



GARLAND

INTERNAL AUDIT

Rental Registration – Tax Exempt Status Audit

Craig Hametner, CPA, CIA, CISA, CMA, CFE
City Auditor

Prepared By

Marla Hamilton, Staff Auditor

Reviewed By

Jed Johnson, Sr. Auditor

INTERNAL AUDIT DEPARTMENT

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Authorization

We have conducted an audit of the tax exempt status of registered rental properties in the City of Garland. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

Determine if the City's registered rental properties carry any inappropriate tax exemptions and calculate the potential revenue.

Scope and Methodology

We conducted the 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 conclusions based on our audit objectives.

To adequately address the audit objective, we performed the following:

- Obtained database records from Dallas Central Appraisal District (DCAD) that included over 68,000 residential and business property listings with appraised values for 2011 and 2012 tax years.
- Obtained rental registration database records from the Code Enforcement Department consisting of over 8,100 records.
- Obtained DCAD's property tax rates for 2011 and the estimated tax rate for 2012.
- Compared the two different databases to identify properties with exemptions.

Overall Conclusion

We found 745 registered rental properties with possible inappropriate exemptions that have been registered with the City as rental properties. The total estimated approximate amount of lost revenue for 2011 was \$64,222. If these exemptions are not removed by the DCAD, the future approximate lost revenue for the City will be \$81,864 for 2012. DCAD has been notified of these properties and is in the process of researching each one individually to determine if the exemptions should be removed. Due to DCAD's current process, we will not know the actual lost revenue for at least 60 days from approximately October 21, 2012.

Background

According to the Tax Code, Title 1 - Property Tax Code, the State of Texas has jurisdiction to tax all real and tangible personal property located in this state unless exempt by law. The law also gives authority to "Taxing Units" such as DCAD to collect taxes. Taxing Units calculate estimated property taxes due based on the approved rate multiplied by the taxable value of the property. ⁽¹⁾

As allowed by the law, homeowners may apply for certain exemptions on his or her principal residence which remove a portion of the home's value from taxation thereby effectively lowering the taxable value of the property. A taxpayer's principal residence homestead qualifies for exemptions and is defined by the law as a separate structure, condominium or a manufactured home located on owned or leased land, as long as the individual living in the home owns it. A qualified residential structure does not lose its character as a residence homestead if a portion of the structure is rented to another or is used primarily for other purposes that are incompatible with the owner's residential use of the structure. ⁽¹⁾

In order to qualify for an exemption, the home's owner must be an individual (for example: not a corporation or other business entity) and use the home as his or her principal residence on January 1 of the tax year. An individual age 65 or older, or disabled may receive additional exemptions on the home under the same conditions. ⁽¹⁾

If a taxpayer should move or the qualification ends, he or she must inform the appraisal district in writing before the next May 1st. The law allows a taxpayer to be temporarily away as long as he or she does not establish another principal residence and intends to return in less than two years. A taxpayer may exceed the two year limit if proof is provided that he or she is in military serving outside of the United States or lives in a facility providing services related to health, infirmity or aging. ⁽²⁾

City of Garland Tax rates for tax years 2011 and 2012 are as follows ⁽²⁾:

Optional Homestead	Over 65	Disabled Person	Estimated Tax Rate
8% of home value	\$51,000	\$51,000	0.7046%

Source: DCAD's website

Example Estimated Tax Calculation for the median home value of \$98,840 for 2012 and the median home value of \$102,160 for 2011 with a homestead exemption:

Tax Year	Taxing Authority	Median Home Value	-	Optional Homestead	=	Taxable Value	x	Tax Rate	=	Est. Taxes Due
2012	COG	\$98,840	-	(\$98,840 x 8%)	=	\$90,932.80	x	0.7046%	=	\$640.71
2011	COG	\$102,160	-	(\$102,160 x 8%)	=	\$93,987.20	x	0.7046%	=	\$662.23

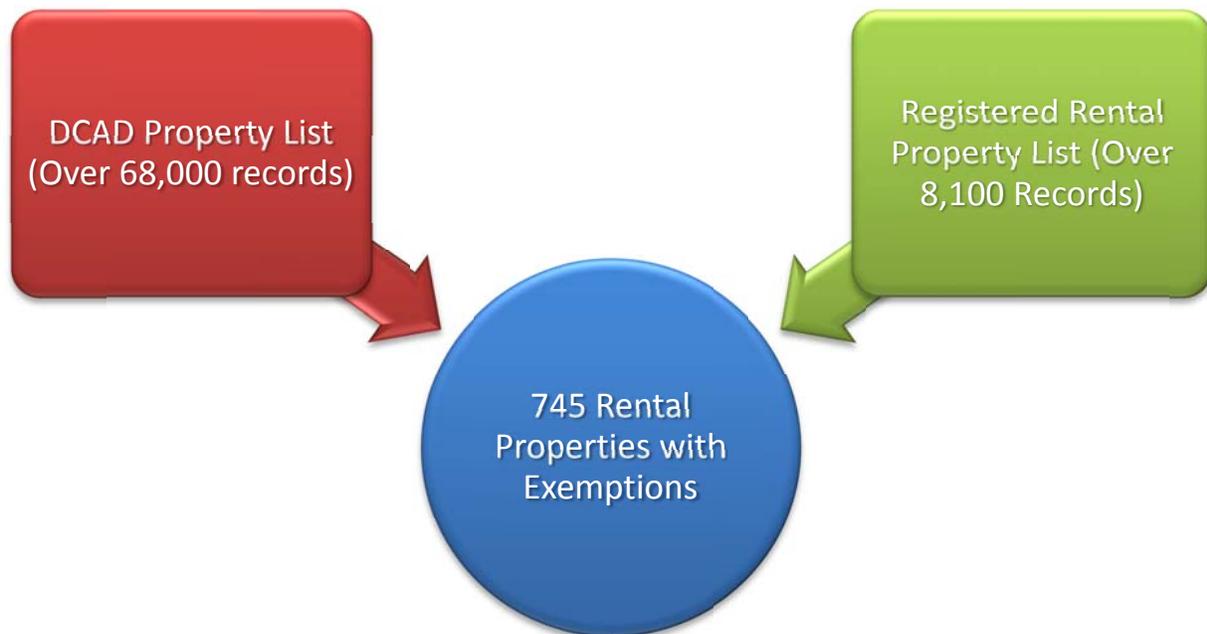
Source: Internal Audit

(1) State of Texas Tax Code, <http://www.statutes.legis.state.tx.us/>

(2) DCAD, <http://www.dallascad.org/>

Analysis

We obtained a database of records from DCAD that included over 68,000 residential and business property records with appraised values for the 2011 and 2012 tax years as of March 2012. We then compared this to the rental registration database obtained on July 3, 2012 from Code Enforcement. The rental registration list comprised of over 8,100 records. We matched the rental registration database with DCAD's property database based on property address to determine if exemptions were present on the rental registration list. Once the match was completed, we deleted any records within the rental registration database with no exemption listed reducing the amount of properties to 745.



Source: Internal Audit

We calculated the number of years each property was registered by subtracting the initial registration date with the present date to determine how long the registered property carried the exemption(s).

We provided the list of 745 properties to DCAD who agreed to research each property for inappropriate exemptions and send a letter to the homeowners; however, as previously stated, we will not know the actual lost revenue for approximately 60 days from October 21, 2012.

We used formulas to calculate the approximate value of taxes owed to the City of Garland (COG) with and without the exemptions for each individual property for both tax years. The formulas used were as follows:

- A. (Taxable Value – Exemptions) × COG Rate = COG Tax Amount
- B. (Taxable Value) × COG Rate = COG Tax Amount w/o Exemptions

We subtracted the COG Tax Amount from the COG Tax Amount w/o Exemptions to obtain the difference.

Once the Difference was calculated, we calculated a total approximate value of lost revenue for 2011 and estimated the future possible lost revenue for 2012 if the exemptions are not removed. The table below summarizes the results:

Potential Maximum Lost Revenue for 2011 and 2012

No. of Registered Rental Properties	Years Holding Exemptions	2011 Lost Revenue	2012 Future Lost Revenue
49	> 5 years	\$ 5,471	\$ 5,398
66	4 – 5 years	6,477	5,560
120	3 – 4 years	11,046	10,484
167	2 – 3 years	17,536	17,281
200	1 – 2 years	23,692	23,361
143	0 – 1 year	-	19,780
745		\$ 64,222	\$ 81,864

Source: Internal Audit

We believe the greatest probability of revenue recovery lies within the properties that have been registered as rentals with the City for greater than two years. According to the State Tax Code, the City has authority to collect the previous five years in back taxes.

City of Garland tax rates for the previous five years are as follows:

Tax Year	Tax Rate	Optional Homestead	Over 65	Disabled Person
2011	0.7046%	8%	\$ 51,000	\$ 51,000
2010	0.7046%	8%	51,000	51,000
2009	0.7046%	8%	51,000	51,000
2008	0.6996%	8%	51,000	51,000
2007	0.6886%	7%	51,000	51,000

Source: DCAD’s website

Recommendations

Our recommendations are as follows:

1. Perform this audit every two to three years to ensure registered rental properties are in compliance with the State Tax Code and the City of Garland receives the appropriate revenue.

Management Response: Concur with Internal Audit's recommendation.

2. Request Tax Department check exemption status with DCAD on all newly registered rental properties periodically throughout the year and notify DCAD if an exemption is found.

Management Response: Concur; the Tax department is currently discussing the frequency of the reporting opportunity with DCAD. DCAD has agreed to provide the necessary database each June. They will work with us to review and update their records when invalid property exemptions are identified as a result of this process.

Action Plan: A recent meeting with the cities IT Department and Code Enforcement has resulted in a new report/query being developed. This new report will compare the DCAD database and CRM Rental Registration database. Once the report is set up, the Tax Department will be able to generate the information necessary to compare the two databases. The Tax Department will continue to work with DCAD, IT and Code Enforcement to ensure the reporting mechanism is in place that will ensure verification of exemption status on newly registered rental properties.

Implementation Date: May 2013