status:

In our current review, we found one hotel that was refunding guests their local taxes after 30 days. We recommend that the Department of Finance inform all hotels of the requirements regarding length of stay to ensure that local taxes are not refunded to guests before the 31st day.

2. ***The Department of Finance notify hotel/motel owners of specific way to account for gross receipts and exemptions. The hotel/motel owners should be specifically told what constitutes gross receipts and the definition of each of the three types of exemptions. The sample spreadsheet should be sent to each hotel/motel again to ensure that these establishments have an idea of what is needed for verification purposes.***

Administration's Response:

The Administration concurs with this recommendation. This information will be included in the annual letter to the management of the hotels.

Current Status:

We found that one hotel was not paying tax for amounts collected for "guaranteed no-shows," where a room is held for a guest who does not show up at the hotel. This is still a room

rental charge and tax should be applied. We also found that two hotels were not charging for rollaway beds that are used when an additional person sleeps in the room. Section 20.402 of the Howard County Code defines room rental charges as "the hotel's charge for sleeping accommodations" and a rollaway bed would fit that definition. Additionally, one hotel did not know how to handle exemptions where Federal or State employees were using the hotel while on government business.

3. ***The Department of Finance notify the hotels and motels on how to document all exemptions. Exemptions should be listed on a summary spreadsheet for each month and then verification detail for this spreadsheet should be attached. The spreadsheet should document the guest name, the dates the guest stayed, the category of exemption claimed, and the total tax exempt amount. This spreadsheet should be attached to the monthly Room Rental Tax Collection Report.***

Administration's Response:

The Administration concurs with this recommendation. This information will be included in the annual letter to the management of the hotels.

Current Status:

In our review, we found that one hotel did not keep a listing of exempt guests and we had to look at each day's listing to determine if a guest should have been tax-exempt or not. We also found a hotel that was writing off some uncollectible credit card charges for which tax had been paid and were showing these charges as exemptions.

CURRENT FINDINGS

As part of our 2008 review, we examined the records of eight hotels or motels for adherence to County room rental tax laws. We have included four new recommendations which relate to the computation of taxes and communication with hotel and motel management.

At one hotel, we found that charges for guaranteed no-shows, where a guest commits to using a room but does not show up at the hotel, were not added into the room charges. At this same location, charges for rollaway beds that were used for an extra person in the room were also not included in room charges. For the month of January 2008, the total room charges that were not included in the monthly remittance form were $925.73. This would have resulted in an additional tax of $46.29 for the month and, if extrapolated over a one-year period would have been $555.48. We recommend that:

1. ***The Department of Finance send a bill to the hotel for additional taxes due in the amount of $555.48.***

Administration's Response:

> The Administration concurs with this recommendation. The Department of Finance will send a billing for the above amount with a letter explaining the additional charge.

At another hotel, we found multiple problems. In our review of this hotel's records, we found that, in at least one case and possibly more, the hotel had not deducted the room rental charges for the first 30 days for a guest who stayed for more than 31 days from its taxable room rental charges. Their computer system deducted the tax from the guest's bill on the 31st day, but did not adjust taxable income, resulting in the hotel paying tax on $2,100.00 that should have been tax exempt. This resulted in an overpayment of $105.00 in tax to the County.

This same location also did not include the cost of rollaway beds in its room rental charges. For the month of January, this would have added an extra $2.00 to the taxes due, or $24.00 if extrapolated an annual basis. They also incorrectly listed a write-off of credit card charges that were subsequently denied by the credit card companies and deemed to be uncollectible as exemptions from the tax. This should have been a reduction to revenue, not an exemption. We found that the amount being written off included State and County tax as well as the room rental charges. Only the

uncollected room rental charges should have been deducted from taxable income. The write-off amount was $490.20, of which $44.56 represented State and County taxes and reduces the tax paid to the County by $2.23.

The overpayment of tax of $105.00 and the underpayments of $24.00 and $2.23 nets to a total of $78.77. We recommend that:

2. ***The Department of Finance should issue a credit in the amount of $78.77 to the hotel.***

Administration's Response:

The Administration concurs with this recommendation. The Department of Finance will send a letter to the hotel describing the discrepancies found in the audit and will issue a credit to the hotel upon the filing of an amended tax return for the month of the overpayment.

3. ***If the hotel can prove more instances of overpayment of tax, additional credits should be issued to the hotel.***

Administration's Response:

The Administration concurs with this recommendation. The letter to the hotel sent in the response to Recommendation 2 will include a statement that the Department of Finance will issue a credit for any overpayment of tax in the two years prior to the audit upon submission to the Department amended tax returns with documentation of the errors.

In our discussions with hotel and motel management and with Department of Finance personnel, we discovered that there has not been any written communication between the Department of Finance and the managers of the hotels and motels in recent years. We discovered that there had been recent changes in the management of some hotels, particularly the national chains. We have noted over the years that the national chains generally produce higher income, more tax revenue and more of the exemptions related to long-term stays and government employees. While it is incumbent upon the hotels and motels to know the tax laws and recordkeeping requirements of the County, we believe that the County would be remiss not to provide reminders about our expectations. We believe that the number of recurring errors substantiates this assertion.

We therefore recommend that:

4. ***The Department of Finance should, on an annual basis, send information to the management of each hotel and motel that specifies the types of revenue that constitute gross room rental receipts, defines the types of exemptions allowed under law, and states the recordkeeping requirement for each hotel.***

Administration's Response:

The Administration concurs with this recommendation. The Department of Finance has composed such a letter and will mail it at the beginning of each fiscal year to the management of each hotel along with a supply of tax returns. In addition, the Department will be revising the instructions on the reverse of the tax returns with the next printing that will address the same issues.