

REPORT TO THE JOINT CHAIRMEN ON
MEASURES TAKEN TO ENSURE VERIFIABLE
COMPLIANCE WITHIN THE HOMESTEAD TAX CREDIT PROGRAM

Respectfully Submitted by the
State Department of Assessments and Taxation
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REPORT ON MEASURES TAKEN TO ENSURE VERIFIABLE COMPLIANCE WITHIN THE HOMESTEAD TAX CREDIT PROGRAM

The purpose of this Report is to provide the General Assembly specific information it can use to evaluate the issues related to the Department of Assessments and Taxation's implementation of the Recommendations of the Legislative Auditor resulting from the Performance Audit of the Homestead Tax Credit Program issued by the Office of the Legislative Auditor in February, 2013. There are certain Recommendations that will be immediately implemented by the Department. There is one of the Legislative Auditor's Recommendations that the Department believes to be legally incorrect. There is another Recommendation that the Department believes to be unworkable and unrealistic. The most significant Recommendations in the Legislative Auditor's Performance Audit fall in the category of being clearly contingent upon a major increase in the number of new employees to perform these additional audits and other proposed activities. On page 20 of the Performance Audit, the Legislative Auditor's Recommendation states that the Department should "perform an analysis of personnel and resource funding requirements for developing a comprehensive compliance program and submit a proposal for consideration by appropriate Executive Department agencies and the General Assembly".

Throughout the Performance Audit and the ongoing discussions with the Department, the Legislative Auditor's own audit staff acknowledged the intensive nature of the labor required to investigate and examine whether a particular property owner's Homestead eligibility should be removed and for which years. The Legislative Auditor had a team of two Audit managers and six field auditors at the Department's offices for six full months to find and authenticate limited numbers of improper Homestead Tax Credits. In this regard, it must be emphasized that the Department's employees in the local Assessment Offices who perform Homestead audits do so on a part-time basis because they have other regular Real Property reassessment duties to perform each day.

The Department is going to discuss below the specific Findings and Recommendations of the Legislative Auditor and provide the General Assembly the information it needs for an informed decision about the feasibility and timing of implementing the Auditor's Recommendations.

Auditor's Finding 1

DAT had not developed a documented comprehensive compliance program to help ensure that HTC's are only granted for eligible properties.

The Recommendation accompanying this Finding is for the Department to develop a comprehensive written manual describing all of the specific procedures

to validate Homestead eligibility. This written manual will combine existing procedures historically utilized by local Assessment Offices to validate Homestead eligibility and the newer procedures developed by the central Homestead Application Processing Unit in 2007 as well as incorporating certain new automated procedures proposed in this Audit. While the Auditor's comments note that some local Assessment Offices did not consistently perform certain detection methods, there is no recognition that a Supervisor of Assessments made the decision to utilize the limited staff time to pursue other checks (*e.g.* name matches) that have proven more effective in that office for detecting improper Homestead Credits.

By December 31, 2013, the Department will prepare a written manual that will describe in detail the specific audit functions to be performed by the central Application Unit and the local Assessment Offices, respectively. The manual will include a mandatory monthly schedule for the audits being performed by the different offices. The resulting audit reports will be retained and a supervisory level employee will sign and date the particular report verifying what information has been reviewed. The central administration of the Homestead Tax Credit Program will monitor the activities performed by the local Assessment Offices.

The final part of the Recommendation for this Finding contains the directive that the Department prepare an analysis of necessary personnel and funding requirements for a submission of a proposal for consideration by appropriate Executive Department agencies and the General Assembly. The Department has prepared this information as part of its Fiscal Year 2015 Budget Request.

Auditor's Finding 2
Procedures over the HTC application processing need improvement.

The Department agrees with the Auditor's Finding here that certain "enhancements" to existing processes and data programs should be added. The Department will implement these Recommendations during the current 2014 Fiscal Year. The Recommendation to compare the names on HTC applications to the listed owners will require that the existing data processing program performing this function be rewritten to eliminate the large number of "false positive" exceptions based upon reverting to a maiden name by the former spouse or *et al* ("and others") ownership of the property. This revised computer program will retroactively compare applicant name in the property records with all electronically filed applications for prior years. Regarding the part of the Recommendation for an independent managerial employee to review certain information, the Department will have to assign a manager from another Department program to perform this review on a test basis because of the limited number of employees in the Homestead Application Processing Unit.

Finally, there is a Recommendation here that the Department ensure the backlog of 175,000 applications received in the last months before the filing deadline be processed as soon as possible. All of these applications were already processed by April 15, 2013. It should be noted that during the months of August and September 2013, the Department did another special statewide mailing of an application to the 131,000 homeowners who received a 2013 Homestead Credit but still had not yet submitted an application. In response to the mailing, the Department has received over 55,000 new applications being processed at the present time.

Auditor's Finding 3

DAT did not establish adequate controls over its automated reports to prevent or detect unauthorized changes to HTC eligibility determinations.

This Finding and the Recommendations deal with matters of internal IT administration within the Department related to the Homestead Tax Credit Program. By December 31, 2013, the Department will establish a procedure to have an independent supervisory review of changes to critical fields such as deleting a Homestead application. In another part of the Finding, the Department has already begun restricting access to its Real Property AAVS automated assessment system as it relates to the Homestead Qualification Field. The only reason that 371 of 400 employees in Real Property had access that included the ability to change information (such as the Homestead Qualification Field) was because AAVS is a new data system itself where the Department's Real Property assessment employees (in the local Assessment offices) were testing its applications and functionality at that particular time. It is also important to keep in mind that the Department's AAVS system has a provision to permanently record the identification number of any employee making a change to a field. The Department's appropriate AAVS data manager will continue to monitor and eliminate data permission for employees who do not have an ongoing need for such access to perform their specific duties. Finally, the Department submits that the last part of the Finding and Recommendation dealing with possible discrepancies between AAVS and the Homestead Application on Homestead eligibility are due simply to timing issues based upon the updating of the system by the agency's IT Unit. By December 31, 2013, a new automated report for identifying any discrepancies will be written and implemented.

Auditor's Finding 4

Certain policies and requirements could be established to improve DAT oversight of the HTC program.

The substance of this Finding and Recommendation is that the Legislative Auditor wants the Department to adopt a policy on the **number** of back years of recaptured Homestead Tax Credits that the Department believes is not supported by Maryland law. The Department's legal counsel believes that the Legislative

Auditor is incorrectly relying on a general statute of limitations provision (Tax-Property Article §14-915) that allows for the recovery of taxes imposed for the most recent **seven** years. It is DAT's legal position that the number of years that the Department and the local government can collect for back years of improper Homestead Credits is dependent upon finding a specific statutory authorization for collecting Homestead Credits for a number of years.

The first specific statutory provision authorizing recapture of erroneous Homestead credits was not enacted by the General Assembly until the passage of Chapter 701, Laws of Maryland 2012 adding subsection (n) to Tax-Property Article §9-105. This enactment also created a 25% penalty for willful misrepresentation beginning for the July 1, 2012 tax year. The important point to be noted is that this is the only specific statutory authority to recapture erroneous Homestead Tax Credit for prior tax years but it begins with the July 1, 2012 tax year and going forward.

Contrary to the statement in the Legislative Auditor's Finding here, the Department has had an established policy of collecting prior year credits for a period of **three** previous years. This three year period is what the Auditor observed in the three Assessment Offices in which it conducted its site visit audits. DAT decided on the three previous year recapture period for several reasons: (1) the three year recapture is consistent with the number of previous years that "escaped property" may be assessed under Tax-Property Article §8-417; (2) the time period is consistent with the limited three year period by which a homeowner can claim a refund of taxes erroneously paid found at Tax-Property Article §14-915; (3) the three year period is consistent with the number of years of federal tax return information that the Department is able to retain for data storage purposes in order to audit Homestead eligibility in the first place; and (4) the majority of the local governments (whom the Auditor notes have the legal responsibility to collect taxes and who would receive the bulk of the tax dollars for the recaptures) have requested that time period be used by the Department.

On October 11, 2013, the Maryland Tax Court issued a decision affirming the Department's authorization for the City of Baltimore to collect back **three years** of erroneously granted Homestead Credits for the years 2008, 2009 and 2010. *Phillip Mizrach v. State Department of Assessments and Taxation*, (Md. Tax Court Case No. 13-MI-BA-0436). Since these years predated the 2012 enactment by the General Assembly specifically codifying the right to collect back years of erroneous tax credits from that year forward, the Maryland Tax Court had to find another statutory authority for recovering these credits for the three previous years. Taking judicial notice of Court of Appeals decisions that find these "tax credits are by their nature an exemption", the Tax Court then held that the "escaped property" provisions for exempt property (Tax-Property Article §8-417) are applicable to the tax credits for three years for this property. That statute notes that escaped property for exempt property may be taxed for the current tax year as well as three previous years. Significantly, the Maryland Tax

Court also declined to rule on the applicability of the seven year limitation on the collection of taxes. In other words, the Maryland Tax Court found statutory authority for collecting three and not seven years of previous tax credits.

Pending the outcome of likely appeals in the *Mizrach* case, the Department will continue to follow a policy statewide of advising local governments to recapture tax credits for three prior years. It also should be noted that when the Department's employee finds more years than three years in which the homeowner has improperly received the County Homestead Credit, then the employee will advise the county government employee of the additional years so that the county can make its own billing determination.

Finally, because of the amount of time it takes to investigate and document the removal of several years worth of credits, this is a Recommendation by the Legislative Auditor that will increase the need for new additional employees in order for the Department to also conduct these audits. Again, it must be remembered that the Department has to advise in writing each homeowner of his or her right to appeal within thirty (30) days the removal of any Homestead Credit.

Auditor's Finding 5

DAT does not have a plan to investigate the propriety of HTCs received in prior years on properties removed from eligibility after the application filing period.

Upon further examination of this matter after the "exit" discussion with the Legislative Auditor, the Department has now concluded that the Auditor's Recommendation to develop a plan to investigate non-filers of Homestead applications for improper credits in prior years is simply unworkable and unrealistic. The Auditor's comments note that there are 512,823 properties currently "grandfathered" in as being eligible for (though not necessarily receiving) the HTC, and they have not submitted an application. The Auditor's verbal suggestion made to the Department to "test" the properties receiving the highest amounts of credit is not an effective guideline because most of the largest credits are typically received by longtime homeowners still actively residing in their homes. Even with an increased number of new Homestead employees, the Department cannot represent to the General Assembly that the majority of even 131,000 non-filers receiving a credit can be individually audited, especially given the tens of thousands of accounts in the other audits the Department is to perform. A crucial fact that the Legislative Auditor apparently overlooked is that the Department does not have a Social Security number for the homeowner not filing an application, and therefore, the automated audits that rely on a Social Security number cannot be used to do an initial screening of this volume of property owners. This audit will require multiple, manual lookups of every account.

Auditor's Finding 6

DAT's real property records were not formatted in a manner to facilitate computer matches.

The Department's new AAVS Real Property system allows for the entry of all owners' names regardless of how many owners there are. This AAVS system is utilized in all county Assessment Offices except for Baltimore City where the City Government uses its own property record system to provide lesser ownership information to the Department. The Department's new property record system does format names in a manner to facilitate computer matches for Homestead audit purposes.

Prior to the implementation of the AAVS system, there are 2.2 million existing ownership records where there are incomplete listings of owners' names and old archaic conventions (*e.g.* "WF" wife or et al for others). It is cost prohibitive for the Department to obtain a contractor to research 2.2 million deeds and add a complete listing of all owners' names and in the same format without abbreviation.

The Department has issued a memorandum reminding its local office transfer clerks in the 23 counties to enter all of the ownership names in the same way and locate in a specific place within the naming field odd legal ownership interests (*e.g.* Smith John T Jr Trustee and not Smith Jr Trustee John T).

It needs to be noted for the record that this Recommendation by the Auditor will produce little audit value because it affects only recently transferred accounts where the new owner(s) must submit a Homestead Application with his or her Social Security number before he or she can receive Homestead eligibility on that property. If the General Assembly does not again change the current December 30, 2013 Homestead application filing deadline, then the more effective means to find homeowners receiving Homestead credits on more than one property is to run a Social Security number match for every property in the State still eligible for a Homestead Credit because of the submission of an application for that property.

Auditor's Finding 7

Additional automated procedures are available to help ensure properties remain eligible for the HTC on an ongoing basis.

The Department strongly agrees with the Auditor's Finding and Recommendation here that additional automated audits can be developed to detect ineligible HTC properties by using data matches against other State and local agencies' records. However, the volume of accounts that will have to be individually reconciled by the Department in each of these audits are at such levels that it will require a significant increase in the number of new employees to

conduct these audits. To cite just one example, the Department already prepared on July 2, 2013 (with the cooperation of the Maryland Motor Vehicle Administration) a new comparative report on the number of Maryland property owners who surrendered their driver's licenses to another State. There were 12,000 drivers on this report who surrendered their licenses in one year. The Department has to investigate each account to determine whether the Homestead Tax Credit should not be removed because there are multiple co-owners where one recently separated spouse owning the property still resides there or an adult child co-owner of the property still resides there after his or her parents retired to another state. In each instance, the Department is legally required to send the Homestead applicant homeowner a letter providing the person the opportunity to explain what occurred and advising him or her of the right to appeal a negative determination if the Department decides to remove the credit.

Each type of the new automated audits proposed by the Legislative Auditor will generate tens of thousands of accounts to be investigated each year. The Office of Legislative Auditor specifically states in its Performance Audit the following: "While automated procedures to detect properties improperly designated as eligible for the HTC can be performed without a large commitment of resources, investigating potentially ineligible properties can be a time-consuming process." (pg. 31).

Summary

The Department has endeavored in this Report to provide the General Assembly the kinds of detailed information it needs to justify a commitment of new personnel and other resources to conduct the audits proposed in the Performance Audit of the Legislative Auditor for the Homestead Tax Credit Program. The Department has been careful to clearly state which of the Auditor's Recommendations cannot be implemented in a meaningful way without that commitment of the additional resources. At the same time, the Department has provided the specific date by which the Auditor's other Recommendations will be implemented by the Department.