



AUDIT REPORT



DATE

December 29, 2017

NO.

2017-007

CHARLOTTE COUNTY REVENUES

TAXABLE TRANSACTIONS

INTERNAL AUDIT DIVISION
ROGER D. EATON
CLERK OF THE CIRCUIT COURT AND COUNTY COMPTROLLER
CHARLOTTE COUNTY FLORIDA

Honorable Roger D. Eaton
Charlotte County Clerk of the Circuit Court and County Comptroller
350 East Marion Avenue
Punta Gorda, Florida 33950

We have completed an audit of revenues generated by Charlotte County departments from various sources including the sale of tangible personal property and the rental of real property. The audit was performed to determine that the County was in compliance with Florida tax law and that sales taxes were being properly calculated, collected and remitted on all taxable revenues.

The following is a report of the results of our audit procedures. The report details the current practices employed by the various County departments and includes our comments and recommendations.

Responses from County Management to the recommendations have also been included.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D Mitchell", written in a cursive style.

Diane Mitchell
Internal Audit Director

TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	2
BACKGROUND.....	3
AUDIT OBJECTIVES	3
AUDIT SCOPE.....	4
AUDIT METHODOLOGY.....	4
COMMENTS AND RECOMMENDATIONS.....	5
ACKNOWLEDGEMENT.....	10

EXECUTIVE SUMMARY

Internal Audit has completed a review and analysis of revenues generated by various Charlotte County departments/divisions from sources such as the sale of tangible personal property and the rental of real property. The audit was performed to determine compliance with current Florida sales and use tax law. The review did not include the Community Services Department or the Housing Division of the Social Services Department.

Our review disclosed the following:

1. The County does not have a formal policy and procedure in place to ensure proper classification and treatment of taxable and exempt transactions by the various County departments. In addition, County personnel are not aware of the sales and use tax implications in regard to their department's sources of revenue.
2. The Solid Waste Division of Public Works is not collecting sales tax on sales of recycled white goods and on leases of real property as required by Florida Statutes and Administrative Rules.
3. Documentation required by Florida Statutes and the Florida Administrative Code to establish the exempt nature of the sales made for resale as well as the sales made to exempt entities is not being obtained from the purchaser and retained by the County.
4. The County-Wide monthly sales tax return is not prepared in accordance with Florida Department of Revenue guidelines since the County is not recording all taxable and exempt sales.

Due to our findings, we offer the following recommendations:

1. **We recommend** the County develop and implement control policies and procedures over all sources of countywide revenues to ensure compliance with existing Florida sales and use tax laws.

2. **We recommend:**

The Solid Waste Division begins collecting and remitting sales tax and discretionary sales surtax to comply with Florida Statutes and Administrative Rules.

The County Attorney's Office review the landfill's lease agreements, in which the County is the lessor, and any related contracts for issues that might be considered additional rent and are therefore taxable.

3. **We recommend** the County establish procedures to comply with the receipt of documentation and the retention requirements of the Florida Department of Revenue in order to:

- a. Substantiate the exempt nature of sales for resale in accordance with Rule 12A-1.039 of the Florida Administrative Code, and
- b. Substantiate the exempt nature of sales to exempt entities in accordance with Rule 12A-1.038 of the Florida Administrative Code.

4. **We recommend** the County monitor all sales, both taxable and exempt, to allow for the correct preparation of the County's sales tax return.

BACKGROUND

Charlotte County departments and divisions generate revenue from a wide range of sources. The authority for generating revenues is derived from the State Constitution, Florida Law, and home ruling authority. Examples of revenue sources authorized by the State Constitution are Ad Valorem Taxes and Constitutional Fuel Tax. Examples of revenues authorized by the legislature are state revenue sharing, discretionary sales surtax, local option fuel taxes, local business taxes, and fines and forfeitures. Examples of revenues authorized by home ruling authority are proprietary fees, regulatory fees, and special assessments.

Counties may also charge for the facilities and services they provide and regulate in a reasonable and equitable manner.

Florida Sales Tax

The legislature of Florida, pursuant to Chapter 212 Florida Statutes, has established that every **person is exercising a taxable privilege who engages in the business of selling or renting anything of value**. Section 212.02(12), F.S., defines "**person**" to include **political subdivisions and municipalities**. Section 212.02(2), F.S., defines "business" as "any activity engaged in by any person, or caused to be engaged in by him or her, with the object of private or public gain, benefit, or advantage, whether direct or indirect...." Therefore, based on the statutory provisions of Chapter 212, F.S., political subdivisions and municipalities are persons that exercise a taxable privilege when they sell anything of value.

Florida law allows schools, churches, governmental agencies, and other not-for-profit organizations to make purchases without paying sales tax if the purchases are used in carrying on their nonprofit or exempt purpose.

However, sales made by these entities are generally taxable and subject to a 6% state sales tax rate, and if applicable, subject to discretionary sales surtax. The surtax is imposed by most counties in Florida to transactions subject to the state sales tax and applies only to the total sale of taxable items or services delivered into a county imposing the surtax. Charlotte County imposes a 1% discretionary sales surtax.

Charlotte County as a political subdivision of the state exercises a taxable privilege and is required to collect sales tax on taxable sales, including sales and leases of tangible personal property, leases of and licenses to use real property, and any of the sales taxable under Chapter 212, F.S. The County has been entrusted with the fiduciary duty to collect and remit the tax to the state.

AUDIT OBJECTIVES

The purpose of our audit was to:

Determine that the County is properly collecting and remitting sales tax on all taxable revenues.

Ensure that the County has policies and procedures in place to guarantee accurate, complete, and timely collection, reporting, and submission of sales tax in accordance with applicable state laws and Department of Revenue guidelines.

Determine if the County's sales tax collection practices are in compliance with those policies and procedures.

Ensure that County departments and divisions remain in compliance with all applicable laws regarding sales tax for any newly created revenue streams.

AUDIT SCOPE

Our audit focused on revenues generated by various County departments and divisions from October 2015 through September 2016.

AUDIT METHODOLOGY

We reviewed:

Applicable provisions of Florida Statutes Title XIV (Taxation and Finance), Chapter 212 (Tax on Sales, Use, and Other Transactions) as well as applicable provisions of Florida Administrative Code Chapter 12A-1 (Sales and Use Tax).

Florida Department of Revenue publications on sales and use tax collection and reporting, including the Sales and Use Tax Return form DR-15EZ instructions, for the form used by the County to report sales and sales tax and the Florida Department of Revenue's Tax Revenue Law Library for statutes, rules, court cases, technical assistance advisements, publications, etc.

Internal Revenue Service (IRS) and Charlotte County Government websites.

County-Wide Sales and Use Tax Returns filed in the fiscal year 2016, the period under audit.

Charlotte County Purchasing Manual, contracts for leases of real property in which the County acts as landlord, agreements for the placement of vending machines on County property, invoices, billings, payments, etc. to verify the nature of the transactions, taxability, appropriate payments, and revenue postings.

The EDEN General Ledger for verification of County-Wide Revenue and Sales Tax Liability accounts.

We interviewed the staff responsible for revenue accounting and reporting at several County departments and divisions, the Fiscal Services Division, and the Clerk of the Circuit Court Comptroller's Division.

We observed the sales tax collection, compilation, reporting, and filing processes at the Clerk of the Circuit Court Comptroller's Division.

COMMENTS AND RECOMMENDATIONS

1. Policies and procedures should be developed and implemented over County-wide revenue collections to ensure proper classification and correct treatment over those collections that are subject to sales and use tax.

During the audit, sales and use tax was discussed with the supervisors and staff from numerous departments that generate various revenues for the County.

Personnel involved in the various processes were generally unaware of the sales and use tax requirements prescribed by Florida Statutes and Administrative rules. Personnel were well versed in the policies and procedures established for running their day to day operations but not with tax guidelines. In addition, there appears to be a misconception in regard to the County's exemption from sales tax in believing that the statutory provisions that exempt the County from paying sales tax on purchases, exempt the County from collecting sales tax on County sales as well.

We found that the County lacks procedures and controls over revenues to ensure the proper classification and treatment of sales transactions for accurate collection and remittance of sales and use tax.

We recommend the County develop procedures and controls over county-wide revenue collections. These procedures should include, but not be limited, to the following:

- a. A documented, uniform process to ensure proper classification and treatment of sales transactions.
- b. An immediate review of the County revenue stream to ensure accurate collection and remittance of sales tax in compliance with current tax law in Florida.
- c. Identifying a centralized contact or liaison knowledgeable in sales and use tax guidelines to advise departments and divisions on how to properly classify existent and new revenue items.

2. The Solid Waste Division of Public Works is not collecting sales tax and discretionary sales surtax on taxable transactions.

As part of its operation, the Solid Waste Division of Public Works recycles riding/push lawnmowers and white goods such as washers and dryers, microwaves, refrigerators, water heaters, BBQ grills and ranges that are delivered to the County facilities. All these items are available for sale to the general public, at a set cost and on a first come-first serve basis, at the County Mini Transfer and Recycling Facilities in Englewood and Port Charlotte.

***The legislative intent spelled out in Section 212.21(2), F.S. is to tax each and every sale unless the sale is specifically exempted. In addition, Section 212.05, F.S. provides that "It is hereby declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state, ..." and that "for the exercise of such privilege, a tax is levied on each taxable transaction or incident ...".**

Based on these statutory provisions, the sale of recycled white goods and riding/push mowers to non-dealer individuals is taxable. During the review of Solid Waste Division receipts and copies of checks/money orders for the sales of these items, Audit found that sales tax was not charged on \$9,492 in revenues generated at the County Transfer and Recycling Facilities. As a result, the County is exposed to an assessment for a combined 7% uncollected sales tax and discretionary sales surtax, plus penalties and interest in the case of a compliance audit by the Florida Department of Revenue (FDOR).

The Solid Waste Division is also renting out land at the Zemel Road Landfill. The County entered into lease agreements with Charlotte County Bio-recycling Center, LLC (Synagro); Culture BioSystems (formerly known as Culture Fuels) and North American Natural Resources, LLC (current contract owner and lessee is Fortistar Methane 3, LLC).

Section 212.031, F.S. and Rule 12A-1070, F.A.C. imposes a sales or use tax on the total rent or fee charged for renting, leasing, letting, or granting a license for the use of any real property. Section 212.031(1)(a) provides that “It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of renting, leasing, letting, or granting a license for the use of any real property....” And 212.031(1)(c) provides that “for the exercise of such privilege, a tax is levied in an amount equal to 6 percent of and on the total rent or license fee charged for such real property by the person charging or collecting the rental or license fee. The total rent or license fee charged for such real property shall include payments for the granting of a privilege to use or occupy real property for any purpose and shall include base rent, **percentage rents, or similar charges**....”

Additionally Section 212.02(10)(h), F.S. and Rule 12A-1070, F.A.C. provide the definition of real property: “Real property” means the surface land, improvements thereto and fixtures, and is synonymous with “realty” and “real estate”.

Based on these statutory provisions, the leases of real property at the Landfill are taxable unless the lessees are exempt entities.

Audit found that the County did not charge sales tax on the \$36,000 rental payment received from Synagro in May 2016 and the \$300 received from Culture BioSystems in October 2015. As a result, the County is exposed to an assessment for a combined 7% uncollected sales tax and discretionary sales surtax, plus penalties and interest in the case of a compliance audit by the FDOR.

In reference to the lease agreement with North American Natural Resources, LLC signed in 2008, the County leases out landfill property for the annual nominal amount of \$100 from the date of the signing of the lease agreement through the duration of Contract No. 2008000121 – Landfill Gas Purchase Agreement.

This contract stipulates that the leased property is used to convert Landfill gas into electricity. It has been transferred several times and the current owner is Fortistar Methane 3, LLC. As per the terms of the contract, the County will be entitled to a percentage of gross revenues received by the contract owner/lessee from the sale of capacity and energy and to retain 80% of the revenue from the sale of carbon credits that might be created during the term of the contract, once construction costs are recovered by the contract owner.

The issues surrounding commercial leases and sales tax have been addressed by the FDOR in the form of various Technical Assistance Advisements (TAAs). The FDOR generally considers any payment required to be paid as a condition of occupancy under a commercial lease to be taxable as rent. Research performed by Audit on this

issue revealed that the County might be exposed to a tax liability in the future caused by the potential taxability of the percentage of gross revenue from the sale of capacity and energy and the 80% of carbon credits that the County might eventually receive. Court cases decisions and the determinations rendered by the DOR on several TAAs further interpret and clarify the provisions of Section 212.031, F.S. and Rule 12A-1.070, F.A.C. supporting the likelihood that these revenues could be categorized as additional rental consideration or compensation paid for the use of real property.

In addition, both the Synagro and the North American Natural Resources, LLC lease agreements stipulate that the buildings and structures installed by the lessees become the property of the County at the end of the lease. Improvements to leased premises may be subject to sales tax regardless of whether they are minor improvements or significant capital improvements. To determine their taxability, the relevant inquiry is whether the payments are part of the total consideration paid by the tenant for the right to occupy the property. The structures and buildings installed by Synagro and North American Natural Resources, LLC may or may not be considered additional rent, depending on the specific circumstances of the lease agreements and/or related contracts.

We recommend the Solid Waste Division begin collecting and remitting sales tax and discretionary sales surtax to comply with Florida Statutes and Administrative Rules.

We recommend the County Attorney's Office review the Landfill lease agreements, in which the County is the lessor, and all related contracts for issues that might potentially be considered additional rent and, therefore, be subject to sales and use tax.

3. Documentation required by Florida Statutes and Florida Administrative Code to establish the exempt nature of County "sales made for resale" and County "sales made to exempt entities" is not being obtained from the purchaser.

a. Sales Made for Resale:

Public Works Solid Waste and Maintenance and Operations Divisions, Facilities Management, and Charlotte County Utilities recycle ferrous and non-ferrous metals; the Solid Waste Division recycles batteries, white goods, paper and cardboard, cooking oil, computers, etc.; and the Public Safety Department recycles used tires from its vehicles.

All these recycled materials are sold to contracted businesses that resell them or incorporate them into other items of tangible personal property that are later sold or repaired for subsequent sale. In awarding the contracts to these businesses, the County departments and divisions followed established procedures required by the County Purchasing Manual. They solicited requests for quote to secure the services of a contractor for the pick-up, removal, and recycling of the items from County facilities. Contracts were awarded to the highest responsive and responsible bidder for each of the solicited requests.

As stated earlier in Comment 1 *, Florida tax law is construed to tax every sale of tangible personal property unless there is an exemption.

Therefore, in selling recycled items, the County is engaged in the sale of tangible personal property, a taxable transaction under the Florida Statutes. However, Rule 12A-1.039, F.A.C. provides an exemption when a sale is

made for resale: “a sale for resale is exempt from the tax imposed by Chapter 212, F.S., only when the sale for resale is in strict compliance with the provisions of this rule ...” and “the exempt nature of the transaction must be established by the selling dealer”.

The rule defines “sales for resale” to include sales to a person that is an “active registered dealer” and who resells the items or incorporates them into the fabrication or repair of items of tangible personal property. “Active registered dealer” is defined as “a person **who is registered with the Department** as a dealer for sales tax purposes and who is required to file a sales and use tax return”.

Based on the definitions given by the rule, the sale of recycled materials to contracted businesses may qualify as a transaction exempt from sales tax with the proviso that the County can establish the exempt nature of the transaction. **To establish the exempt nature of a sale for resale, Rule 12A-1.039 requires that the selling dealer (in this case, the County) document the exempt sale either by obtaining and retaining on file a copy of the purchaser’s Annual Resale Certificate (form DR-13) or obtaining a Transaction Resale Authorization number or a Vendor Resale Authorization number from the Florida Department of Revenue.**

We found that County departments were not aware of the requirements prescribed by Florida Statutes and Administrative Rules. Consequently, they failed to obtain and maintain the required authorization numbers and certificates in its records for the time period prescribed by law.

Based on the revenues of \$98,051 generated in fiscal year 2016 from the sale of scrap metals and materials to dealers, the County is exposed to an assessment of combined 7% state sales tax and discretionary sales surtax, plus penalty and interest, for unsupported exempted sales in the case of a compliance audit by the FDOR.

b. Sales Made to Exempt Entities:

Several County departments are renting out building space to state government and federal government agencies, and to several entities that appear to be exempt under IRC code Section 501(c)(3). The Human Services Department also rents garden plots to individuals and entities at the County Community Garden located at the property they occupy.

Leases of real property are governed by Sections 212.031(1)(a) and (c), F.S. that impose a sales or use tax on the total rent or fee charged for the renting, leasing, or letting of any real property. However Sections 212.08(6) and 212.08(7), F.S. provide exemptions. Section 212.08(6), F.S. exempts from the sales made to the United States Government, a state, or any county, municipality, or political subdivision of a state when payment is made directly to the dealer by the governmental entity. Section 212.08(7)(p), F.S. also exempts from the tax those sales or leases made to organizations currently determined by the Internal Revenue Service to be exempt from federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code, if such leases or purchases are used in carrying on their customary nonprofit activities and payment is made with the entity’s funds.

Rule 12A-1.038, F.A.C. puts the burden of proof on the person leasing, renting, or letting of any real property by providing that “the exempt nature of the transaction must be established by the selling dealer and unless the selling dealer shall have taken from the purchaser the required documentation as provided by this rule, the sale shall be deemed to be taxable.” The selling dealer is required to document the exempt sale by either obtaining a copy of the entity’s valid Consumer’s Certificate of Exemption (form-DR-214), a Transaction Authorization Number or a Vendor Authorization Number obtained from the Florida Department of Revenue. The selling dealer

is also required to keep proof that payment for tax-exempt rentals is made directly by the exempt entity or governmental unit and not with personal funds of an authorized representative. For sales made to the United States Government and its units, Rule 12A-1.038(4)(a), F.A.C. provides that the United States Government is not required to hold a Consumer's Certificate of Exemption to make tax-exempt purchases and rentals.

Based on the statutory provisions, the rental of building space and garden plots by the County is subject to sales tax and the discretionary sales surtax, unless the County obtains from the purchaser and retains on file a copy of the entity's valid Consumer's Certificate of Exemption (form-DR-214) and proof of payment by the entity. In lieu of obtaining a copy of form DR-214, the County has the option of getting a Transaction Authorization number or a Vendor Authorization number from the Florida Department of Revenue.

We found that County departments were not aware of the requirements prescribed by Florida Statutes and Administrative Rules. Consequently, they failed to obtain and maintain the required authorization numbers and certificates in its records for the time period prescribed by law.

Based on the revenues of \$109,815 generated in fiscal year 2016 from the rental of real property, the County is exposed to an assessment of combined 7% state sales tax and discretionary sales surtax tax, plus penalty and interest, for unsupported exempted sales in the case of a compliance audit by the FDOR.

Due to these findings:

a. We recommend the County establish and implement procedures to comply with Rule 12A-1.039 of the Florida Administrative Code to ensure that proper documentation is obtained before "exempting" a sale transaction. In addition, a file should be maintained by each department with copies of Annual Resale Certificates (Form DR-13) to verify the exempt nature of the sales.

b. We recommend the County establish and implement procedures to comply with Rule 12A-1.038 of the Florida Administrative Code to ensure that proper documentation is obtained before "exempting" a sale transaction. In addition, to verify the exempt nature of sales, a file should be maintained by each department and division with copies of Consumer's Certificate of Exemption (Form DR-214) and proof that payment was made with the purchasing entity's funds.

If the County accepts in good faith a copy of an entity's valid Annual Resale Certificate, Consumer's Certificate of Exemption, or a Transaction Authorization Number or Vendor Authorization Number issued by the Florida Department of Revenue, it meets the burden of proof for establishing the exempt nature of the sale. Therefore, it is relieved from any liability for tax due on that sale and will not be held liable for any tax due on sales made to the entity during the effective dates indicated on the Certificate or the Authorization Number.

4. The County-Wide monthly sales tax return cannot be prepared in accordance with Florida Department of Revenue guidelines since taxable and exempt sales are not reported by the County departments.

At the end of each month, the Clerk of the Circuit Court Comptroller's Division prepares and electronically files a consolidated County-wide sales tax return with the Florida Department of Revenue. We reviewed and analyzed

the returns for October 2015 through September 2016 and found that the Comptroller's Division, using the sales tax accrued during the month, calculates the amount of taxable sales by dividing the sales tax accrued in the sales tax liability account by 1.07%. The resulting amount is then reported as both gross and taxable sales and exempt sales are reported as zero.

(When Audit analyzed the sales tax liability account, we found that only the revenue generated by the Parks and Recreation Division of Community Services was being taxed for sales tax.)

Sales and Use Tax Returns should be prepared in compliance with the guidelines prescribed by the Florida Department of Revenue. According to form DR-15N instructions, the Sales and Use Tax Return requires reporting exempt sales in two places. Exempt sales should be included on the return as part of the gross sales and then in a separate line on the return labeled exempt sales.

Due to these conditions, Charlotte County cannot substantiate the exact amount of reportable sales exempted from the collection of sales tax in the case of a compliance audit by the FDOR. This could expose the County to an assessment of 7% sales tax and discretionary sales surtax, plus penalty and interest for unsupported exempt sales.

We recommend the County track in detail all sales including those sales exempted from sales tax to allow for the correct preparation of the County's sales tax return.

ACKNOWLEDGEMENT

We would like to thank the personnel of various County departments and divisions, including the Fiscal Services Division, and the Clerk of the Circuit Court Comptroller's Division for their cooperation and assistance in completing this audit.

Audit performed by:
Orlando Solarte
Senior Internal Auditor



Charlotte County Government

"To exceed expectations in the delivery of public services."

www.CharlotteCountyFL.com

MEMORANDUM

Date: December 29, 2017

To: Diane Mitchell, Internal Audit Director

From: Cari Branco, Sr. Division Manager, Fiscal Services

CC: Gordon Burger, Director of Budget and Administrative Services

Subject: Responses to the Internal Audit on analysis of revenues from County Departments

Please find below the list of recommendations from your department, and the response from the Board.

1. Recommend the County develop and implement control policies and procedures over all sources of countywide revenues to ensure compliance with existing Florida sales and use tax laws.
Response: Fiscal Services will meet with the Comptroller's office to develop a procedure for County Departments that collect sales tax.
2. Recommend:
 - a. The Solid Waste Division begins collecting and remitting sales tax and discretionary sales surtax to comply with Florida Statutes and Administrative Rules.
 - i. Response: Fiscal Services staff will meet with the Solid Waste Department to work on documenting collection of sales tax for their white goods sold.
 - b. The County Attorney's Office review the landfill's lease agreements, in which the County is the lessor, and any related contracts for issues that might be considered rent and therefore taxable.
 - i. Response: Fiscal Services will submit a legal request to the Attorney's office requesting they review the Landfill's lease agreements and other lease

Budget & Administrative Services Department

18500 Murdock Circle | Port Charlotte, FL 33948-1068

Phone: 941.743.1551 | Fax: 941.743.1286

agreements that might be considered rent and taxable; and determine how to collect taxes on lease agreements.

3. Recommend the County establish procedures to comply with the receipt of documentation and the retention requirements of the Florida Department of Revenue in order to:
 - a. Substantiate the exempt nature of sales for resale in accordance with Rule 12A-1.039 of the Florida Administrative Code and
 - i. Response: We contacted Public Works to ensure their goods sold were sales for resale. We did receive the resale certificate for vendor Garden Street Scrap Metal for 2017; waiting on 2018, company has not received it as of today.
 - ii. Response: Fiscal Services will contact Solid Waste to determine what goods are being sold to Trademark, their scrap metal vendor. Additionally we will obtain their current resale certificate.
 - b. Substantiate the exempt nature of sales to exempt entities in accordance with Rule 12A-1.038 of the Florida Administrative Code.
 - i. Response; Fiscal will research/determine if any sales are made to exempt entities and obtain a Consumer's Certificate of Exemption for documentation and verify it using the Dept. of Revenue's online Certificate Verification System.
4. Recommend the County monitor all sales, both taxable and exempt, to allow for the correct preparation of the County's sales tax return.
 - i. Response: Fiscal staff will meet to discuss a process on how to monitor all sales.

