



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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September 2, 2020

David Atalig
Secretary of Finance
Department of Finance
P.O. Box 5234 CHRB
Saipan, MP 96950

Dear Secretary Atalig:

Report on the Audit of DRT - Hotel Occupancy Tax

This report presents the Office of the Public Auditor's (OPA) Audit of the Division of Revenue and Taxation (DRT) - Hotel Occupancy Tax (HOT). Our objective was to determine if DRT has adequate procedures to detect underreported HOT and unlicensed businesses subject to HOT.

Our audit offers a total of nine recommendations that encompasses the importance of adopting regulations, conducting tax audits, and implementing procedures to strengthen DRT's administration and enforcement of the HOT Law. The implementation of these recommendations will address the report findings.

We appreciate the response received from your office and look forward to the completion of the proposed action plans. The law requires OPA to report semiannually on the audited entity's compliance with OPA's recommendations. OPA will contact DRT every June and December until all recommendations are resolved.

As required by law and the auditing standards, all reports issued by OPA are made public and can be found on OPA's website at www.opacnmi.com.

Sincerely,

Michael Pai, CPA
Public Auditor

Enclosures
MP/db/gt/jb

cc: Honorable Ralph DLG. Torres, Governor
Interagency Audit Coordinating Advisory Group
Tracy Norita, DRT Director
David Blake, OPA
Geraldine Tenorio, OPA

Office of the Public Auditor
Commonwealth of the Northern Mariana Islands

Audit of the
Division of Revenue and Taxation
Hotel Occupancy Tax



OPA Report No.
20-07

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Results in Brief

The CNMI Hotel Occupancy Tax (HOT) imposes upon transient occupants a 15 percent tax on the amounts charged or paid for the accommodations at short-term lodging facilities. Mandated to collect the tax from transient occupants, Operators of short-term lodging facilities (Operators) are required to remit its collections of HOT and file the HOT form with the Division of Revenue and Taxation (DRT) on a monthly basis.

DRT was established under the Department of Finance (DOF) to administer the tax laws of the CNMI. Through the Secretary of Finance's designated authority, DRT is authorized to prescribe all necessary rules and regulations to carry out the intent of the division and for purposes of tax administration and enforcement.

The Office of the Public Auditor (OPA) conducted an audit of DRT to determine if DRT has adequate procedures to detect underreported HOT and unlicensed businesses subject to HOT. We found that DRT:

- Has not adopted regulations specific to HOT;
- Has not conducted tax audits of HOT and lacks audit procedures;
- Does not have procedures in place to effectively detect underreported HOT;
 - Does not proactively address non-filings of HOT;
 - Does not require the proper reporting of revenues in the BGRT form;
- Efforts to detect unlicensed Operators are limited in scope.

Introduction

Objective

The objective of the audit was to determine if DRT has adequate procedures to detect underreported HOT and unlicensed businesses subject to HOT.

Please see APPENDIX 1 for the scope and methodology of the audit.

Background

Established under the Revenue and Taxation Act of 1982, the Hotel Occupancy Tax imposed upon transient occupants of a room or rooms in a hotel or similar facility, a 10 percent tax on the amount charged or paid for accommodations. Mandated to collect the tax, Operators are required to remit their monthly collections of HOT from transient occupants and file the monthly HOT form with DRT no later than the 20th day of the succeeding month. In March 2013, the tax rate was increased from 10 percent to 15 percent under Public Law 18-1. The monthly HOT form shows an Operator's revenue subject to HOT and calculation of the tax due for the month.

Separate from HOT, the Business Gross Revenue Tax (BGRT) is imposed on the gross revenues, or total sales, of all businesses operating in the CNMI. Businesses are required to pay the tax and file the monthly BGRT form with DRT no later than the last day of the succeeding month. When preparing the monthly BGRT form, businesses are expected to include a breakdown of their revenue collection for the month by business activity using applicable activity codes listed in the BGRT form. Being subject to both taxes, an Operator must report its monthly collections of HOT and assessment of BGRT on the revenues from accommodating transient occupants.

Subject to the overall direction of the Secretary of Finance, DRT is responsible for all matters on the day-to-day administration and enforcement of CNMI taxes.

According to Public Law 19-36, eighty percent (80%) of the CNMI's collection of HOT is to be paid to the Marianas Visitors Authority for its duty to promote tourism and attract tourists to the Northern Mariana Islands. The remaining twenty percent (20%) of HOT collections is to be allocated to fund the operations and obligations of the Northern Mariana Islands Retirement Fund and/or the 25 percent pension payments to retirees.

Prior Audit Coverage

In 2017, OPA initiated a similar audit of DRT's processes and procedures for administering and enforcing HOT. In our review of several HOT and BGRT filings, OPA noted inaccurate reporting of revenues between the filings, and instances where taxpayers failed to file the BGRT form or potentially failed to report all revenues in the BGRT form. During the audit, OPA learned that DRT started verifying the accuracy of revenues reported in HOT and BGRT filings. DRT also included the procedure of canvassing websites that advertise short-term lodging establishments to detect unlicensed Operators in its enforcement of business license requirements. In December 2017, OPA terminated the audit due to DOF's delay in providing sufficient tax data necessary for completing the audit.

Please see APPENDIX 2 for OPA's December 4, 2017 letter to the Secretary of Finance.

Findings

Our audit found that DRT does not have adequate procedures to detect underreported HOT and unlicensed businesses subject to HOT. Specifically, DRT:

- Has not adopted regulations specific to HOT;
- Has not conducted tax audits of HOT and lacks audit procedures;
- Does not have procedures in place to effectively detect underreported HOT;
 - Does not proactively address non-filings of HOT;
 - Does not require the proper reporting of revenues in the BGRT form; and
- Efforts to detect unlicensed Operators are limited in scope.

The following sections provide detailed discussions on these findings.

DRT Has Not Adopted Regulations Specific to HOT

Enabling legislation typically provides general rules and framework for an agency’s activities or practices. Often such enabling legislation authorizes the agency charged with administering the laws to promulgate rules and regulations to further define how the agency and its mandate will operate.

DRT was established under DOF to administer the tax laws of the CNMI. Through the Secretary of Finance’s designated authority, DRT is authorized to prescribe all necessary rules and regulations to carry out the intent of the division and for purposes of tax administration and enforcement. As such, the CNMI’s Revenue and Taxation Regulations state that the purpose of the regulations is to establish policy and procedures to implement and provide uniform enforcement of the tax laws of the CNMI.

§ 70-40.6-005 Purpose and Scope:

The purpose of the regulations in this subchapter is to establish policy and procedures to implement and provide uniform enforcement of the tax laws of the Commonwealth of the Northern Mariana Islands and other laws delegated to and administered by the Division of Revenue and Taxation.

-NMI Administrative Code

However, DRT has not adopted regulations specific to HOT since the tax’s establishment in 1982. Although various sections of existing regulations mention HOT, DRT has not prescribed any clarification for the extent of imposing and collecting HOT on the various charges paid by transient occupants.

OPA conducted a review of the tax laws and regulations of other U.S. states or cities and note that many define particular terms to clarify the extent of collecting occupancy tax. For example, the term *Occupancy* is usually defined as follows:

*Occupancy*¹ means the use or possession, or right or entitlement to the use or possession of any room or rooms or portion thereof, in any hotel for dwelling, lodging or sleeping purposes.

Definitions for *Occupancy* commonly include the phrase “room or rooms...for dwelling, lodging, or sleeping purposes” or “sleeping room” which narrows the scope of the tax to rooms made available for sleeping. It is also common for definitions of *Occupancy* to include the phrase “or the right or entitlement to the use or possession of any room...” to imply that occupancy can also result from the establishment of a guest’s right or entitlement to a room.

In addition to the room rate, hotels and other similar facilities charge guests a variety of other fees which may include one or more of the following:

- Room package rates (inclusive of meals, car rental, spa, etc.)
- Cancellation fees
- Early check in and late check out fees
- Resort or facility fee
- Additional guest fee
- Extra bed fee
- Room connecting fee
- Telephone surcharge
- Wi-Fi access fee
- Mini bar or snack fee
- Room cleaning fee
- Pet cleaning fee
- Room service
- Airport pick-up/drop-off service

Given the range of charges that are associated with a guest’s stay, some states or cities identify specific charges that are subject to the tax. For example, Texas State Regulations provide

¹ Los Angeles County, CA Code of Ordinances Title 4.72.020 – Definitions.

definitions to identify the charges included in the amount paid for a hotel² room and subject to the Texas Hotel Occupancy Tax (See Figure 1 below).

<p><i>Charges for personal services.</i> Charges which are unrelated to the cost of the actual occupancy of the room or rooms. Charges for personal services do not include charges which are related to the cleaning and readying of a room for occupancy.</p> <p><i>Charges subject to the tax.</i> All charges for items or services, other than personal services or charges for the use of a telephone, which are furnished in connection with the actual occupancy of the room are subject to the hotel occupancy tax. The taxable charges include charges for the use of a television and charges for the furnishing of additional beds or cots. These charges are includable within the tax base whether or not separately stated.</p> <p><i>Package deals.</i> If a hotel includes meals, drinks, admission to tourist attractions, or any other unrelated benefit in the charge for lodging, hotel occupancy tax must be paid on the entire amount. Only if these charges are separately stated on the bill to the customer may they be deducted from the amount subject to tax.</p>	Example	
	Charge for room occupancy	\$37.50
Television rental	\$2.50	
Total	\$40.00 (amount subject to tax)	
Charge for room occupancy (includes use of a television)	\$40	
Total	\$40.00 (amount subject to tax)	

Figure 1. Texas Administrative Code Title 34.3.162 - Definitions.

According to Texas Regulations, the price of a room includes charges for items or services provided in connection with the actual occupancy of a room, whether or not separately stated on the guest invoice.

Similarly, Clark County, Nevada’s Combined Transient Lodging Tax Law defines its use of the term *Rent* to mean the amount charged for a sleeping room including charges that are mandatory and charged in connection with the rental of a sleeping room. See Figure 2 below for Clark County’s specific definition of *Rent* and list of charges subject to the tax.

<p>"Rent"</p> <p>(a) Means the amount charged for a sleeping room/space in a transient lodging establishment, valued in money, whether received in money or otherwise, and including the following, regardless of whether separately stated:</p> <ul style="list-style-type: none"> (i) Charges that would normally be part of an all inclusive room rate, such as, but not limited to, payment processing fees, check-in fees, accommodation fees, facility fees, access fees, charges for additional guests, late check-out fees, and utility surcharges; (ii) Charges applicable to cleaning and readying such room/space for occupancy including, but not limited to linen fees, cleaning fees, and non-refundable deposits; (iii) Charges for rental of furnishings and appliances including, but not limited to, cribs, rollaways, refrigerators, televisions, microwaves, and in-room safes; (iv) Room charges applicable to pets including, but not limited to, non-refundable pet cleaning fees/deposits; (v) Charges associated with attrition, cancellation, late arrival, or failure to occupy a room, including, but not limited to, attrition fees, cancellation fees, late arrival fees, early departure fees, and no-show fees; (vi) Reimbursements received for use of a sleeping room/space under incentive programs, such as, but not limited to, frequent guest programs or rewards programs; (vii) The value of a sleeping room/space included as a component of a package, pursuant to Section 4.08.035; (viii) Any charges for services, amenities, accommodations, or use, not otherwise specified above, that are mandatory in nature and charged in connection with rental of a sleeping/room space. <p>(b) Shall not include the charge for any food served or personal services rendered to the occupant, including but not limited to, valet service, room service, or delivery service.</p>

Figure 2. Clark County, Nevada Code of Ordinances Title 4.08.005 - Definitions.

² Texas State Tax Code defines “hotel” to mean a building in which members of the public obtain sleeping accommodations for consideration. The term includes a hotel, motel, tourist home, tourist house, tourist court, lodging house, inn, rooming house, or bed and breakfast.

Unlike other tax legislations which clarify specific charges subject to the tax, the CNMI HOT Law does not define its use of the term *accommodations* (See Figures 3 and 4). Therefore, it is unclear whether or not *accommodations* mean or refer to:

- 1) Only the room;
- 2) The room including charges for items or services provided in connection with the actual use of the room; or
- 3) The room including any charges whether or not related to the actual use of the room.

Title 4 Division 1 §1103. Definitions

(cc) “Transient occupant of a room or rooms in a hotel, lodging house or similar facility” means those persons who occupy such facilities in a specific location for less than 90 consecutive days.

(gg) “Transient occupant” means those persons who for compensation occupy the living facilities listed in 4 CMC § 1502(a) for less than 90 days.

(hh) “Bed and breakfast” means a private residence or building appurtenant or accessory to a private residence containing five or fewer rooms intended or designed to be used, or which are used, rented, or hired out to be occupied for sleeping purposes.

Figure 3. Commonwealth Law Revision Commission. Relevant definitions provided under the Commonwealth Code.

Title 4 Division 1 §1502. Hotel Occupancy Tax

(a) An occupancy tax is imposed upon transient occupants of a room or rooms in a hotel, lodging house, motel, resort motel, apartment, apartment motel, rooming house, private residence, bed and breakfast, condominium or similar facility located in the Commonwealth. The tax shall be 15 percent of the amount charged or paid for the **accommodations**.

(b) The tax imposed by this section shall be collected by the person who operates, owns or manages a hotel, lodging house, motel, resort motel, apartment, apartment motel, rooming house, private residence, bed and breakfast, condominium, or similar facility as and when paid or charged to the hotel, lodging house, motel, resort motel, apartment, apartment motel, rooming house, private residence, bed and breakfast, condominium, or similar facility.

Figure 4. Commonwealth Law Revision Commission.

Regulations are necessary to clarify the law’s use of the term *accommodations* and ensure that Operators properly collect HOT. Based on our review of the reservation websites of several major hotels in the CNMI, OPA noted that hotels generally:

- Collect HOT on the room rate;
- Collect HOT on the entire price of room package deals;
- Collect HOT on cancellation fees;
- Do not collect HOT on optional charges for meals, extra beds or guest, and airport pick-ups/drop offs; and
- Do not collect HOT on resort or facility fees (mandatory charges for hotel amenities whether or not used by guests).

Given the lack of regulations, it is unclear whether or not collecting HOT on charges other than the room rate complies with the HOT Law. For example, a cancellation fee is charged as a penalty for not cancelling a room reservation before a specified date or period. Although cancellation fees typically amount to the price of a room for a one-night stay, cancellation fees are 1) charged to persons who do not appear to meet the law’s definitions of transient occupants and 2) are penalties for *not* occupying a room. It is also unclear whether or not HOT must be

collected on the entire price of a room package or *only* on the value of the room as a component of a room package.

Regulations providing clear interpretation of the CNMI HOT Law is essential for DRT to uniformly enforce proper collections of the tax by Operators. Specifically, regulations would provide DRT sufficient information to perform tax audits and determine whether Operators are properly collecting and remitting the tax to the CNMI. Various DRT staff have recognized the lack of regulations and were unable to definitively clarify the following:

- | | |
|---|--|
| 1. Does the law's use of the phrase "for less than 90 days" when defining a transient occupant mean excluding the 90th day or including the 90th day? | 5. Are Operators required to collect HOT on additional room fees for extra beds, room cleaning, pet cleaning, etc.? |
| 2. Are Operators required to collect HOT for the first 89 days from occupants who stay for more than 90 days? | 6. Is HOT required to be collected from tenants of apartment units who breached their rental contract and occupied the unit for less than 90 days? |
| 3. Does the law's use of the term "occupy" mean that a transient occupant has to physically or actually use the room(s)? | 7. Do operators collect HOT for stays resulting from an occupant's redemption of rewards points of a loyalty program? |
| 4. Are Operators required to collect HOT on room cancelation fees? | |

Figure 3. OPA Interview Questions.

DRT informed OPA that current Revenue and Taxation Regulations are being revised several sections at a time. Although draft revisions to certain sections are under review, DRT has yet to develop regulations specific to HOT.

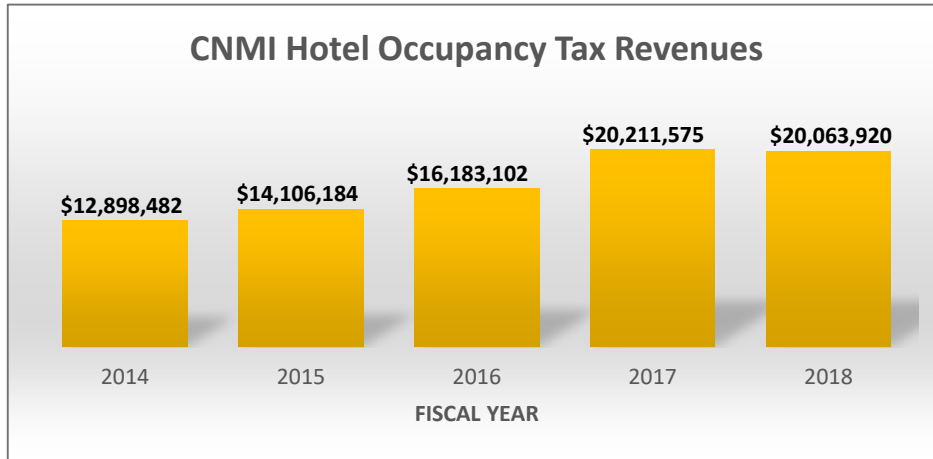
The above references to other U.S. state or city tax legislation and discussions are for the purposes of demonstrating the importance of regulations and are not intended to be legal interpretations of the CNMI HOT Law.

OPA recommends that DRT:

1. Adopt regulations which interpret the HOT Law's use of the term *accommodations* and enable DRT's uniform enforcement of HOT.

DRT Has Not Conducted Tax Audits of HOT and Lack Audit Procedures

Following the end of the garment industry in 2009, the CNMI Hotel Occupancy Tax (HOT) became the fourth largest tax revenue source of the CNMI providing an average of \$5.3 million per fiscal year (FY) from 2010 to 2012. Following the legislative increase of the HOT rate to 15 percent in 2013, HOT revenues grew from \$12.8 million in FY 2014 to \$20 million in FY 2018.



Source: CNMI Report on the Audit of Financial Statements for Fiscal Years 2014 to 2018.

Although authorized to examine any books, papers, records, or other data for the purposes of ascertaining the correctness of any tax return, DRT has not conducted tax audits of Operators' revenue records to verify the credibility of reported HOT. Consequently, it is unknown whether or not Operators are:

- Properly collecting HOT from transient occupants in accordance with the HOT Law; and
- Accurately remitting collections of HOT to the CNMI.

Additionally, DRT has not implemented a process, through the tax system or staff-performed procedures, for identifying suspicious reporting activities of HOT and initiating tax audits. Unlike the processing of HOT, income tax filings entered into the tax system are systematically verified against other sources of information to determine the accuracy of reported income tax. The tax system is also programmed to flag income tax filings with suspicious reporting activities, and require Examination Branch's review before further processing of income tax filings are allowed. Whereas for HOT filings, the tax system merely re-calculates the tax due on revenues reported in the HOT forms.

In our review of several Operator websites, OPA noted that Operators appear to be collecting HOT on the entire price of room package deals and on room cancellation fees. Room package deals are higher priced room offers that may include meals, car rentals, spa, golf or other items. Cancellation fees are penalties for not cancelling room reservations within an allowable period of time. Tax audits of Operator revenue records would reveal how HOT is collected on these and other charges paid by transient occupants, and if HOT collections were accurately reported to DRT. Regularly conducting tax audits of HOT may uncover instances of fraudulent or negligent reporting of the tax, improve general taxpayer compliance with the tax laws, and potentially lead to an increase in the CNMI's collection of HOT.

Other than the U.S. Internal Revenue Manual, which DRT uses as a guide for examining income tax filings, DRT has not adopted a procedures manual for auditing HOT. An audit manual specific to HOT would serve as a reference tool for providing staff with relevant information on the CNMI HOT Law, and procedures or techniques to effectively examine the revenue records of Operators.

OPA recommends that DRT:

2. Adopt a procedures manual for auditing HOT;
3. Conduct tax audits of HOT that involve examinations of Operator revenue records; and
4. Implement procedures using the automation capabilities of the tax system for initiating tax audits of HOT.

DRT Does Not Have Procedures in Place to Effectively Detect Underreported HOT

DRT's most noticeable effort to detecting underreported HOT were embodied in staff-performed procedures of a desk audit program initiated by the Examination Branch in April 2017. The objectives of the desk audit were to 1) ensure licensed short-term lodging operators report both HOT and Business Gross Revenue Taxes, 2) ascertain the correctness of reported taxes by cross checking HOT and BGRT filings, and 3) ensure taxpayers are using proper rates and timely filing tax forms.

OPA noted the following from its September 2017 discussions with DRT's former staff assigned to the desk audit procedures:

- The excel worksheets used for reviewing monthly HOT and BGRT filings were still a work-in-progress and were not yet standardized;
- About 29 notice letters were issued to taxpayers informing them of identified errors;
- Some taxpayers were unaware that HOT and BGRT are separate taxes;
- Some of the larger hotels were reporting unrelated revenues under activity code 7401 of the BGRT form;
- The review did not include the monthly HOT and BGRT filings of all licensed Operators; and
- The review will be re-performed to include all licensees of short-term lodging operations.

The Examination Manager informed OPA that they had discontinued procedures of the desk audit in June 2017, just two months after they were initiated in April 2017. This was due to the then-assigned staff's other work assignments and later vacancy of the job position. OPA noted that procedures of the desk audit had been discontinued for more than two years. During the course of this current audit, the Examination Manager informed OPA that no changes were made to the desk audit program, and that a recently transferred employee will resume procedures in October 2019.

OPA noted that DRT's existing procedures for processing HOT and BGRT filings inhibit DRT's efforts to detect underreported HOT. Specifically, DRT:

- Lacks procedures to proactively address non-filings of monthly HOT forms; and
- Does not enforce proper reporting of revenues in monthly BGRT forms.

Although the objectives of the desk audit program appear to address the above weaknesses, its procedures are inefficient because they require the manual steps of exporting monthly HOT and BGRT filing data from the tax system and reviews of the data in excel spreadsheets. OPA also noted that procedures of the desk audit program could be streamlined through the automation capabilities of the tax system and integrated into Compliance Branch's processing of both tax filings. Automating the procedures of the desk audit program would alleviate Examination staff from the additional work of preparing and analyzing the data, and allow the Examination Branch to focus on conducting thorough tax audits of HOT.

DRT Does Not Proactively Address Non-filings of Monthly HOT Forms

In order for DRT to verify the accuracy of revenues reported between monthly HOT and BGRT forms, DRT must ensure that Operators timely file all required HOT forms. However, according to the Compliance Acting-Manager, the Compliance Branch has not implemented procedures to routinely identify and immediately address non-filings of HOT. The Compliance Branch does not utilize the “Non-filer Filing Detection” feature of the tax system which was developed to efficiently identify non-filers or missing filings of any tax, and print notice letters to inform taxpayers of missing filings.

Title 4 Division 1 §1502. Hotel Occupancy Tax

- (c) Every person required to collect the tax shall, on or before the 20th day of the succeeding month make a monthly return and pay over the taxes required to be collected for the previous month.

Instead, the Compliance Branch relies on the Business License Office’s (BLO) procedures for screening tax filing records of renewing licensees who visit DRT. When processing a business license renewal, BLO staff must access the licensee’s tax filing records within the tax system and verify whether the licensee has filed all required filings for the last three years. Licensees who are missing any tax filing, including HOT or BGRT, are referred to the Compliance Branch to resolve the tax issue and are required to obtain clearances in order to renew their business license. If tax issues require more time to resolve, the Compliance Branch may grant a conditional clearance and allow the licensee to renew the business license. According to the Compliance Acting-Manager, licensees who are unresponsive with resolving their tax issues will not be allowed to renew their business license at the next renewal date.

OPA notes that BLO’s screenings of required HOT filings is initiated only for Operators who renew their business license - typically one year after the issuance date. According to the Compliance Data Entry Supervisor, she is not aware of any other procedures for addressing missing HOT filings of Operators who do not renew their business license. Further, conditional clearances appear to allow non-compliant Operators an additional one-year delay in filing missing HOT or BGRT filings.

In our review of the HOT filing and business license data provided by DRT, OPA noted that Operators did not file about 1,222 (or 44%) of 2,761 estimated total required HOT forms for 2018 and 2019. See Figure 6 below.

HOT Filings (As of Oct. 18, 2019)			
	Filed At least One HOT form	Did Not File Any HOT Form	Total
2018			
Licensed Operators	86	70	156
Required No. of Forms	958	715	1,673
Filed	906	0	906
Missing	52	715	767
2019			
Licensed Operators	83	67	150
Required No. of Forms	669	419	1088
Filed	633	0	633
Missing	36	419	455
2018 & 2019			
Est. Total Required Forms			2,761
Missing			1,222

Figure 6: OPA’s comparison between estimated total required monthly HOT filings according to Operators’ business license information and HOT filing data for 2018 and 2019.

Although penalties for failure to file, failure to pay, and interest are established to discourage untimely filings, DRT does not conduct tax audits of HOT to deter Operators from fraudulently reporting zero tax dues when filing late or missing HOT forms to circumvent the penalties. The lack of tax audits to verify the credibility of reported HOT weakens the role of penalties in deterring untimely reporting of HOT. As discussed in the previous finding section, DRT has not implemented a process for identifying and initiating tax audits of suspicious reporting activities of HOT.

According to DRT’s tax system consultants, the tax system can be modified to instantly alert Compliance staff of an Operator’s missing HOT or BGRT filing when entering data of either tax form into the system. For example, an Operator’s BGRT filing will be automatically flagged for not filing a HOT form for the same tax month, and vice versa. The tax system is also capable of generating relevant reports on the status of filings.



Utilizing the tax system to streamline the procedure of identifying missing HOT and BGRT filings at the Compliance Branch would enable DRT to immediately address any missing filing, and avoid extended delays in receiving all required HOT and BGRT forms for review.

- OPA recommends that DRT:**
5. Implement procedures using the automation capabilities of the tax system to routinely identify non-filings or Non-filers of HOT and BGRT; and
 6. Implement procedures for staff to immediately notify and request Operators to file all missing HOT and BGRT filings.

DRT Does Not Require the Proper Reporting of Revenues in the BGRT Form

In order for DRT to verify the accuracy of reported revenues between monthly HOT and BGRT forms, DRT must ensure that Operators properly report revenues that are subject to both HOT and BGRT under a specific business activity code (code) in the monthly BGRT form.

CODE	Business activity	CODE	Business activity	CODE	Business activity
FOR GENERAL BUSINESS					
6701	Air (Tour, including helicopter)	7203	Exterminators and pests control	6618	Other retail trades (not otherwise classified)
6700	Air transportation (airlines, etc.)	8903	Financial service (non-depository)	7510	Other services (not otherwise classified)
7515	Air-conditioning repair, parts and service	6606	Florist	6617	Pet, and pet supplies stores
7400	Apartment	6708	Freight and trucking services	7900	Pawn brokers
6702	Auto and tire repairs / towing	7509	Funeral homes / funeral services	6613	Photo shops / photographic services
8601	Auto parts	7500	Beauty salon and barber shop	6609	General merchandise / department stores
6600	Automobile	7404	Bed and Breakfast (B&B)	6610	Glass
6900	Banks and credit unions	6703	Bus and limousine service	8400	Golf courses
7500	Beauty salons	6704	Car rental (U-drive)	6611	Grocery / food store
7404	Bed and breakfast	7200	Carpet / Upholstery cleaning	8500	Hardware
6703	Bus and limousine	8001	Casino gaming activities	7303	Health providers services
6704	Car rental	7300	Child care services (child day care services)	7401	Hotel and motels
7200	Carpet / Upholstery	7501	Cleaning services/maintenance (yard, janitorial, etc.)	7402	House rentals
8001	Casino gaming	6602	Clothing	7600	Imports
7300	Child care	6603	Coin operated, amusement / vending machines	6902	Insurance brokers and agents
7501	Cleaning services	7201	Collection agencies	6612	Jewelry, gift, novelty and souvenir shop
6602	Clothing	7403	Commercial space rental	7000	Land lease
6603	Coin operated	6604	Computer / software	7503	Laundromats / dry cleaners
7201	Collection	8002	Electronic gaming machines	6600	Newspaper publishing industries
7403	Commercial	7700	Embroidery	7700	Night clubs and bars
8604	Computer	6904	Engineering, architectural and surveying	8300	All others not elsewhere classified
7502	Consulting				
6705	Courier or messenger				
6901	Currency exchange				
7301	Dental and dental services				
7202	Document reproduction				
7302	Drug and drug paraphernalia				
6605	Electronic				
8002	Electronic gaming machines				
7513	Embroidery				
7100	Engineering, architectural and surveying				

Source: Form OS-3105 page 3. Filers of the monthly BGRT form are expected to allocate, or breakdown, their total monthly revenue collection per business activity using applicable business activity codes.

However, DRT has not established, by regulation or instructions of the BGRT form, any requirement for Operators to report revenues that are subject to HOT exclusively under code 7401 (Hotels and motels), or any specific code, when preparing the monthly BGRT form. Consequently, Operators may report revenues in unrelated codes or include unrelated revenues under code 7401 of the BGRT form. Managers of both the Examination Branch and Compliance Branch informed OPA that such instances prevent staff from verifying the revenues reported between the two forms.

In our review of the 2018 and 2019 HOT and BGRT filing data provided by DRT, OPA noted that the revenues reported under code 7401 in 247 BGRT forms either exceeded or were less than the revenues reported in the HOT forms. Additionally, 161 BGRT forms that did not report code 7401, reported revenue under codes for Apartment, House rental, Other services, and All others not elsewhere classified that accurately matched HOT revenues. See Figure 7 below.

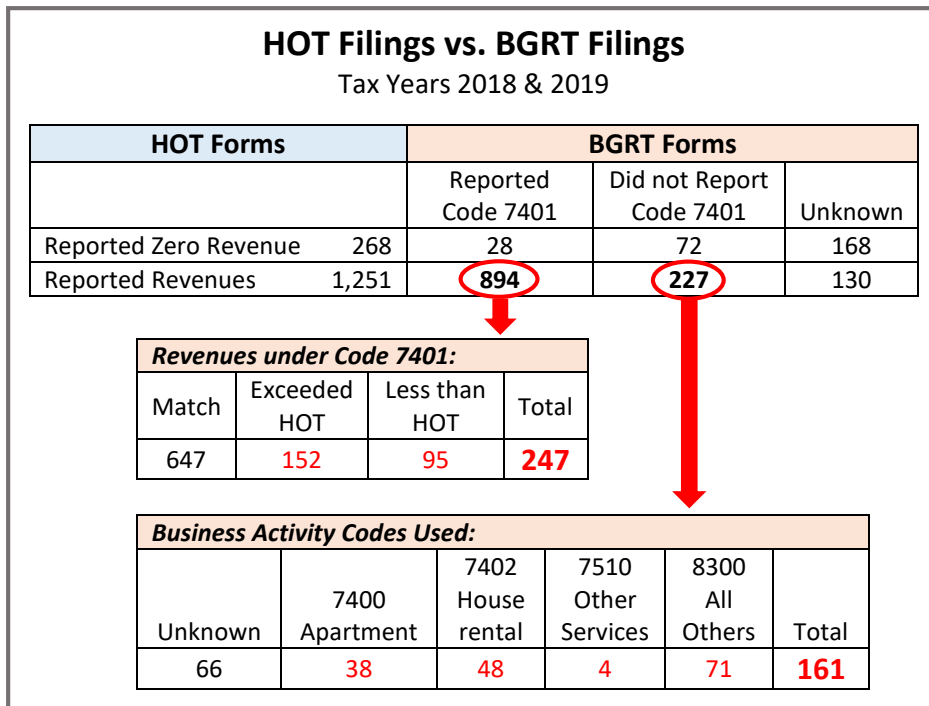


Figure 7. OPA’s review of HOT filings (with reported revenues) and corresponding BGRT filings filed for 2018 and 2019. Per DRT, activity code 7404 for “Bed and breakfast” was created and made available in the BGRT form (Rev 10/2018), but was not activated in the tax system. Therefore, Compliance staff entered other codes (e.g. 7401 Hotel and motels, 8300 All other services, etc.).

DRT does not monitor the appropriateness of codes that are reported in the monthly BGRT form. According to Compliance staff, the tax system accepts any code(s) reported in the BGRT form and does not confirm those code(s) against a taxpayer’s business license(s).

According to DRT’s tax system consultants, the tax system can be modified to automate the following procedures after entering the HOT and BGRT forms of Operators into the system:

- Flag BGRT forms for not containing code 7401, or other designated code(s);
- Verify the accuracy of reported revenues between HOT and BGRT forms; and
- Flag one or both tax forms for non-matching revenues.

Automating the above procedures through the tax system would streamline DRT’s verification of the revenues reported in both tax forms, and replace the desk audit program’s manual procedure of reviewing the filing data in excel spreadsheets.

OPA recommends that DRT:

7. Formally require Operators to report revenues that are subject to both HOT and BGRT under a specific business activity code(s) in the monthly BGRT form; and
8. Implement the automation capabilities of the tax system to streamline the verification of revenues reported in HOT and BGRT forms.

DRT's Efforts to Detect Unlicensed Operators are Limited in Scope

The Enforcement Branch initially focused its efforts in detecting unlicensed Operators in April 2016 by searching the internet and conducting inspections of properties marketed as short-term rentals on advertising websites. At the time, the Enforcement staff conducted 38 site inspections of 78 suspected unlicensed Operators, and found six (6) Operators without valid business licenses. The canvassing of websites and related inspections were discontinued just two months later in June 2016 due to management's concern about potentially violating taxpayer or private citizen rights. Management has yet to provide its Enforcement staff the proper guidance to proceed with enforcing business license requirements on short-term rentals advertised on the internet.

The Enforcement Manager informed OPA they have recently resumed efforts in detecting unlicensed Operators in October 2019. However, inspections were limited to a list of establishments permitted to operate as bed and breakfasts by the CNMI Zoning Office. Because advertising websites may contain Operators who have not registered with any government agency, OPA notes that canvassing advertising websites improves DRT's effort of identifying and detecting unlicensed Operators in the CNMI. The method of searching the internet to detect unlicensed short-term rentals is a common technique implemented by other regulatory agencies, or their contracted third parties.

In our review of various advertising websites, OPA noted that one website contained over 300 listings of rooms, houses, or apartments with daily rental rates ranging from as low as \$24 to as high as \$10,000 per night. Any further delay in bringing all Operators, including operations conducted on residential properties, into compliance with the HOT Law may lead to the loss of potential tax revenues to the CNMI.

OPA recommends that DRT:

9. Promptly review the rules and regulations and laws that impact DRT's enforcement of the HOT Law, and implement appropriate procedures for uniformly enforcing business license requirements and the HOT Law on all operations of short-term lodging, including operations conducted at private residences.

Conclusion and Recommendations

Regulations are intended to guide the activities of those who are regulated by an agency, define proper compliance with the law, and enable an agency to uniformly enforce the law. However, DRT has failed to adopt regulations which would provide Operators with clear guidance for properly collecting HOT, and enable DRT to effectively and equitably enforce the HOT Law.

DRT has also not conducted tax audits of Operators' revenue records to verify the proper collection and remittance of HOT due to the CNMI. Regularly conducting tax audits not only ensures the correctness of reported HOT, but may also influence the voluntary tax compliance of Operators who have not been audited. DRT should assess the effectiveness and efficiency of its existing procedures, including capabilities of the tax system, for processing and enforcing the filings of monthly HOT forms.

OPA commends DRT for its intent on continuing its efforts aimed at the detection of potential underreporting of HOT and unlicensed businesses subject to HOT. Under the leadership of a now full-time Director, OPA believes that DRT is well positioned to continually develop its enforcement capabilities for the uniform enforcement of the HOT Law.

Recommendation Summary

We recommend that DRT:

1. Adopt regulations which interpret the HOT Law's use of the term *accommodations* and enable DRT's uniform enforcement of HOT;
2. Adopt a procedures manual for auditing HOT;
3. Conduct tax audits of HOT that involve examinations of Operator revenue records;
4. Implement procedures using the automation capabilities of the tax system for initiating tax audits of HOT;
5. Implement procedures using the automation capabilities of the tax system to routinely identify non-filings or Non-filers of HOT and BGRT;
6. Implement procedures for staff to immediately notify and request Operators to file all missing HOT and BGRT filings;
7. Formally require Operators to report revenues that are subject to both HOT and BGRT under a specific business activity code(s) in the monthly BGRT form;
8. Implement the automation capabilities of the tax system to streamline the verification of revenues reported in HOT and BGRT forms; and
9. Promptly review the rules and regulations and laws that impact DRT's enforcement of the HOT Law, and implement appropriate procedures for uniformly enforcing business license requirements and the HOT Law on all operations of short-term lodging, including operations conducted at private residences.

Summary of Responses

DRT agreed with all of OPA's findings and provided action plans to address the recommendations in a response letter received on August 26, 2020.

Please see APPENDIX 3 for DRT's full response.


Appendix 1. Scope and Methodology

The scope of the audit focused on DRT's procedures for detecting underreported HOT and unlicensed businesses subject to HOT. To achieve our objective, we performed the following:

- Gained an understanding of laws and regulations applicable to DRT's operations.
- Interviewed DRT staff regarding the relevant processes and procedures for administering and enforcing HOT.
- Reviewed DRT's HOT and BGRT filing data, and business license data for tax years 2018 and 2019 (data as of Oct. 18, 2019).
- Summarized audit results.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix 2. Prior Audit Coverage

	Office of the Public Auditor	COPY
	Commonwealth of the Northern Mariana Islands Website: http://opacnmi.com 1236 Yap Drive, Capitol Hill, Saipan, MP 96950	RECEIVED SECRETARY OF FINANCE 2017 DEC -4 PM 2:40

December 4, 2017

Larrisa Larson
Secretary
Department of Finance
P.O. Box 5234 CHRB
Saipan, MP 96950

Dear Secretary Larson:

This letter is to advise you that the Office of the Public Auditor (OPA) has decided to terminate our audit of the Division of Revenue and Taxation (DRT). This is due to the lengthy delay in receiving requested tax data.

The audit began on March 23, 2017 with the goal of collecting preliminary information regarding the operations at DRT. After completing the survey phase, OPA concluded that a full audit would be beneficial.

The audit objective was to determine whether DRT has appropriate internal controls to detect unlicensed businesses and underreported business gross revenue and hotel occupancy taxes. To accomplish our audit objective, we interviewed DRT managers and reviewed laws and regulations applicable to DRT's operations. As part of the audit fieldwork, OPA requested specific tax data from DRT on August 25, 2017 and received the tax data on October 13, 2017.

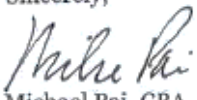
A review of the tax data revealed that specific information was not included in the request which prevented OPA from adequately conducting test procedures.

On November 1, 2017, OPA met with the Secretary of Finance (SOF) and managers from DRT and the Electronic Data Processing Division to discuss the insufficiency of the tax data. The SOF and DRT's Disclosure Officer shared concerns regarding the release of this data. The SOF informed OPA that she would seek advice from the Office of the Attorney General (AG) before providing additional information to OPA. To date, OPA has not received a response from the SOF or the AG.

OPA believes that the law is very clear as to OPA's access to all government records, including tax documents per 1 CMC § 7844. We cannot move forward without the information; therefore, we cannot continue the current audit.


Generally Accepted Government Auditing Standards (Section 6.50) require that when an audit is terminated that it be documented. The reason for termination, at the auditor's discretion, will be communicated to appropriate officials.

Sincerely,



Michael Pai, CPA
Public Auditor

Cc: G. Tenorio, OPA
D. Blake, OPA

Appendix 3. Agency Response




**Office of the Secretary
Department of Finance**



P.O. Box 5234 CHRBSAIPAN, MP 96950 TEL (670) 664-1100 FAX: (670) 664-1115

August 26, 2020 SFL 2020-443

Michael Pai, CPA
Public Auditor
Office of the Public Auditor
1236 Yap Drive, Capitol Hill
Saipan, MP 96950



Subject: Response for the Hotel Occupancy Tax Audit Findings

Dear Mr. Pai:

This letter is in response to the audit of the Division of Revenue and Taxation – Hotel Occupancy Tax and other identified findings. The Department of Finance, Division of Revenue and Taxation has reviewed the draft audit report, and the following are the responses for the findings:

Finding No.	Finding and Corrective Action Plan
001	<p>Finding: The Division of Revenue and Taxation has not adopted regulations specific to Hotel Occupancy Tax.</p> <p>OPA Recommendation: Adopt regulations which interpret the HOT law’s use of the term accommodations and enable DRT’s uniform enforcement of HOT.</p> <p>Status: Corrective action plan in progress</p> <p>Corrective Action: The Division concurs with this finding. The Division of Revenue and Taxation (DRT) adopted updated regulations in the July 2020 register but did not include regulations specific to the Hotel Occupancy Tax (HOT). DRT will draft proposed HOT regulations, which will consist of audit procedures for adoption by October 1, 2020.</p> <p>Completion Date: <i>October 1, 2020</i></p> <p>Division Contact: Tracy B. Norita Director, Revenue and Taxation P.O. Box 5234 CHRBSAIPAN, MP 96950 (670) 664-1000 t.norita@dof.gov.mp</p>

Finding No.	Finding and Corrective Action Plan
002	<p>Finding: The Division of Revenue and Taxation has not conducted tax audits of Hotel Occupancy Tax and lack audit procedures.</p> <p>OPA Recommendation: Adopt procedures manual for auditing HOT; conduct tax audits of HOT that involve examinations of Operator revenue records; and Implement procedures using the automation capabilities of the tax system for initiating tax audits of HOT.</p> <p>Status: Corrective action plan in progress</p> <p>Corrective Action: The Division concurs with this finding. DRT has been challenged with understaffing since FY 2015. The Examinations Branch began audit activities of HOT in FY 2017 but discontinued due to lack of staff. Audit activities included drafting audit procedures, compiling records of potential Operators from Business License Section and Saipan Zoning Office, and reconciling BGRT reported to HOT reported. To address this finding, DRT will work with the tax system developers to mimic the income tax matching process to flag suspicious activity in the HOT database.</p> <p>Additionally, DRT will include an audit procedure manual in the proposed HOT regulations for adoption by October 1, 2020.</p> <p>Completion Date: <i>October 1, 2020</i></p> <p>Division Contact: Melvina Litulumar Examinations Branch Manager, Revenue and Taxation P.O. Box 5234 CHRB Saipan, MP 96950 (670) 664-1000 t.norita@dof.gov.mp</p>

Finding No.	Finding and Corrective Action Plan
003	<p>Finding: The Division of Revenue and Taxation (DRT) does not have procedures in place to effectively detect underreported Hotel Occupancy Tax (HOT).</p> <ul style="list-style-type: none"> a) DRT does not proactively address non-filings of monthly HOT forms. b) DRT does not require the proper reporting of revenues in the BGRT form. <p>OPA Recommendation: Implement procedures using the automation capabilities of the tax system to routinely identify non-filings or non-filers of HOT and BGRT; and implement procedures for staff to immediately notify and request Operators to file all missing HOT and BGRT filings.</p> <p>Status: Corrective action plan in progress</p>

Corrective Action: The Division concurs with this finding. To address this finding, DRT will work with the tax system developers to mimic the income tax matching process to flag non-filings of OS-3300 based on revenues reported in the BGRT OS-3105 tax activity codes. DRT would like to note that the lack of resources has hindered the Compliance Branch from immediately notifying taxpayers of non-filings. Lack of resources includes adequate staffing, mailings, postage, and other necessary requirements to send out notices immediately and consistently.

Additionally, DRT has found that a compliance review prior to a business license renewal has been effective at encouraging taxpayers to remit full payment of tax dues to receive a license. Because our tax structure is built on voluntary timely reporting of business revenues, penalties and interest on a tax balance, and other collections actions, are usually an effective deterrent of late filing. DRT is also aware of the lack of taxpayer education and knowledge on tax preparation and could be the cause of improper reporting. Thus, DRT will also be developing guidance for proper HOT reporting to be issued with new or renewed business licenses for relevant tax activities.

Completion Date: *October 1, 2020*

Division Contact: Pauline Kapileo
 Compliance Branch Manager, Revenue and Taxation
 P.O. Box 5234 CHRB
 Saipan, MP 96950
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 t.norita@dof.gov.mp

Finding No.	Finding and Corrective Action Plan
004	<p>Finding: The Division of Revenue and Taxation’s efforts to detect unlicensed operators are limited in scope.</p> <p>OPA Recommendation: Promptly review the rules and regulations and laws that impact DRT’s enforcement of the HOT law, and implement appropriate procedures for uniformly enforcing business license requirements and the HOT Law on all operations of short-term lodging, including operations conducted at private residences.</p> <p>Status: Corrective action plan in progress</p> <p>Corrective Action: The Division concurs with this finding. DRT will seek legal guidance on laws that impact enforcement procedures where Bed and Breakfast’s (B&B) and related business activities are located on private residential properties. DRT would like to note that in its enforcement efforts canvassing websites, the majority of postings intentionally feature interior photos of rentals, giving no external clues as to the location of the business and requiring an actual booking to provide information.</p>

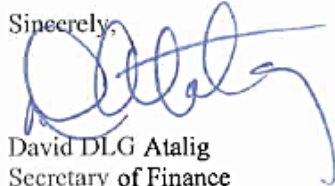
Additionally, many of the posts on the websites are multiple posts for the same rental location, displaying different types of layouts of rooms and kitchens to attract bookings and to maintain a high rating on the site. These multiple posts can be misleading when estimating the number of unlicensed operators and solely relying on the number of posts assuming they represent individual properties.

Completion Date: *October 1, 2020*

Division Contact: John Reyes
Enforcement Branch Manager, Revenue and Taxation
P.O. Box 5234 CHRB
Saipan, MP 96950
(670) 664-1000
t.norita@dof.gov.mp

On behalf of the Department of Finance, Office of the Secretary, we thank you for the opportunity to respond to the Hotel Occupancy Tax audit findings. Should you have any questions, please call me at 664-1100 or via email at david.atalig@dof.gov.mp.

Sincerely,



David DLG Atalig
Secretary of Finance

Appendix 4: Status of Recommendations

No. Recommendation	Status
OPA recommends that DRT:	
1. Adopt regulations which interpret the HOT Law's use of the term <i>accommodations</i> and enable DRT's uniform enforcement of HOT.	Unresolved
2. Adopt a procedures manual for auditing HOT.	Unresolved
3. Conduct tax audits of HOT that involve examinations of Operator revenue records.	Unresolved
4. Implement procedures using the automation capabilities of the tax system for initiating tax audits of HOT.	Unresolved
5. Implement procedures using the automation capabilities of the tax system to routinely identify non-filings or Non-filers of HOT and BGRT.	Unresolved
6. Implement procedures for staff to immediately notify and request Operators to file all missing HOT and BGRT filings.	Unresolved
7. Formally require Operators to report revenues that are subject to both HOT and BGRT under a specific business activity code(s) in the monthly BGRT form.	Unresolved
8. Implement the automation capabilities of the tax system to streamline the verification of revenues reported in HOT and BGRT forms.	Unresolved
9. Promptly review the rules and regulations and laws that impact DRT's enforcement of the HOT Law, and implement appropriate procedures for uniformly enforcing business license requirements and the HOT Law on all operations of short-term lodging, including operations conducted at private residences.	Unresolved



**Division of Revenue and Taxation
Hotel Occupancy Tax
Report No. 20-07, September 2020**

CONSTITUTIONAL MANDATE

Article III, Section 12 of the CNMI Constitution and the Commonwealth Auditing Act (1 CMC, 2301, 7812 et. seq. of the Commonwealth Code) established the Office of the Public Auditor as an independent agency of the Commonwealth Government to audit the receipt, possession, and disbursement of public funds and to perform such other duties as required by law.

CONSTITUTIONAL MANDATE

- Call the OPA HOTLINE at (670) 235-3937
- Visit our website and fill out our online form at www.opacnmi.com
- Contact the OPA Investigators at 322-3937/8/9
- OR visit our office on 1236 Yap Drive, Capitol Hill