

RON GALPERIN  
CONTROLLER

August 19, 2015

Honorable Eric Garcetti, Mayor  
Honorable Michael Feuer, City Attorney  
Honorable Members of the Los Angeles City Council

**Re: Smart Data Sharing: A Path To More Revenue**

Taxes and fees collected by agencies of our county and state governments on the City's behalf account for 44% of the City's General Fund revenues.

For too long, the City has merely counted what it received from these agencies instead of looking critically at how much it *could* be receiving, then working with the other agencies to get better results. As a consequence, there have been lost opportunities to collect millions of dollars in tax and other revenues to fund services Angelenos depend upon.

Data sharing between the City, the County and the State would help all to take advantage of the revolution in big data--and to identify avoiders of state and local taxes.

While it is not possible to forecast with certainty how much in additional tax revenues increased data sharing will yield the City, our auditors predict that the various efforts we are advocating could eventually add \$20 million per year or more to City revenues. That is no small sum. It is, to pick one example, roughly five times what the City spends to counsel and shelter victims of the scourge of domestic violence, which is the subject of another audit forthcoming from my office. While there are certain practical and legal complexities, we believe that, with the right strategies, we can achieve what we are recommending.

In this audit, we delve deeply into esoteric areas of local finance to recommend:

- **GROSS RECEIPTS** -- That the City, which collects a gross receipts tax on business conducted in Los Angeles, share its information on gross receipts with the County Assessor, who is responsible for collecting taxes on business equipment. The idea is

that the Assessor could use the City's information to identify businesses that report significant revenues to the City but report to the County little or no business equipment or assets, on which the law says they should be paying business personal property taxes. We currently get more than \$30 million from business personal property taxes annually.

- **ASSESSMENTS** -- That the City provide financial information to the Assessor that the City already collects on more than 500 larger hotels within City limits. Information on gross receipts and hotel occupancy would better equip the County Assessor to calculate how much income a hotel generates—which is one method appraisers use to figure out the taxable value of hotel buildings and land.
- **REASSESSMENTS** -- That other County agencies, such as the County Recorder and County Department of Public Health shall promptly notify the City and the County Assessor when they get information that property owners have died. With lawful exceptions, including deaths that result in inheritances by a spouse, deaths of property owners result in property transfers that should trigger substantially higher reassessments under Proposition 13, resulting in greater property tax revenues for the City.
- **SALES AND USE TAXES** -- That the City exchange information with the State Board of Equalization, which oversees sales tax collections—some of which are then distributed to the City. Information in City files on business' gross receipts will help the State agency identify businesses that report high volumes of sales to the City but lower volumes to sales tax authorities. Conversely, information in the State agency's files will help the City identify businesses that report high sales to the State but low gross receipts to the City. The City took a partial step in this direction three months ago while this audit was under way. While the City may be contemplating an eventual end to the business gross receipts tax, so long as it is still in place, it should be enforced fairly and equitably.
- **REAL PROPERTY TRANSFER TAXES** -- That the City consider ways to improve collection of its transfer tax of \$4.50 per \$1,000 of the sales price of real property. Collection gets tricky when property is transferred within a legal entity and no recordation of the transfer takes place. Further, the City, unlike several others in California, deducts the value of a property's liens and encumbrances from its sales price in calculating how much in real property transfer taxes is owed. The City should consider removing the latter provision from its code.

The fact that pooling data leads to more tax revenues grew out of work I did prior to becoming City Controller, when I chaired the lay-led Commission on Revenue Efficiency (CORE). I would like to thank my then-fellow commissioners for laying the groundwork for this new report and its recommendations which call for what I believe are smart uses of big data.

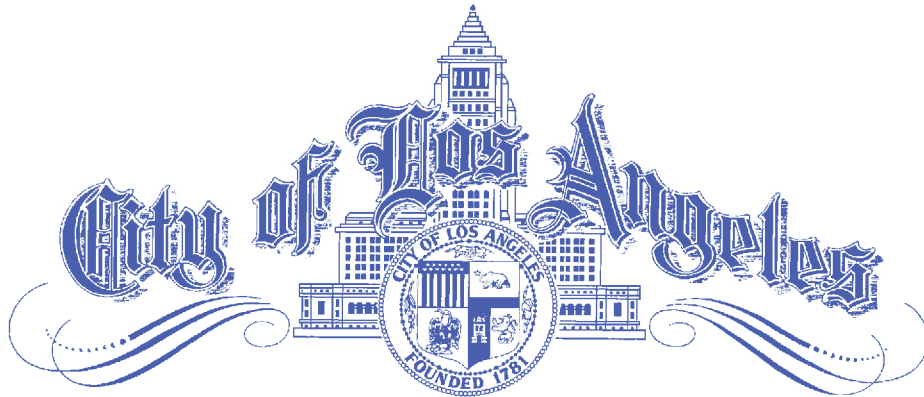
Honorable Eric Garcetti, Mayor  
Honorable Michael Feuer, City Attorney  
Honorable Members of the Los Angeles City Council  
August 19, 2015  
Page 3 of 3

I want to thank the Honorable Jeffrey Prang, Assessor for the County of Los Angeles, the County Recorder's office, the State Board of Equalization and the State Franchise Tax Board which have expressed their support for data sharing. This presents an opportunity for the City, County and State governments to work together to benefit the residents and businesses of Los Angeles.

Respectfully Submitted,

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

RON GALPERIN  
City Controller



RON GALPERIN  
CONTROLLER

August 19, 2015

Antoinette Christovale, CPA, Director of Finance/City Treasurer  
Office of Finance  
200 N. Spring Street, Room 220  
Los Angeles, CA 90012

Dear Ms. Christovale:

Enclosed is the final report entitled "Smart Data Sharing: A Path to More Revenue", that reviewed the City's practices regarding the City's General Fund revenue remitted by other government agencies. A draft of this report was previously provided to your Office and comments provided at the exit conference held on May 5, 2015 were considered as we finalized the report.

Please review the report and advise the Controller's Office by September 18, 2015 of the actions planned and/or taken to implement the recommendations that are addressed to the Office of Finance. An electronic template has been provided to your staff to facilitate this process.

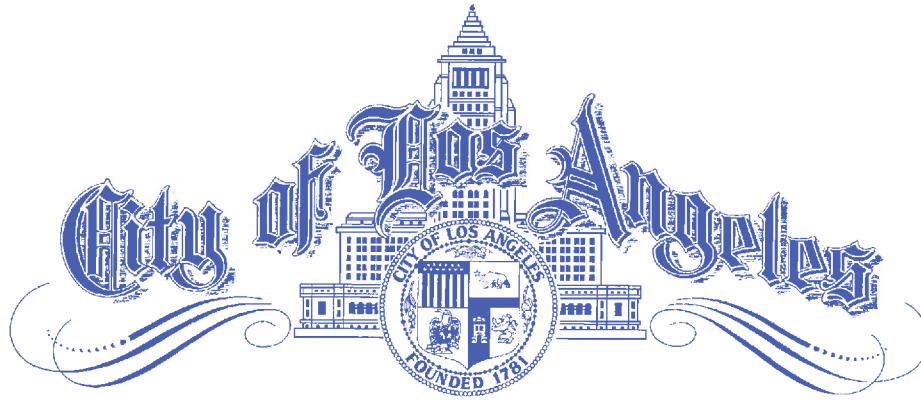
If you have any questions or comments, please contact me at [farid.saffar@lacity.org](mailto:farid.saffar@lacity.org) or (213) 978-7392.

Sincerely,

  
FARID SAFFAR, CPA  
Director of Auditing

Enclosure

cc: Ana Guerrero, Chief of Staff, Office of the Mayor  
Sharon Tso, Chief Legislative Analyst  
Holly L. Wolcott, City Clerk  
Independent City Auditors



RON GALPERIN  
CONTROLLER

August 19, 2015

Miguel Santana, City Administrative Officer  
Office of the City Administrative Officer  
200 N. Main Street, Suite 1500  
Los Angeles, CA 90012

Dear Mr. Santana:

Enclosed is the final report entitled "Smart Data Sharing: A Path to More Revenue", that reviewed the City's practices regarding the City's General Fund revenue remitted by other government agencies. A draft of this report was previously provided to your Office and comments provided by your staff at the exit conference held on April 21, 2015 were considered as we finalized the report.

Please review the report and advise the Controller's Office by September 18, 2015 of the actions planned and/or taken to implement the four recommendations that are addressed to your Office. An electronic template has been provided to your staff to facilitate this process.

If you have any questions or comments, please contact me at [farid.saffar@lacity.org](mailto:farid.saffar@lacity.org) or (213) 978-7392.

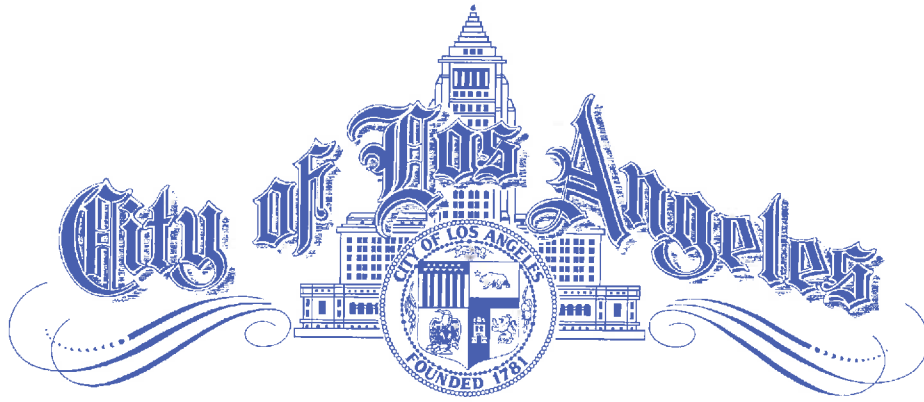
Sincerely,

*for Farid Saffar*

FARID SAFFAR, CPA  
Director of Auditing

Enclosure

cc: Ana Guerrero, Chief of Staff, Office of the Mayor  
Sharon Tso, Chief Legislative Analyst  
Holly L. Wolcott, City Clerk  
Independent City Auditors



RON GALPERIN  
CONTROLLER

August 19, 2015

Claire Bartels, Chief Deputy Controller  
Office of the Controller  
200 N. Main Street, Suite 300  
Los Angeles, CA 90012


Dear Ms. Bartels:

Enclosed is the final report entitled "Smart Data Sharing: A Path to More Revenue", that reviewed the City's practices regarding the City's General Fund revenue remitted by other government agencies. A draft of this report was previously provided to your Office and comments provided by staff of the Financial Analysis and Reporting Division were considered as we finalized the report.

Please review the report and advise the Audit Division by September 18, 2015 of the actions planned and/or taken to implement the two recommendations that are addressed to the Controller's Office. An electronic template has been provided to your staff to facilitate this process.

If you have any questions or comments, please contact me at [farid.saffar@lacity.org](mailto:farid.saffar@lacity.org) or (213) 978-7392.

Sincerely,

*for*   
FARID SAFFAR, CPA  
Director of Auditing

Enclosure

cc: Ana Guerrero, Chief of Staff, Office of the Mayor  
Sharon Tso, Chief Legislative Analyst  
Holly L. Wolcott, City Clerk  
Independent City Auditors



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public sector management consulting



August 19, 2015

Mr. Ron Galperin  
City Controller  
City of Los Angeles  
200 North Main Street, Room 300  
Los Angeles, CA 90012

Dear Mr. Galperin:

Harvey M. Rose Associates, LLC is pleased to present this report, *Smart Data Sharing: A Path to More Revenue*. This report was prepared in response to your office's request for an evaluation of current revenue collection practices pertaining to City General Fund revenues remitted by non-City entities such as Los Angeles County, the State of California and the Superior Court of the Los Angeles County.

Thank you for providing our firm with the opportunity to prepare this report for the City of Los Angeles. Upon your request, we are available to present the report to the City Council or other City officials and to respond to any questions about this report from you and your staff.

Sincerely,

A handwritten signature in blue ink that reads 'Fred Brousseau'. The signature is fluid and cursive, written over a light blue circular stamp.

Fred Brousseau  
Project Manager



# AUDIT

## City of Los Angeles

### SMART DATA SHARING: A PATH TO MORE REVENUE

August 19, 2015



**RON | GALPERIN**  
Los Angeles City Controller  
[controller.lacity.org](http://controller.lacity.org)





# Contents

	PAGE
SUMMARY.....	i
OVERALL ASSESSMENT .....	iii
BACKGROUND .....	1
AUDIT FINDINGS.....	26
SECTION I: BUSINESS PERSONAL PROPERTY TAX .....	26
SECTION II: REAL PROPERTY TAX .....	55
SECTION III: REAL PROPERTY (DOCUMENTARY) TRANSFER TAX .....	69
SECTION IV: SALES TAX .....	87
SECTION V: COURT FINES.....	97
SECTION VI: REVENUE BUDGETING.....	103
GLOSSARY OF KEY TERMS.....	115
APPENDIX I: AUDIT ACTION PLAN .....	116
APPENDIX II: FINANCIAL SCORECARD.....	127
APPENDIX III: SCOPE & METHODOLOGY .....	127
APPENDIX IV: BENCHMARKING .....	130
<b><u>EXHIBITS:</u></b>	
<b>EXHIBIT 1:</b> PROPOSED BUDGETED GENERAL FUND REVENUES REMITTED BY COUNTY AND STATE AGENCIES FISCAL YEAR 2014-15.....	2
<b>EXHIBIT 2:</b> SPECIFIC DUTIES OF CITY OFFICERS PERTAINING TO GENERAL FUND AND OTHER REVENUES .....	4
<b>EXHIBIT 3:</b> CITY AGENCIES RESPONSIBLE FOR MONITORING GENERAL FUND REVENUES REMITTED BY EXTERNAL ENTITIES .....	8

# Contents

<b>EXHIBIT 4:</b> RESULTS OF ANALYSIS OF BUSINESSES REGISTERED WITH CITY BUT NOT FOUND IN COUNTY ASSESSOR RECORDS.....	34
<b>EXHIBIT 5:</b> DISTRIBUTION OF BUSINESSES AND VALUE ASSESSED BY THE COUNTY ASSESSOR IN THE CITY OF LOS ANGELES .	39
<b>EXHIBIT 6:</b> NUMBER OF BUSINESSES IN COUNTY ASSESSOR'S 2014 BUSINESS PERSONAL PROPERTY DATABASE .....	44
<b>EXHIBIT 7:</b> TEN BUSINESSES WITH THE LOWEST REPORTED BUSINESS PERSONAL PROPERTY VALUES IN THREE BUSINESS SECTOR CLASSIFICATIONS .....	47
<b>Exhibit 8:</b> ESTIMATED REVENUE EFFECTS OF POTENTIAL BUSINESSES UNDER-VALUED BUSINESS PERSONAL PROPERTY TAX.....	51
<b>EXHIBIT 9:</b> STATE BOARD OF EQUALIZATION LISTING OF PROPERTY CHANGES IN OWNERSHIP EXCLUDED BY LAW FROM RE-APPRAISAL.....	65
<b>EXHIBIT 10:</b> ESTIMATED AGGREGATED REVENUE LOSS TO THE CITY OF LOS ANGELES THROUGH 2011 DUE TO EXEMPTION OF ASSUMED LOANS FROM REAL PROPERTY TRANSFER TAX.....	78
<b>EXHIBIT 11:</b> ESTIMATED ANNUAL LOSS TO THE CITY OF LOS ANGELES FROM UNDER-PAYMENT OF CITY REAL PROPERTY TRANSFER TAX BASED ON RECOVERIES BY THE COUNTY OF RIVERSIDE .....	83
<b>EXHIBIT 12:</b> DECREASE IN COURT-ORDERED DEBT REVENUES TO THE CITY .....	99
<b>EXHIBIT 13:</b> TRAFFIC AND NON-TRAFFIC MISDEMEANOR AND INFRACTION CITATIONS IN LOS ANGELES COUNTY.....	100
<b>EXHIBIT 14:</b> DECREASE IN CITATIONS ISSUED BY THE LAPD .....	100
<b>EXHIBIT 15:</b> REDUCTION IN DISTRIBUTION OF COURT-ORDERED DEBT REVENUE.....	101
<b>EXHIBIT 16:</b> ACCURACY OF PROPERTY TAX ESTIMATES APPEAR RELATED TO LENGTH OF ESTIMATION PERIODS .....	106

# Contents

<b>EXHIBIT 17:</b> DEADLINES TO ISSUE PROPOSED GENERAL FUND REVENUE BUDGETS AND AVERAGE PROPERTY TAX BUDGET DISCREPANCIES .....	107
<b>EXHIBIT 18:</b> ESTIMATED AND PROJECTED ASSESSED PROPERTY VALUE GROWTH FY 2014-15 FOR THE CITY AND COUNTYWIDE.....	108
<b>EXHIBIT 19:</b> IMPACT OF EARLY PROPERTY TAX ESTIMATES ON FY 2013-14 BUDGET .....	109
<b>EXHIBIT 20:</b> CITY OF LOS ANGELES PROPERTY TAX BUDGET VERSUS ACTUAL RECEIPTS FYS 2010-11 THROUGH 2012-13 .....	111

## Summary

This report, *Smart Data Sharing: a Path to More Revenue*, focuses on key receipts, such as taxes on sales, property transfers, real property – inclusive of receipts previously distributed to redevelopment areas – and business personal property.

We documented between \$19.6 to \$21.6 million in estimated annual, ongoing City General Fund receipts foregone as a result of current practices by the City, the responsible agencies, or both. Since Los Angeles County receives a portion of some of these same revenues, its losses were estimated to be at least \$6.5 million per year for just some of the revenues covered in this audit report. These estimates are extremely conservative, due to lack of County data necessary to quantify amounts. Certain losses identified in this report are not quantified at all, due to lack of data, but are nonetheless likely to be material.

This estimated range does not include losses to other taxing entities, such as the other cities in Los Angeles County, or school and special districts. However, we found certain practice deficiencies that affect all taxing jurisdictions. For example, the County Assessor lacks the information necessary to consistently identify properties that are required by law – as a result of certain transfers – to be evaluated for re-assessment from below market to market values. Such properties exist Countywide and, therefore, it is likely that every taxing jurisdiction in the County experiences ongoing revenue reductions as a result of this information gap.

For example, as detailed in the report, both the City and the County possess information important to the timely and complete valuation of properties within the City for property tax purposes, but this information is not shared with the County Assessor. This means that some individuals and businesses that owe taxes may pay less than other similarly situated peers, and that taxing entities may never receive some of the revenues to which they are entitled. Similarly, we found examples of variation in the assessment of the value of business equipment and furnishings, with some businesses paying tax on far less equipment value than others within the same industry. In other cases, we found examples of active businesses with storefronts with no assessed values for equipment or furnishings.

In addition to the major tax receipts, we evaluated smaller revenues, including court fines, tobacco tax settlement monies and “excess” vehicle license fees and have made recommendations where relevant to improve transparency regarding some of these revenues.

With regard to the City's budgeting of intergovernmental revenues, we identified a mismatch between the City's budget calendar, which establishes early dates for preparation of revenue estimates, and the availability of information essential to making estimates of major General Fund revenues, which is not available until after the estimates must be prepared.

We obtained budget and actual information, as available, from selected cities for FYs 2009-10, 2011-12 and 2012-13, to identify cities whose intergovernmental revenue estimates were relatively accurate. In general, cities struggled to estimate intergovernmental revenues accurately on a consistent basis during this volatile period. However, we did note a correlation between cities with budget timelines that permit access to projected property tax roll information and the accuracy of total property tax estimates. We also obtained limited information from other county Recorders and Assessors regarding their practices. Where relevant, this information is presented in the detailed audit findings.

The need to address intergovernmental revenues through audits was identified by the Ad Hoc Commission on Revenue Efficiency (CORE), which was chaired by the City Controller. Review of practices underlying those receipts is warranted as those revenues constituted 44.2 percent of all City General Fund monies in the proposed FY 2014-15 budget.

Numerous opportunities exist for the City of Los Angeles and County and State agencies to share information and resources to enable proper application of State tax laws and local ordinances to ensure all revenues that are due to local agencies are in fact collected and remitted. In addition to increasing receipts for local agencies, sharing of information would also result in greater equity in the assessment and collection of taxes by making the identification and collection of taxes due more systematic and comprehensive.

## I. Overall Assessment

State and local governmental agencies need to share information to ensure proper tax assessment and collection, but we found that they are not doing so, and this lack of collaboration results in material amounts of lost revenue to the City of Los Angeles and other taxing entities. The basis for this conclusion is detailed in the Key Points presented below.

## II. Key Points

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*Non-assessment of business personal property by the County costs the City and the County an unquantified amount annually.*

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Based on a sample of businesses, more businesses are believed to have taxable personal property than is currently on the Assessor's unsecured roll. The City's business database could be better used to ensure that all taxable business property is captured on the tax roll.

*The County Assessor's Office could benefit from data sharing with the City to identify and appraise business personal property for the high number of businesses in the City that are not being taxed.*

Approximately 89.3 percent of business personal property assessed value in the City is attributable to just 10.9 percent of all businesses, each with property valued at more than \$100,000. The value of business property for the remaining 89.1 percent of all businesses amounts to only 10.7 percent of total business property value in the City. Cost-effectively identifying the value of business personal property for these relatively smaller businesses to ensure that they are paying their fair share of business personal property taxes presents a challenge for the County Assessor. Data collected by the City about these businesses could assist the Assessor in these efforts.

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*Under-assessment of business personal property by the County is estimated to cost the City at least \$394,159 per year.*

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Based on a sample of businesses, up to 38,071 businesses may have under-valued personal property. The City's business database could be better used to ensure that all taxable business property is captured on the tax roll.

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*The County Assessor lacks data to accurately assess: 1) hotel values, and 2) change in value due to the death of property owners. With such data, the City would realize an estimated \$830,100 per year from just half the properties transferred due to owner death.*

The City maintains hotel income information that would enable the Assessor to more accurately assess City hotel values. In addition, the County Recorder maintains –indices and images of death certificate records, which would enable the Assessor to re-assess-eligible properties that transfer as of the date of the owner’s death, as required by law.

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*The City foregoes an estimated \$4.5 million of real property transfer tax receipts annually as a result of its own tax exemptions, weak contractual internal control requirements, and case law exempting certain changes in ownership from transfer taxes. The City foregoes another \$7.3 million in property tax revenue and the County \$1.5 million in revenue due to the current change in ownership laws.*

We estimate that the City of Los Angeles’ real property transfer tax exemptions cost \$394,389 per year, and that another \$809,759 is lost annually due to failure to verify exemptions. Case law allowing transfers of the property of legal entities to occur in certain circumstances without taxation is estimated to cost \$3.3 million in transfer taxes, as well as \$7.3 million in property taxes. For the County, the estimated reduction in county documentary transfer tax and property tax revenue just for properties changing owners in the unincorporated areas and subject to the same exemption is \$1.5 million per year.

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*An estimated \$17.2 to \$19.2 million of sales and use tax revenue is lost to the City annually in spite of the City’s current efforts to audit selected businesses. For the County, the loss is estimated at \$5.75 million.*

Sales tax revenue losses occur due to noncompliance and tax evasion among businesses and unpaid use tax on out-of-state internet sales. This could be addressed through collaborations between the City and the State, such as a new initiative currently entered in to by the City.

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*The City's General Fund Court-ordered debt revenues decreased by 70 percent from \$6.3 million to \$1.9 million over four years.*

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The decrease in court revenues to the City General Fund is due to fewer citations filed in Los Angeles Superior Court and the elimination of the City's Red Light Photo Program in 2011.

*The City's budgeted property tax revenues for FY 2013-14 were \$40.4 million short. City revenue estimates for the budget year must be completed in March. This early date may result in less accurate revenue estimates compared to other cities with later budget deadlines that use more current information.*

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The budget schedule requires staff to project major revenues predicated on February and March economic forecasts and receipts, and property tax receipts are projected for the coming year without benefit of assessed value estimates issued by the Assessor on May 15.



### III. Significant Recommendations

The Office of Finance should:

- Collaborate with the County Assessor's Office to determine the data each agency has and what would be useful to each other in the interest of identifying businesses that have not filed business personal property statements with the County Assessor's Office and that have unpaid business personal property tax liabilities.
- Request that the City Attorney prepare a formal agreement for the City to provide its full business tax registration certificate data, including gross receipts, to the County Assessor's Office in exchange for access to the County Assessor's Office's Business Property Abstracts.
- Prepare an internal analysis of how Office of Finance business registration tax certificate records could be analyzed by industry, area and other characteristics to help identify businesses with likely under-reported business personal property valuations for use by the County Assessor's Office.
- Collaborate with the County Assessor's Office about establishing a task force to improve assessment and revenue collection. Consider opportunities to partner with third-parties such as the California Franchise Tax Board and the California Secretary of State for sharing Universal Commercial Code (UCC) filings data.
- Collaborate with the County Assessor's Office about the City utilizing the County's unique identification system in its taxpayer databases, or both parties transitioning to a more universal standard such as the Internal Revenue Services' electronic identification numbers (EIN).

The City Office of Finance and the City Attorney should:

- Facilitate entering in to a Memorandum of Understanding with the County Assessor's Office to: 1) track transient occupancy tax receipts by hotel and furnish this information monthly to the County Assessor's Office, and 2) supply annual gross receipts as reported for City business tax purposes to the Assessor's Office upon receipt.
- Amend the existing real property transfer tax agreement between the City and County Recorder, or enter into a new agreement, with the

County Recorder to require the Recorder to furnish --electronic death certificate information of City property owners as needed by the County Assessor's Office to fulfill its duty to reassess property effective on the date of the owner's death.

The Office of Finance should confer with the City Attorney to plan to:

- Amend the City's tax collection agreement with the County Recorder's Office, and, if necessary, the City Municipal Ordinance Code, to require the Recorder to obtain documentation of all instances in which City real property transfer tax is calculated on an amount less than the full value of the property transferred and to furnish this information to the Office of Finance on at least a monthly basis.
- Take steps necessary to ensure enforcement of the existing agreement requirement for the Recorder's Office notifying the City of instances of non-payment of City transfer tax receipts.

The Office of Finance should:

- Collaborate with the State Board of Equalization as part of its newly signed agreement to identify the data each agency has and what would be useful to each other in the interest of identifying businesses that have not registered with the City and that are under-reporting or not filing sales and use tax to the State.
- Request that the City Attorney prepare an amendment to the City's Agreement for State Administration of Local Sales and Use Taxes to allow for data exchange between the Office of Finance and the State Board of Equalization.

The City Administrative Officer should:

- Determine City funding and staffing needed for an investigative unit to support enforcement of City taxes and fees, and third-party taxes and fees that are remitted to the City and recommend funding levels for this function to the Mayor and City Council.

The Mayor and City Administrative Officer should:

- Revise the annual budget calendar to require major General Fund revenue estimate updates in the third week of May, thereby ensuring the revenue budget is based on the Assessor's Office estimated

assessed values, and the most up-to-date actual receipts and economic forecasts available.

- Determine if adequate resources are in place for the City's revenue forecasting and agree to changes in the City Administrative Officer's FY 2016-17 budget to provide for additional staff and/or consultants to assist in revenue estimation and documentation of proposed and final revenue assumptions, as warranted.
- Evaluate the level of detail legally required for the March 1 revenue estimates produced by the Controller's Office pursuant to the City Charter, and, if possible, reduce the level of detail in the estimates, and do not include them in attachments to the proposed budget as they conflict with the "official" proposed amounts.

#### **IV. Review of the Report**

We provided a draft of this report to the Los Angeles County Assessor and the Los Angeles County Registrar/Recorder-County Clerk, as well as the City of Los Angeles Office of Finance, the City Administrative Office, and the Building and Safety Department. We also provided relevant sections of the draft to the management of the Recorders' offices in the counties of Riverside and Santa Clara.

Exit conferences were held on the following dates in 2015:

April 16: Los Angeles County Assessor via telephone. The Recorder's Office of the Los Angeles County Registrar/Recorder-County Clerk also participated.

April 21: City of Los Angeles Building and Safety Department and City of Los Angeles City Administrative Office.

May 5: City of Los Angeles Office of Finance.

Additionally, on April 17, an exit conference was scheduled for the Recorder's Office of the Los Angeles County Registrar/Recorder-County Clerk, but was cancelled by the Recorder's Office, based on a preference to provide information in writing. The Recorder furnished written information and new documentation and subsequently requested a meeting, which was held via telephone on May 22.

We also received written information and/or new documentation from the County Assessor and from the Office of Finance in late May and June. We considered the comments provided as we finalized this report.

# Background

**Proposed FY 2014-15 General Fund Revenues From Other Agencies is \$2.3 Billion, or 44% of the City's General Fund Receipts**

The revenues within the scope of this audit are those the City receives from other governmental agencies and allocates to the General Fund. These receipts were proposed to be budgeted at \$2.3 billion for Fiscal Year 2014-15, as shown in Exhibit 1, and represented 44.2 percent of all General Fund receipts proposed for FY 2014-15.

Property tax receipts represent the largest share of these monies, at \$1.6 billion; followed by sales and use taxes, at \$374 million; documentary transfer tax (real property transfer tax), at \$196.8 million; property tax receipts re-directed from redevelopment due to the dissolution of the redevelopment agencies, at \$48 million; receipts from the settlement with tobacco companies, at \$9 million; court fines, at \$2.5 million; and "excess" motor vehicle license fees (VLF, per Revenue and Taxation Code 11001.5 (b) (1)) at \$1.7 million.

The \$1.6 billion of property tax includes \$1.15 billion from the "one percent" property tax, plus property tax monies allocated to the City to reimburse revenues previously allocated to the City that are now retained by the State: vehicle license fees (\$355 million) and sales and use tax (\$127 million.)

Property Tax Receipts are the City’s largest revenue, with a proposed budget of \$1.6 billion for FY 2014-15

**Exhibit 1: Proposed Budgeted General Fund Revenues Remitted by County and State Agencies Fiscal Year 2014-15**

Revenue	Proposed Budget	% Total GF
Property Tax Secured	\$1,066,639,000	20.84%
Property Tax Unsecured	46,068,000	0.90%
Homeowner exemption	7,874,000	0.15%
Supplemental	30,900,000	0.60%
Redemptions	24,351,000	0.48%
County Admin Fee	(16,523,000)	-0.32%
Refunds	(10,929,000)	-0.21%
Adjustments	301,000	0.01%
Community Redevelopment Agency (CRA) Adjustments	-	0.00%
Subtotal: 1% Property Tax	\$1,148,681,000	22.45%
VLF Replacement	355,080,000	6.94%
Sales Tax Replacement	126,600,000	2.47%
<b>Total Property Tax</b>	<b>\$1,630,361,000</b>	<b>31.86%</b>
Sales Tax	374,100,000	7.31%
Documentary Transfer Tax	196,800,000	3.85%
Redirected Ex-CRA Tax Inc.	48,023,000	0.94%
Tobacco Settlement	9,006,000	0.18%
Court Fines	2,500,000	0.05%
Motor Vehicle License Fee	1,700,000	0.03%
<b>Total: Subject Revenues</b>	<b>\$2,262,490,000</b>	<b>44.2%</b>
<b>Total General Fund (GF)</b>	<b>\$5,117,529,000</b>	<b>100.0%</b>

Source: City Administrator’s Office, FY 2014-15  
Supplement to the Proposed Budget

The City Charter, Administrative Code and Municipal Code Establish Requirements Related to These Revenues

The Charter of the City of Los Angeles establishes the following requirements pertinent to General Fund revenues:

- On or before February 1 of each year, the Mayor is to publish budget priorities for the next fiscal year. (Charter Section 311)
- On or before March 1 of each year, the

**On or Before  
March 1, the City  
Controller must  
provide estimated  
revenues for the  
next fiscal year**

**On or before April  
20, the Mayor  
must submit the  
proposed revenue  
budget for the  
next fiscal year**

**On or before June  
1, the City Council  
must consider the  
proposed revenue  
budget**

Controller is to provide the Mayor, with copies to the City Council and City Administrative Officer, an estimate of revenues, funds needed for interest and sinking funds, outstanding indebtedness, and other lawful obligations of the City for the next fiscal year. (*Charter Section 311*)

- On or before April 20 of each year, the Mayor is to submit to the City Council a budget for the next fiscal year setting forth in summary and detail (*Charter Section 312*):
  - Revenues and expenditures for the last completed fiscal year,
  - Estimates of revenues and expenditures for the completed fiscal year,
  - Estimates of revenues and expenditures for the ensuing fiscal year, and
  - Other detailed financial statements and data needed to present the financial condition of the City such as information on the City's Reserve Fund, unappropriated balances available for the ensuing fiscal year, condition of the Treasury and other information.
  
- On or before June 1 of each year, the City Council must consider the Mayor's proposed budget and either approve the budget as submitted or modify the proposed budget by increasing or decreasing any item, or adding a new item before returning the budget to the Mayor. The Mayor can veto, restore or otherwise change the budget as submitted by

**The Municipal Code requires the Office of Finance to ensure collection of City Real Property Transfer Taxes either by the County or by the City**

the City Council. If that occurs, the City Council, by a two-thirds vote, can then readopt or change an item of the budget to an amount between what was originally adopted by the Council and that as changed by the Mayor. (*Charter Section 313*)

Section 21.9.11 of the Municipal Code provides that the Director of Finance, as the City Tax Collector, is responsible for “maintaining relations with the County of Los Angeles” for the purpose of administering the Real Property Transfer Tax ordinance, and collecting any such taxes due if they are not collected by the County. The Code also requires that such taxes be collected prior to recording of transfers with the County.

The Charter and Administrative Code establish the following roles and responsibilities of City officers and agencies pertaining to monitoring, estimating and forecasting revenues, including General Fund revenues received from other government entities.

**Preliminary Revenue Estimates Prepared by the Controller are Not Used in the Budget**

**Exhibit 2: Specific Duties of City Officers Pertaining to General Fund and other Revenues**

Officer	Charter Requirements	Administrative Code Requirements
Controller	Prepare estimate of revenues for subsequent fiscal year by March 1 of each year. <i>(Section 311)</i>	No specific requirements related to General Fund revenue.



**The City  
Administrative  
Officer Estimates  
Major Revenues  
for Budget  
Purposes**

	<p>Provide general supervision of all offices, departments, boards and employees of the City charged in any manner with the receipt, collection or disbursement of the money of the City. <i>(Sections 260-261)</i></p>
<p>City Administrative Officer (CAO)</p>	<p>Assist in the preparation of the annual budget; prepare reports on revenues and costs, throughout the year and conduct studies and investigations to assist in preparation of the budget.</p> <p>Advise the Mayor and Council on the condition, finances and</p>
	<p>Perform revenue estimating and long term financial and capital planning and report thereon to the Council and Mayor.</p> <p><i>(Section 20.8(a)) Administrative Code</i></p>

**The Office of Finance Serves as City Tax Collector, Tracks Receipts and Disbursements, and is Responsible for Ensuring Collection of Real Property Transfer Taxes**

	<p>future needs of the City, and other related duties.</p> <p><i>(Sections 290-291)</i></p>	
Office of Finance	<p>Collect revenues not collected by other City departments; develop and implement the City's revenue policy; make recommendations to the Mayor and City Council on the efficient organization of revenue collection performed by City offices and departments.</p> <p><i>(Section 300)</i></p>	<p>Annually prepare a detailed statement on the receipts, disbursements and balances of the Office.</p> <p><i>(Section 20.75 Administrative Code)</i></p>
Office of Finance		<p>As the City Tax Collector, the Office of Finance is responsible for ensuring</p>

collection of Real Property Transfers Taxes, either by the County or the City.  
*(Section 21.9.11 (a) and (b)) Municipal Code*

Sources: City Charter, Administrative Code, Municipal Code

Through interviews and review of key revenue-related City, County and State documents, the following information has been collected about how the requirements above are implemented and how the City monitors, forecasts and ensures the accuracy of the General Fund receipts from other government entities.

The Controller’s Office’s Financial Analysis and Reporting division and the City’s Office of Finance receive remittance advisories, or notices, indicating amounts remitted from external entities for the General Fund revenues, as shown in Exhibit 3.

**The Controller and the Office of Finance are Responsible for Monitoring Revenue Receipts**

**Exhibit 3: City Agencies Responsible for Monitoring General Fund Revenues Remitted by External Entities**

<b>Revenue</b>	<b>Remitting Entity</b>	<b>Primary City Agency Receiving Remittance Advisories</b>
Property Tax (including Sales Tax Replacement and Vehicle License Fee Replacement tax revenues)	Los Angeles County Auditor-Controller	Controller
Former Community Redevelopment Agency Tax Increment	Los Angeles County Auditor-Controller	Controller
Sales and Use Tax	State Board of Equalization	Office of Finance
Documentary Transfer Tax	Los Angeles County Recorder	Office of Finance
Tobacco Settlement	State Department of Justice	Controller
Court Fines	Los Angeles County Superior Court	Controller

**Two Revenue Forecasts Are Prepared by Two Different Departments**

The amounts remitted are posted in FMS, the City's financial system, by staff from either the Office of Finance or City Controller.

In conformance with the City Charter, the Controller's Office prepares an annual forecast of General Fund revenues for the subsequent fiscal year by March 1 of each year.

The City Administrator's Office (CAO) prepares a separate forecast of General Fund and other revenues for the subsequent year as part of the Charter-required budget preparation process, discussed above. While the CAO reviews and may consider the Controller's Office's forecast, the CAO's forecast process is separate and the resulting forecast amounts can vary from those produced by the Controller's Office. Unlike the Controller's forecasts, which are for informational purposes only, the CAO's forecasts are part of the Mayor's proposed budget for the subsequent year, subject to approval by the City Council.

**General Fund Revenue Budget is \$5.1 billion**

The City of Los Angeles had a \$5.1 billion proposed General Fund revenue budget for FY 2014-15, of which Property Tax receipts made up the single largest share, at approximately 31.9 percent, inclusive of receipts replacing State take-aways of Sales and Use Tax and Motor Vehicle License Fee revenues.

**At \$1.6 billion, Property Tax is almost a third of City General Fund receipts**

<b>Property Tax</b>	
<b>FY2014-15 Proposed Amount</b>	<b>\$1,630,361,000</b>
<b>% Total General Fund Revenue FY 2013-14</b>	<b>31.9%</b>

The City's Property Tax receipts are primarily the result of a one-percent tax applied to the assessed value of non-exempt property. Assessed values are determined by the County Assessor, billed and collected by the County Tax Collector and allocated to the City by the Auditor-Controller. The City's share of the collected funds is wire transferred to a City account, with remittance notices sent to the Office of Finance and Controller. The proposed receipts from this "one-percent" tax are budgeted at about \$1.2 billion for FY 2014-15.

There are multiple categories of "one percent" revenues, with categories generally relating to either the type of property being taxed (e.g., secured vs. unsecured) and the timing of the tax bill (e.g., supplemental). In addition to the "one percent" receipts, the City also receives additional Property Tax monies as "replacement" for the dollars it formerly received from both State Sales and Use Taxes and Vehicle License Fees. The budgets for these receipts were proposed at approximately \$481.7 million for the General Fund in FY 2014-15.

**Assessed property value is usually its purchase price,**

Pursuant to the State Constitution, in general, the assessed value of property is its purchase price plus up to two percent per year in increased value.

**plus up to two percent per year in increased value**

Some property, such as that owned by governments and religious organizations, is usually exempt from taxation, except for government-owned property that is leased or used by a private entity.

**Properties are identified through building permits and deed recordings, among other sources**

The County Assessor receives building permit data from cities and deed recordings from the County Recorder annually to update the assessment roll. The Assessor then determines the assessed value of all real estate and personal property in the County. In addition to all privately owned residential, commercial and industrial properties, this value includes assessed value of “possessory interests,” which occur when a person or entity leases, rents or uses real estate owned by any of Los Angeles County’s taxing agencies. Under State law, the Assessor must survey each taxing agency within the County annually as to its leases or other arrangements that create a taxable interest on the property.

**The County Auditor-Controller allocates property tax receipts to more than 900 taxing agencies throughout Los Angeles County, including the City of Los Angeles**

The County Treasurer-Tax Collector mails tax bills to property owners and collects and deposits payments. The Auditor-Controller allocates these receipts to more than 900 taxing agencies within Los Angeles County, including the City of Los Angeles. The County direct deposits Property Tax receipts to the City on about the 20<sup>th</sup> of each month of the year between November and August. These distributions are not uniform; for example, first-quarter advances on secured taxes (by far the largest source of Property Tax revenue) are paid in December and January with the final half of the first quarter of secured payments remitted in February. The next secured advance is 85 percent of the

second quarter receipts, but it does not occur until April. Remittances for other categories are similarly variable.

Funds are wire transferred from the County to the City, with notices sent to both the Office of Finance and the Controller's Office. The Controller's Office records the full remittance amount in FMS. The remittance information from the County breaks out the amounts for all of the components of Property Tax revenue: secured, unsecured, redemptions, supplemental Property Tax, homeowners' exemptions, refunds, administrative fees, and others.

***Forecasting Property Tax***

For its annual revenue forecast published in March of each year, the Controller's Office reviews actual receipts for the first portion of the year and prepares forecasts for the remainder of the current fiscal year and the subsequent fiscal year. Economic forecasts prepared by external parties such as the State of California Legislative Analyst, the UCLA Anderson Forecast, the California Department of Finance and the Los Angeles Economic Development Corporation are reviewed and considered but, more important for secured and unsecured Property Tax receipts, is a preliminary estimate produced by the County Assessor each year on expected changes in assessed valuation. For the Controller's Office forecast, many factors are considered, including the estimated rate of increase in assessed value. -

**Revenue forecasts take into account a variety of economic forecasts**

**The CAO's revenue forecasts take into account economic**

The CAO's revenue estimates, produced as part of the Mayor's proposed budget, are largely prepared by one analyst, in consultation with –management



**forecasts, and best estimates of assessed value growth**

and another colleague. These estimates are independent of those prepared earlier by the City Controller's Office. The Controller's Office's estimates are not included in the Mayor's proposed annual budget for approval by the City Council, though they are presented for informational purposes as an appendix to the annual budget document.

**The CAO used to have better information about assessed value growth for the budget year**

The CAO prepares three estimates related to Property Tax receipts, which, together, amounted to more than \$1.6 billion in proposed revenue budgeted for FY 2014-15. These estimates are 1) the net "one-percent" revenue, without regard to its subcategories, 2) Property Tax Replacement for former Sales and Use Tax receipts and 3) Property Tax Replacement for former Motor Vehicle License Fee receipts. As previously indicated, the subcategories generally capture differences in the timing of assessments or payments, or differences in the type of property taxed, as well as refunds and administrative fees charged by the County.

**The CAO property tax estimates take into account, among other things, the historical actual receipts and roll growth, statistical**

Until recent years, the CAO had at its disposal advance estimates prepared by the County Assessor regarding the one-percent assessed roll growth (or lack thereof). These estimates were provided voluntarily by the Assessor in time to allow agencies to make budget estimates. However, the sharp decline in property value as a result of the market collapse resulted in the Assessor's voluntary advance estimates being too high, which led agencies, including the City of Los Angeles, to over-estimate Property Tax revenues. As a result, the Assessor ceased providing agencies with advance estimates of increases in assessed value.

**forecasting based on those receipts, actual receipts through March of the current and most recent three years, and its own projection of the percentage change in assessed values**

The key resources and practices employed by the CAO to estimate the one-percent receipts for the FY 2014-15 proposed budget are as follows:

- Review of actual City receipts since the early 1990s, including subcomponents, which are used to analyze trends and apply statistical forecasting methods.
- Analyze actual City receipts through April for the current and past three fiscal years.
- Review Countywide assessment roll values since the early 1990s, as well as changes in value associated with sales, inflation, and construction.
- Analyze the County's estimated percentage change in the County-wide assessment roll. This roll forecast is provided officially each year by the Assessor, but, pursuant to California Government Code Section 27421, not until mid-May, or after the Mayor's proposed budget must be published. However, the CAO obtains an early, informal estimate from the County.
- Consider a variety of third-party economic forecasts and broad economic factors that may affect Property Tax receipts.
- Review information informally obtained from other cities to get a sense of their estimated receipts, although the focus of this is mostly on projections for outlying years.

**Total property tax receipts are estimated primarily based on projected assessed growth, then allocated across various categories (secured, unsecured, etc.)**

With all of these factors, the CAO's personnel settle on a percentage value of year-over-year growth. Once obtained, this percentage is applied to actual receipts, generating a total one-percent tax amount for the upcoming year. This amount is then apportioned to subcomponent categories (such as redemptions and supplemental Property Tax) such that the sum of the categories equals the one-percent total. No estimates are made for the Property Tax subcategories.

**Replacement Motor Vehicle License (VLF) Fee receipts are estimated based on projected assessed value growth**

***Property Taxes Replacing Former Vehicle License Fee Revenues***

The CAO projects the upcoming year's Replacement Motor Vehicle License Fee receipts by applying the previously described one-percent Property Tax percentage change figure to actual and current year forecasted Replacement Vehicle License Fee receipts.

**Replacement Sales Tax receipts are estimated based on the sales and use tax estimation methods**

***Property Taxes Replacing Former Sales Tax Receipts***

The CAO projects the upcoming year's Replacement Sales Tax receipts by applying the Sales and Use Tax growth percentage figure, as described below, to actual replacement Motor Vehicle License Fee receipts.

**Sales & Use Tax was proposed at \$374.1 million for FY 2014-15**

<b>Sales and Use Tax</b>	
<b>FY 2014-15 -Proposed Amount</b>	<b>\$374,100,000</b>
<b>% Total General Fund Revenue</b>	
<b>FY 2013-14</b>	<b>7.3%</b>

**Sales tax is the second-largest revenue within the scope of this audit**

Sales and Use Tax receipts make up approximately 7.3 percent of the City’s total General Fund revenues proposed for FY 2014-15, making it the fourth-largest single revenue General Fund revenue source, behind Property Tax, Utility Users’ Tax and Business Tax, and the second-largest single revenue source within the scope of this audit. Because of the complexity of this revenue and the magnitude of potential effects on City operations of small percentage differences between actual and budgeted amounts, our review thus focused on these and Property Tax receipts, discussed above.

**The City’s taxable sales are taxed at 9.0 percent. The City received more than 1/3<sup>rd</sup> of all sales and use tax dollars distributed county-wide in FY 2013-14**

Taxable sales in the City of Los Angeles are taxed at 9.0 percent. This includes the State-wide tax rate of 7.5 percent, of which one percent is allocated locally, including .75 percent to the County and cities. BOE data shows that the City of Los Angeles received 34 percent of the total amount of Sales and Use Tax allocated County-wide in FY 2013-14.

**Distributions of sales tax are not uniform across the fiscal year**

After deduction of refunds and administrative costs, Sales and Use Tax revenues are distributed by the State Board of Equalization (BOE) as follows. The BOE begins with the prior year’s quarterly tax allocation, from which it deducts nonrecurring transactions, such as audit payments and refunds. The BOE adjusts the resulting figure for growth to establish the estimated “base” amount. Ninety

**The City's budget forecasts are primarily based on major economic forecasts**

percent of this amount is then advanced to the City in three stages prior to the computation of the quarter's actual receipts. Ten percent is withheld as a reserve for unanticipated events such as natural disasters. The first and second advances each represent 30 percent, while the third advance is 40 percent. The quarterly reconciliation payment is made along with the first quarter advance for the following quarter. As a result of this distribution process, actual City receipts are not uniform across the months.

The Office of Finance prepares forecasts of Sales and Use Tax revenues for subsequent fiscal years using projected percentage increases prepared by the contractor MuniServices, LLC. The same firm also conducts analyses of potential misallocations of Sales and Use Tax revenues for the Office of Finance.

The CAO prepares forecasts of Sales and Use Tax for the Mayor's proposed budget based in part on a variety of forecasts of Sales and Use Tax growth prepared by the third parties listed below. For preparation of the FY 2014-15 budget, most of these fiscal year forecasts were dated February 2014 or earlier, including those prepared by:

- Beacon Economics
- County of Los Angeles
- State Legislative Analyst's Office Fiscal Outlook
- L.A. County Economic Development Corporation
- UCLA Anderson Forecast

Additional estimates obtained by the CAO included

**The FY 2014-15 proposed budget estimated sales tax growth of 4.6 percent**

**Sales tax estimates do not take into account pending changes, such as new retail or retail closures**

the Governor's budget, growth estimates by the State Department of Finance, and calendar year estimates from Chapman University, UCLA Business Forecasting Project, Woodbury University, WP Carey Blue Chip Average, and the Sacramento Forecast Project. The CAO's staff also tracks various trends, such as Sales and Use Tax receipts in relation to the unemployment rate and U.S. retail sales.

For the FY 2014-15 proposed budget, the CAO calculated the average percent increase in the forecasts of the bulleted sources above to be 4.9 percent. The CAO settled on an estimate of 4.6 percent after taking into account all factors. This percentage was applied to estimated FY 2013-14 actual Sales and Use Tax receipts.

Total receipts for FY 2013-14 were estimated as follows: actual receipts through March, plus estimates for April, May and June. The estimates were based on actual receipts for these same months in the prior year, plus the actual 12-month growth rate of 5.1 percent. The 4.6 percent growth estimate was then applied to the estimated total for FY 2013-14, to arrive at the proposed budgeted amount for FY 2014-15. The estimate does not take into account pending changes, if any, to major retail operations in the City based on building permits or any specialized consultant datasets.

**Real Property Transfer Tax was proposed at \$196.8 million in FY 2014-15**

**The City's Real Property Transfer Tax rate is \$4.50 per \$1,000 of taxable value transferred**

**The City's Real Property Transfer Tax is a separate tax from the County's Documentary Transfer Tax**

**City Real Property Transfer Tax is estimated by a consultant, and may be adjusted by staff**

**Real Property (Documentary) Transfer Tax**

**FY 2014-15 Proposed Amount \$196,800,000**  
**% Total General Fund Revenue 3.8%**  
**FY 2013-14**

The City has established a tax on eligible property transfers of \$4.50 per \$1,000 of the property value, less the value of liens and encumbrances. This tax is collected by the Los Angeles County Registrar-Recorder County Clerk Recorder's Division (County Recorder's Office). Besides traditional sales of residential and commercial properties, these transactions include transfers of legal entities, such as through changes in the ownership of a company that owns real property. The City's Office of Finance receives remittance advisories for this revenue from the County Recorder and posts the amounts received on FMS. City budget documents refer to this tax as Documentary Transfer Tax. That is the name of the County tax and is distinct from the City's Real Property Transfer Tax. The City does not receive any of the Documentary Transfer Tax collected by the County because the City has its own tax.

***Forecasting Real Property Transfer Tax***

The Office of Finance prepares an annual forecast of Real Property Transfer Tax receipts for the subsequent fiscal year based on current-year trends and an assessment of real estate price trends and sales activity. For forecasting this revenue source, the CAO gathers data as available for the current year such as the volume of recorded deeds and Transfer Tax receipts, changes in home prices and

The budget for the City's share of former redevelopment agency property tax receipts was proposed to be \$48.0 million in FY 2014-15

sales volume, supplemental Property Tax payments and informally provided estimates of growth in assessed value prepared by the County Assessor. This information is turned over to a consultant, who furnishes a forecast amount for inclusion in the budget. Sometimes, City staff adjusts the estimate.

Real Property Transfer Tax is an extremely volatile revenue, and budget estimates in Los Angeles and other cities are especially prone to inaccurate estimates.

**Redirected ex-Community Redevelopment Agency (CRA) Property Tax Increment**

<b>FY 2014-15 Proposed Amount</b>	<b>\$48,023,000</b>
<b>% Total General Fund Revenue</b>	<b>0.9%</b>
<b>FY 2013-14</b>	

Ex-Community Redevelopment Agency Property Tax Increment is remitted to the City by the County Auditor-Controller. This revenue source is the result of dissolution of redevelopment agencies by the State in 2012, with Property Tax increment monies previously reserved for the City's Community Redevelopment Agency (CRA) now redistributed to various taxing entities, including school districts, Los Angeles County and the City of Los Angeles in accordance with provisions of State law. The amounts available from this source of funds is the net Property Tax increment that previously would have been allocated to the CRA, after accounting for remaining CRA debt and obligations approved by the State.



**Former CRA monies are forecast based on projections from the CRA Successor Agency**

The Controller's Office receives and reviews remittances for this source from the County Auditor-Controller.

***Forecasting ex-CRA Tax Increment***

The forecasts are mostly based on the latest information available from the CRA successor agency and computations from the County's Auditor-Controller or Treasurer-Tax Collector.

The CAO appears to mostly use amounts calculated by the CRA successor agency.

**Tobacco Settlement funds were proposed to be budgeted at \$9.0 million in FY 2014-15, and are based on the legal settlement between tobacco companies and states**

**Tobacco Settlement**

<b>FY 2014-15 Proposed Amount</b>	<b>\$9,006,000</b>
<b>% Total General Fund Revenue</b>	<b>0.2%</b>
<b>FY 2013-14</b>	

**Tobacco Settlement monies are remitted to the City pursuant to an MOU between the State Attorney General and counties and cities**

Tobacco Settlement funds are provided to the City pursuant to the Tobacco Master Settlement Agreement between certain tobacco companies and a number of states, including California, that were party to a lawsuit. The Agreement calls for the tobacco companies to provide payments to the states in perpetuity, totaling about \$206 billion by 2025, with allocations to individual states determined by formulas agreed to by attorneys general of those states. In California, the amounts received each year are shared, with 50 percent allocated to the State and 50 percent allocated to all counties and the four largest cities, including the City of Los Angeles, pursuant to a formula in a Memorandum of Understanding (MOU) between the State Attorney General and the counties and cities.

**Tobacco Settlement budget forecasts are based on current and recent-year trends**

While the City's percentage allocation is fixed at 2.5 percent of the local government share in the MOU, the total amount distributed to the cities and counties each year can vary as adjustments are made due to other Master Settlement Agreement litigation and claims. These adjustments can result in receipts exceeding the amounts budgeted based on Master Settlement Agreement provisions.

The State Department of Justice wires Tobacco Settlement funds to the City and remittance notices to the -Controller's Office, which posts the transmitted amount in FMS. The Office of Finance also receives and reviews the remittance notices and allocation amounts to California entities but neither office receives any documentation explaining the basis for the amounts remitted.

***Forecasting Tobacco Settlement Receipts***

The Controller's Office prepares a forecast of Tobacco Settlement revenues for the subsequent fiscal year based on current year remittances and any information provided by the State Department of Justice about any adjustments to the City's allocation anticipated for the next year. In recent years, the Controller's Office reports that the State has provided little information in advance about expected allocations for the ensuing year.

The CAO forecasts Tobacco Settlement receipts for the Mayor's proposed budget for the subsequent fiscal year based on current and recent year trends.

**Court Fines were proposed to be \$2.5 million in the FY 2014-15 budget**

<b>Court Fines</b>	
<b>FY 2013-14 Proposed Amount</b>	<b>\$2,500,000</b>
<b>% Total General Fund Revenue FY 2013-14</b>	<b>0.05%</b>

**Court fines are budgeted based on current-year actual receipts**

Court fines are remitted to the City by the Los Angeles County Superior Court from Court Fines for citations other than moving violations. The Controller’s Office receives remittance advisories from the Court but does not receive any explanation for how the amounts remitted were determined.

***Forecasting Court Fines***

The Controller’s Office prepares forecasts of Court Fines as part of its annual forecast of total General Fund revenues for the subsequent fiscal year. The CAO includes a forecast of Court Fines in the Mayor’s proposed budget revenue outlook. For FY 2014-15, the amount forecast was the same as actual collections through March 2014 plus the forecast amount for the last three months of the fiscal year.

**The “Excess” Motor Vehicle License Fees (VLF) budget was a proposed \$1.7 million in FY 2014-15**

<b>Excess Motor Vehicle License Fee</b>	
<b>FY 2014-15 Proposed Amount</b>	<b>\$1,700,000</b>
<b>% Total General Fund Revenue FY 2013-14</b>	<b>0.03%</b>

**Most VLF receipts are no longer remitted to cities,**

Motor Vehicle License Fee revenues collected by the Department of Motor Vehicles as a result of certain compliance procedures are allocated to local government entities under provisions of Revenue

**but backfilled by property tax monies, except for this small “excess” amount**

**The City receives 12.6 percent of statewide “excess” VLF revenue**

**Budgeted amounts are based on current-year receipts**

and Taxation Code Section 11001.5(b). Referred to as “excess” revenues since this source of municipal revenue was otherwise discontinued by the State in FY 2011-12, half of these revenues go to counties and half go to cities, apportioned on a population basis. The City of Los Angeles receives 12.6 percent of the statewide allocation, which is allocated by the State Controller once per year. Motor Vehicle License Fee remittance notices are provided to the City Controller’s Office by the State Controller and the amounts remitted are posted in FMS. This revenue is unrelated to the Property Tax in-lieu of Vehicle License Fee revenues discussed above.

***Forecasting Motor Vehicle License Fee Receipts***

The City Controller prepares a forecast for the current and subsequent fiscal year based mostly on current year receipts and information, if made available from the State Controller’s Office, about the statewide amount to be allocated or any changes in the allocation formula.

The CAO prepares a forecast based on similar information obtained from the City Controller or other sources.

**Objectives**

The objectives of this audit were:

- 1) To estimate the total annual loss of revenues to the City as a result of under-collection of taxable personal business property of City businesses, court-ordered debt, real property transfer tax, and sales and use taxes; and,
- 2) To determine whether existing processes ensure the accuracy of actual receipts from these sources and whether there are opportunities to partner with other governmental agencies to maximize these revenues; and,
- 3) To evaluate the effectiveness and potential improvements in the methods used to estimate the anticipated revenue.

**Other Audits, Investigations and Reviews****The Commission on Revenue Efficiency (CORE)**

The Commission was formed in the spring of 2010 to evaluate and recommend improvements in collections, billing and new revenues. Comprised of seven volunteer Commissioners, CORE issued its Blueprint for Reform of City Collections in the fall of 2010, identifying potential revenues and savings of up to \$100 million annually, with opportunities for up to \$350 million more in savings and revenues. CORE's final report, issued in March 2012, identified opportunities in intergovernmental revenues, including strategies to monitor and maximize City revenues from (a) real property, business personal property, documentary (real property) transfer and sales taxes, and (b) court fees/fines.

**Benchmarking & Best, Leading & Next Practices**

We conducted a benchmarking survey related to budget practices, shown in Appendix V, of the following cities: Pasadena, Riverside, Sacramento, San Diego, and Torrance.

# Findings & Recommendations

## Section I: Business Personal Property Tax

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Unsecured property tax accounts for \$46.1 million of the City of Los Angeles's Fiscal Year 2014-15 budgeted General Fund revenue. Business Personal Property Tax, or assessments on a business's equipment and supplies, represented 68.5 percent of unsecured property tax revenue for the City in Fiscal Year 2012-13, or \$31.6 million in General Fund revenue. The remaining \$14.5 million of General Fund revenue is from a variety of unsecured property such as aircrafts, boats, mobile homes, supplemental escaped property assessments, and possessory interests.

The County of Los Angeles assesses, bills, and collects secured and unsecured property taxes for all jurisdictions within its borders and remits the applicable portion, less an administrative fee, to the City throughout the year. The County Assessor's Office (County Assessor) is responsible for determining business personal property value for all businesses in the County, as mandated by State law:

"Every assessor shall assess all property subject to general property taxation at its full value."<sup>1</sup>

Within this broad mandate, county assessors are given a degree of latitude in how they pursue business personal property assessments. State law divides assessable businesses into two categories: 1) those with an aggregate business personal property cost of \$100,000 or more, which are required to file a signed itemized property statement with the County Assessor indicating the value of each item, and 2) businesses with less than a \$100,000 aggregate cost of business personal property. For the latter group, the assessment process is less specific, with State law only requiring that signed property statements be filed "upon request of the assessor".<sup>2</sup> The majority of businesses in the City fall into this second category.

To identify new businesses or businesses with changes in their business personal property values, the Assessor's Office relies on a labor-intensive process in which staff identifies changes through direct observation field canvassing of commercial areas in the City, and businesses annual submission of businesses personal property statements.

<sup>1</sup> California Revenue and Taxation Code Part 2. Chapter 3, Article 1, Section 401.

<sup>2</sup> California Revenue and Taxation Code Part 2. Chapter 3, Article 2, Section 453

*City's Business Tax Registration Certificate (Businesses Certificate) Program*

The City's Office of Finance administers the City's business tax registration certificate (businesses certificate) program and thus has a complete database of all registered businesses in the City that are potentially subject to business personal property tax assessments. In addition to business name(s), owner name(s), mailing address and location address, annual gross receipts derived from the businesses' operations within the City's boundaries is also recorded for each business. The gross receipt information, in conjunction with other factors, is used to calculate the business-certification fees the City levies.<sup>3</sup>

*Data Sharing Opportunity*

The data from the City's business certificate program could be shared with the County Assessor for use in their discovery and annual assessment of personal business property. Much of the City's data is already shared publicly online but, critically, the gross receipt information is redacted for confidentially purposes. The gross receipts data offers a compelling resource for the County Assessor. A business's gross receipts do not always correlate to its assessable business personal property, but it does in many instances, and can be a leading indicator of high value businesses. With additional analysis by the County Assessor, their understanding of the data could be honed and used to better prioritize and identify assessable property.

*Common Identifiers Would Ease Sharing and Lead to Efficiencies*

Establishing data sharing between the City and County Assessor, specifically the gross receipts data in the City's business certificate database, form the foundation of the recommendations in the following two findings on business personal property tax. A data sharing arrangement is clearly outlined and permissible in the City's Charter. However, the biggest challenge is not statutory; it is simply the data's comparability.

Both the City and County Assessor use different unique identifiers to organize entries in their databases. This hinders one-for-one data comparisons, and explains why the audit used sampling methods when comparing the data. Common unique identifiers would enhance any collaboration between the City and County Assessor. This could be achieved by the City utilizing the County's unique identification system, or both transitioning to a more universal standard such as the Internal Revenue Services' electronic identification numbers (EIN). Regardless of the specific solution, greater interoperability offers long-term opportunities for both the

<sup>3</sup> City of Los Angeles Office of Finance's website, [finance.lacity.org](http://finance.lacity.org), accessed January 16, 2015

City and County Assessor to develop simplified and unified tax and fee systems that ease the administrative burden on businesses and individuals, who often pay fees and taxes to both entities.

#### Other Analysis and Additional Tools

Due to limited data available from the County Assessor the audit team explored two other methods of evaluating the possible revenue impact on the City. Neither method was sufficient to comprehensively evaluate the entire possible population of assessable business personal property in the City. What they did reveal are additional tools and strategies that the County Assessor's Office could consider adding to its analytical resources to augment, support and streamline its discovery and assessment processes.

At the state level, the California Franchise Tax Board (FTB) collects personal and corporate income tax. The audit team explored using data from the FTB on taxpayer's deductions on depreciation of business property and to calculate a total amount of business property in the City or County and compare with current assessments.

The FTB does produce reports on total corporate deductions, but does not - produce summary reports that include all types of business taxpayers such as sole proprietorships and limited liability corporations. As such, the FTB's current data would likely miss a large portion of City of Los Angeles businesses if used for comparison. Unfortunately, at this time the FTB is unable to provide a comprehensive report for purposes of this audit. There may be a possibility of data collaboration with the FTB in the future since the FTB currently runs the City Business Tax Program – Data Exchange. This program establishes reciprocal data exchanges between cities and the FTB "City data helps identify self-employed individuals who are not filing required individual and business entity income tax returns, and state tax data helps identify businesses that may have a local business tax filing requirement".<sup>4</sup>

A second option considered to estimate possible discrepancies between the City's business personal property tax revenue and the actual value of business personal property in the City was using Universal Commercial Code (UCC) filings on record with the Los Angeles County Registrar-Recorder/County Clerk. These are filed for various financing transactions such as corporate debt, letters of credit or leasing of goods. The filings contain a list of corporate assets that could be compared with currently assessed business personal property at least for companies that have had a reason to file a UCC. Similar to the FTB information, the UCC is generally

<sup>4</sup> California Franchise Tax Board, [City Business Tax Program - Data Exchange](#)



applicable to larger-sized businesses and those utilizing financing. While it was determined to be an incomplete tool for this audit's analysis, it could serve as a potential tool for improving the discovery and assessment of business personal property.

**Finding No. 1: Sharing City business registration tax certificate and County property tax assessment records and data between the County and City would help ensure that all 380,416 businesses registered with both entities are being properly, accurately, and efficiently assessed for business personal property taxes.**

**Of the 380,416 City businesses registered with the City's Office of Finance in 2014, there were 91,975 registered with the Los Angeles County Assessor's Office for payment of Business Personal Property taxes according to the Business Property Abstracts database made available to the public by the Assessor's Office and purchased by the audit team for this analysis. While this discrepancy may seem large, many of the businesses that are absent from the County Assessor's database may not be assessable, or are home offices, which are assessable but are difficult to identify through the County Assessor's current methods. The Assessor's Office's also reports that some of these businesses receive property tax bills at locations other than their registered business addresses.**

**Some of the absent businesses do represent larger businesses with storefronts, and traditional office and industrial space. These could represent a material amount of un-assessed business personal property. However, without additional data the potential missing revenue cannot be quantified. However, given the scale of businesses not assessed, it appears that additional revenues could be realized by the City if more of the businesses not assessed by the County but registered with the City were assessed for their business personal property.**

*Differences between City and County Business Databases*

The Los Angeles County Office of the Assessor (County Assessor) had 91,975 businesses in its database of Business Personal Property for the 2014 Unsecured Property Tax Rolls for locations within the boundaries of the City

of Los Angeles. In contrast, as of January 1, 2014 (the lien date for assessments on the County's 2014 rolls) the City of Los Angeles reported 380,416 certificated businesses with locations inside the City limits, or 288,441 more businesses than those on the County Assessor's rolls. The County Assessor's records contain only 24.2 percent of the businesses certificated by the City.

While this discrepancy may seem large, many of the businesses that are absent from the County Assessor's database may not be assessable, or are home offices, which are assessable but difficult to identify and determine if they have \$2,000 or more worth of business personal property using the County Assessor's current business assessment methods.

The City's business registration tax certificate data presents an opportunity for the County Assessor to more efficiently identify, assess and bill these otherwise undiscovered home offices and other businesses. Some of the absent businesses do represent larger businesses with storefronts, and traditional office and industrial space. These could represent a material amount of un-assessed business personal property, but the exact composition and potential revenue value of these is speculative without additional data. What is clear is that opportunities to better collaborate and improve current systems exist. Currently, the City makes business certificate records publically available on [data.lacity.org](http://data.lacity.org), the City's public data clearinghouse website, but redacts potentially valuable information such as the names and closure dates of closed businesses and all businesses' annual reported gross receipts information. Both of these sources of information could be beneficial to the Assessor's Office for identifying businesses that have assessable business personal property.

The County Assessor's staff noted they are not familiar with the details of the City's data and they do not use the publically available City business certificate data.<sup>5</sup> The gross receipts data offers a compelling resource for the County Assessor. A business's gross receipts will not always correlate to the amount of assessable business personal property a business has, but it does in many instances, and can be a leading indicator of high value businesses that could have a material amount of assessable property. The County Assessor's understanding of the data could be honed with additional analysis on their part and used to better prioritize and identify assessable property. Identification of closed businesses could also help in identifying businesses that will no longer be required to pay business personal property tax.

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<sup>5</sup> Discussion with the City of Los Angeles Office of Finance and the County Assessor.

### County Assessor's Process

The Assessor's Office relies on physical field canvassing efforts to discover and assess much of the business personal property that is assessed.<sup>6</sup> The practice of field canvassing for businesses and business personal property is time- and staff-intensive. In contrast, if the County Assessor augmented this practice with analyzing data from the City's business certificate data, field canvassing could be made more efficient. With the data the County Assessor could obtain from the City, key information about business locations, industries, gross receipts and other characteristics would be available and could be used as a tool for discovering and properly assessing businesses personal property currently not being either fully or correctly assessed.

The County Assessor reports that between August and January each year, 46 to 50 certified appraisers and appraisal clerks, physically canvas every major business district in the county to identify new or changed businesses and to determine the presence and value of business personal property. Residential areas are excluded from canvassing, even though they may often contain many home offices and some small business locations, due to the expectation of low returns from such efforts. During this time the County Assessor's Office reports that it often directly assesses business personal property, in which a certified appraiser will quickly assign a value to businesses using rough approximations of visible property and the canvasser's personal understanding of the property's cost and value.<sup>7</sup>

### Cost of Field Canvassing

The staffing requirements for assessing business personal property are as much as seven times more expensive than assessing real property. Much of this cost difference is due to real property's annual formulaic increases based on Proposition 13. Real property is thus less costly to assess since staff time to reappraise is mostly needed when changes occur such as change of ownership or new construction. In contrast, business personal property is not subject to the formulaic changes of Proposition 13, and changes annually as businesses buy and sell assets and as the value of property changes with market conditions.

Out of Los Angeles County's over \$1.2 trillion of 2014 assessed value, \$71.0 billion, or 5.7 percent, is from business personal property. However, in 2013, 12 percent of the County Assessor's staff were personal property appraisers, while 26 percent were real property appraisers, which accounted for 94.3

<sup>6</sup> The County Assessor noted this is the primary discovery source for new assessable business property, but does not have figures available the exact proportion discovered using this method.

<sup>7</sup> Discussion with Office of the Assessor, County of Los Angeles, on January 16, 2015

percent of total valuation.<sup>8</sup> The amount that other non-appraiser staff, such as support, technology and management staff, contribute to either process is unknown. Assuming these staff provide a level of support proportional to the number of appraisers, 46.2 percent of total County Assessor staff is required to generate only 5.7 percent of total assessed valuation.

These staffing ratios and estimated returns on investment are in line with information that the County Assessor reported about their process of performing annual field canvasses of businesses throughout the County. Given the large size of the County and high volume of businesses and business turnover within it, canvassing all of them is presumably a significant task and it is probably impossible to identify every single business and its business personal property. Additionally, the California Board of Equalization notes a variety of discovery methods in their Assessor's Handbook and describes field canvassing as "very time consuming."<sup>9</sup> Electronic canvassing using City business certificate data could help identify businesses with likely business personal property tax liabilities and reduce the labor-intensity and cost associated with some of the current canvassing process.

#### Sampling Methodology

Analyzing the discrepancy between the County Assessor's and City Office of Finance's databases with a one-for-one comparison of the records is not feasible because the databases share no common identifiers, such as IRS issued Employer Identification Numbers or common account numbers or even the same industry classification system. Business names are often recorded differently in the two databases and even addresses can vary. In fact, the challenge of reconciling the two databases informs the audit team's recommendation to better coordinate data sharing and to establish a common identification system between the City and County Assessor's databases since both parties would benefit from sharing information in their databases.

To overcome the limitations of the databases' incompatibility we compared them systematically using 175 businesses picked at random from the City's business registration tax certificate database.<sup>10</sup> Of the 175 randomly

<sup>8</sup> Los Angeles County Auditor-Controller's management audit of the Los Angeles County Office of the Assessor, November 15, 2012, conducted by Strategica and commissioned by the Los Angeles County Board of Supervisors.

<sup>9</sup> Assessors' Handbook Section 504 Assessment of Personal Property And Fixtures October 2002.

<sup>10</sup> The sample size yielded a confidence level of 95 percent and a margin of error at +/- 2.5 percent.

selected businesses from the City's database, 51 businesses were identified in the County Assessor's 2014 rolls, or 29.1 percent, and 124, or 70.9 percent, were not found. As discussed above, we would not expect the two databases to completely match since they have different purposes and we assume many small businesses would not have a business personal property tax liability. However, given the large number of businesses in the City, the challenges of identifying all of them and the value of their business personal property, it is likely that sharing data between the City and County would assist both entities in having more complete and accurate information for the County to use to assess business personal property and for the City to use to identify all active businesses.

As shown in Exhibit 4, 124 businesses registered in the City's database were not found in the County Assessor's database. A physical location for all 124 businesses was visually confirmed by the audit team. As mentioned above, a discrepancy to some extent between the two databases is expected. The two databases serve different purposes, and as shown in Exhibit 4, many of the absent businesses are home offices, which the County Assessor reports they do not target in their discovery programs. These "difficult to discover and assess" businesses could benefit from the recommendations in the report. If the City and County Assessor shared data on these businesses and if this were coupled with more efficient discovery, assessment and billing practices, then any discrepancies between the two systems could be narrowed.

Of our sample of 175 businesses, the 124 businesses not found in the County Assessor's business property abstracts database, which is available to the public for purchase by the Assessor's Office and was purchased by the audit team for this analysis since we did not have access to the Assessor's Office internal database and records, were further analyzed. All referenced names, spelling variations, mailing addresses, and known business aliases were searched for in the County Assessor's database to ensure they were not missed or listed elsewhere in a different format. Then the business type and physical location of the business was analyzed. The audit team relied heavily on search engines, the webpages of the sample businesses, Google Maps, Google Street View, Yelp, the California Secretary of State's corporation and limited liability company and partnership registry, and the Los Angeles County Recorder's business records.

If the physical location of a business could not be visually confirmed with current imagery from Google Street View, or the combination of Google Maps and visual evidence on other websites, they were classified as "Unknown". A second level of scrutiny was placed on differentiating between

storefronts, office and industrial locations versus home offices, since home offices may not have significant assessable value.

Exhibit 4 provides a summary of the results of the audit team review of 175 businesses randomly selected from the City's business registration tax certificate database and compared to the County's Business Property Abstracts.

#### **Exhibit 4: Results of Analysis of Businesses Registered with City but Not Found in County Assessor Records**

	<b>Sample Count</b>	<b>% of Total Sample</b>
Found in County Assessor's Database	51	29.1%
Absent From County Assessor's Database	124	70.9%
<b>Sample Total</b>	<b>175</b>	<b>100%</b>
<b><i>Breakdown of 124 Absent Records:</i></b>		
Storefront, Office, or Industrial	22	17.74%
Home Office	39	31.45%
Closed	6	4.85%
Unknown	57	45.97%
<b>Absent Records Total</b>	<b>124</b>	<b>100.0%</b>

Source: Los Angeles County Assessor's Office Database;  
Location Research by Audit Team

After receipt of a draft copy of this report, the Assessor's Office reviewed the 22 businesses identified as missing against the Office's internal records and reported that they in fact had been assessed or were otherwise accounted for. These 22 businesses were of particular interest because they are the most likely to have a significant amount of assessable business personal property.

The Assessor's Office provided the audit team with a summary of their review. The results showed that one of the 22 businesses was a nonprofit and thus exempt from property tax liability and one was a cellular phone retailer and thus assessed by the State.



One of the 22 businesses, with an assessed business personal property valuation of \$160,509, was not assessed for the 2014 roll according to the Assessor's Office because the business had moved between 2013 and 2014. It has since been processed as an escape assessment, the Assessor's Office reports. Given the single incident and without further insight from the County Assessor, it is difficult to evaluate the extent of any possible systemic problems, particularly when address changes occur. It is also difficult to extrapolate at this level to the entire population of the database and estimate how common this problem might be. However, access to the City's database could have provided the Assessor's Office with an updated address so that the business could have been assessed at the time of the 2014 lien date and avoided having to process an escape assessment.

Of the remaining 19 businesses from the sample not found in the Assessor's Business Property Abstracts database, three were reported to have paid business personal property tax, but from a different address than their listed business address, five were reported as closed or inactive on the January 1, 2014 lien date, and eleven were assumed by the Assessor's Office to have business personal property with a value of \$2,000 or less. The latter group, the majority of the 22 from the sample, included retail clothing shops, a greeting card sales office, a computer sales office, a recording studio, and a Certified Public Accounting office, among others.

While the Assessor's assumptions about these eleven businesses' personal property may be reasonable, it is also possible that the businesses could have \$2,000 or more in business personal property. One example is a hemp clothing retail store that could easily have business personal property above the threshold amount. Similarly, the greeting card sales office could have costly computer equipment if the greeting cards are also designed and/or produced at the site.

To better assess the likelihood of businesses such as the eleven in the sample assumed to have less than \$2,000 in business personal property, the Assessor's Office would benefit from gross receipts data that is collected by and could be made available from the City's Office of Finance. For example, a business such as the small recording studio in the sample could be a very small operation with low gross receipts but if the business were found to have higher reported gross receipts in the City's database, given the cost of recording equipment, it is likely that it would have more than \$2,000 of business personal property on site.

Home Offices

Of the 124 businesses not found in the County Assessor's database, another 39, or 22.3 percent, appear to have a home office location based on Internet searches for the business name and type of building associated with the business address. Home offices likely represent a variety of possible property values; some would be high, some medium level and others may only contain a minimal amount of supplies and equipment worth less than the \$2,000 minimum value for unsecured property tax levy and would thus not be subject to business personal property tax. Per the County Assessor's current practice, it is considered generally not cost effective to physically canvas residential neighborhoods for home office property. As an alternative, and given the high number of such businesses, the City's database represents an opportunity to develop more efficient and automated discovery, assessment and billing systems that could better account for this large category of absent businesses.

Closed

Six businesses in the sample, or 3.4 percent, that were absent from the County Assessor's database appeared to be closed according to the City's database. However, for all but one of these closed locations the exact date of the closure could not be confirmed and they may have been in possession of business personal property as of the January 1, 2014 lien date. Without confirmation of their closure dates (which is not included in the publically available City database, but could be shared by the Office of Finance with the County Assessor), their absence from the Assessor's database cannot be fully evaluated.

The Assessor's Office's records could also be of value to the City since, as reported above, the Assessor's records showed that a number of the 22 businesses that were listed in the City database as open were listed in the Assessor's database as closed. Exchanging and resolving discrepant information could be useful to both the County and the City in removing closed businesses from their databases and eliminating the City's costs of continuing to bill such businesses for business tax renewals and the County's costs associated with any businesses that the Assessor's records show as closed that are actually open.

Unknown

The remaining 57 businesses out of the 175 businesses reviewed, or 32.6 percent, had locations that could not be confirmed or visually identified, or meaningful references to them could not be found through Internet searches. These records were classified by the audit team as Unknown, and, similar to the closed category, their absence cannot be fully evaluated. It is



possible that many are home offices, holding companies or businesses related to real estate that may have limited business property on hand. Again, the City's database could be used to support the County Assessor's efforts and develop a more efficient and automated system that discovers business property at a lower cost than current methods.

#### Potential Lost Revenue

The data available to the audit team for this analysis was limited, making it difficult to reliably estimate the revenue impact on the City and County of businesses not found in the County's database that appear to be operating in a physical location that reasonably could contain \$2,000 or more of business personal property.

Given the profile of the number of businesses and results of our analysis of the sampled 175 businesses, we conclude that additional business personal property revenue could be realized for the City and County through sharing and analyzing data to identify businesses likely to have taxable business personal property. It could also help save both entities from continuing to use resources attempting to collect business personal property and City business taxes from businesses that are closed and/or have moved but that information is not known to either the Assessor's Office or the City's Office of Finance.

We have not estimated the revenue potential but believe that there are a sizable number of smaller and home businesses not being currently assessed that would at least meet the \$2,000 threshold for assessing business personal property. While it would not be cost effective for the Assessor's Office to physically canvas these mostly smaller and/or home office businesses, electronically identifying businesses with higher gross receipts and/or in industries that typically have high levels of taxable business personal property and following up with inquiry and notification letters and information about business personal property tax obligations would enable the County to collect business personal property from more of those businesses.

Given the high number of businesses identified in the sample that are assumed by the Assessor's Office to have business personal property valued at under \$2,000, the audit team concludes that there is significant revenue potential to the City that could be cost effectively collected through greater use of data sharing and electronic analyses of business accounts.

The audit team assumes that many full-time home offices would have at least \$2,000 of assessable business property. For example, a home office

might contain a computer, printer, traditional phone, smart phone, desk, chair, other electronics, and other furniture. Even if the equipment is also for personal use, such as furniture or a smartphone, its use with a business activity makes it fully assessable. This point is clarified by the Fresno, San Mateo and Sonoma County Assessors' frequently asked question webpages that share the same text:

"Q. All the equipment I use is my own personal equipment. Do I report it?

A. If you are using any 'personal' equipment in your business, then yes, it must be reported. For example, persons working out of their homes must report personal desks, computers, calculators and etc., if those items are used in their business."<sup>11 12 13</sup>

There are likely many exceptions in cases where a home office would have less value due to a very minimal use of equipment or older depreciated equipment. However, there are likely other exceptions where the value of a home office exceeds \$2,000. For example, according to a photography business website<sup>14</sup>, a wedding photographer working from a home office might own a professional camera costing \$4,000, camera lenses costing at least \$2,400, a relatively new Apple iMac that retails for over \$1,299, and other electronics costing an estimated \$438. This estimate of \$8,137, does not consider basic office equipment, phones and other photography equipment such as lighting, which would add additional value. Given the variety of businesses that may occupy home offices, \$2,000 is a conservative value that captures the diverse range of businesses and equipment.

### Cause of Absence

For the County Assessor, discovering and assessing business personal property tax is generally expensive. This expense is due in some part to the labor-intensiveness associated with physically field canvassing business districts county-wide for six months of the year, described above. Despite this widespread effort, the County Assessor's Office reports that it prioritizes assessing and reviewing only large-sized businesses and audits only

<sup>11</sup> Fresno County "Business Personal Property F.A.Q.", accessed on January 7, 2015

<sup>12</sup> Sonoma County "Frequently Asked Questions about Business and Personal Property Taxes", accessed on January 7, 2015

<sup>13</sup> San Mateo County Assessor-County Clerk-Recorder & Chief Elections Officer "Business Services: 571-L Business Property Statement FAQs", accessed on January 7, 2015

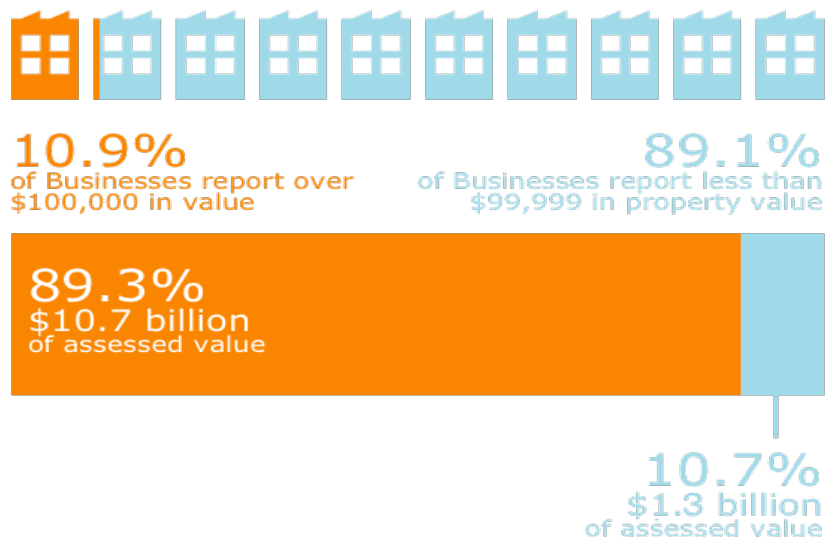
<sup>14</sup> How Much Does It Cost To Start a Photography Business? by Jamie M Swanson, accessed on January 7, 2015

businesses with an assumed value over \$1.9 million<sup>15</sup>. Most of the 175 businesses in our sample appear to have assessable business personal property values well below this and many below \$100,000. If missed in the field canvas, the County Assessor may not have sufficient resources available or low cost procedures in place to discover them as its review efforts focus primarily on large-sized high-value businesses.

Finally, the requirement for paying the business personal property tax may be unknown to many businesses, especially new businesses that have not been visited by an appraiser during a field canvass. Notably, when businesses register and apply for City business certificates, the applicant is not informed about taxes their business may be liable for paying to other entities. The City’s annual contact with businesses re-registering for certificates is a missed opportunity to communicate with them other important information.

Exhibit 5 shows that most businesses have a reported business personal property value less than \$100,000. However, while almost 90 percent of all businesses, this group represents only 10.7 percent, or \$1.3 billion of total assessed value. Given these ratios, the County Assessor’s Office needs more cost-effective tools to identify and appraise business personal property for the high number of low value businesses that are not being taxed.

**Exhibit 5: Distribution of businesses and value assessed by the County Assessor in the City of Los Angeles**



<sup>15</sup> Discussion with Office of the Assessor, County of Los Angeles, on January 16, 2015

### Opportunities

The City and the County Assessor have the opportunity to share data, collaborate more effectively to identify taxable businesses in the City and increase City and County revenue. Sharing data between these entities should be cost effective and more efficient than the County Assessor's current procedures for identifying businesses and business personal property. Such data sharing also has the potential to ease the burden on small businesses and make the taxation process fairer to the businesses already paying their full amounts.

Gross receipts data collected by the City's Office of Finance could serve as a useful tool for the County Assessor to electronically identify previously un-assessed businesses and those that are under-reporting business personal property. While gross receipts data cannot be shared publically, the City's Charter already provides authorization for the City to share it with other taxing entities if a reciprocal agreement is established.<sup>16</sup> In particular the Charter notes:

- "(b) Nothing in this section shall be construed to prevent:
2. the disclosure of information to, or the examination of records by federal or state officials, or the tax officials of another city or county, or city and county, if a reciprocal arrangement exists; or to a grand jury;"

### **Recommendations:**

#### **The Office of Finance should:**

- 1.1 Collaborate with the County Assessor's Office to determine the data each agency has and what would be useful to each other in the interest of identifying businesses that have not filed property statements with the County Assessor's Office and that have unpaid business personal property tax liabilities.**
- 1.2 Conduct an internal analysis of its business registration tax certificate systems and data to determine how it could best extract and assemble data for sharing with the County Assessor.**

<sup>16</sup> Los Angeles City Charter, Article 1 Business Taxes, SEC. 21.17. CONFIDENTIAL CHARACTER OF INFORMATION OBTAINED – DISCLOSURE UNLAWFUL. (Amended by Ord. No. 180,380, Eff. 1/5/09.)

- 1.3 Collaborate with the County Assessor’s Office about the City utilizing the County’s unique identification system in its taxpayer databases, or both parties transitioning to a more universal standard such as the Internal Revenue Services’ electronic identification numbers (EIN).**
- 1.4 Request that the City Attorney prepare a formal agreement for the City to provide its full business certificate data, including gross receipts, to the County Assessor’s Office in exchange for access to the County Assessor’s Office’s Business Property Abstracts.**
- 1.5 Collaborate with the County Assessor’s Office about establishing a task force to improve assessment and revenue collection. Consider opportunities to partner with third-parties such as the California Franchise Tax Board and the California Secretary of State’s Universal Commercial Code (UCC) filings system.**
- 1.6 Make formal arrangements for the City to provide digital and physical copies of the County Assessor’s Business Property Statement, BOE-571-L which requires details on a business’s equipment and supplies if their aggregate costs are \$100,000 or more, to all business certificate applicants in-person, by mail and online.**
- 1.7 Communicate with the County Assessor’s Office about any additional ways the City can communicate with businesses and residents to encourage further compliance and subsequent e-filing of the Business Personal Property Statements.**

**Finding No. 2: Some businesses in the City of Los Angeles appear to have inaccurate and potentially under-valued business personal property in the County Assessor's records.**

**Audit team research identified two trends that suggest some business personal property may be under-valued; however the extent and resulting revenue impact on the City are unclear. The first trend is that 42.2 percent of businesses' assessed values are rounded to the nearest thousand. This level of rounding is well beyond the level expected to occur naturally, but is in-line with the County Assessor's practice. The preponderance of rounded values likely reflects the very limited time field appraisers have to fully account for businesses' property. The second trend is from a review of selected businesses. The audit team identified several examples where business personal property appears to be significantly under-valued. Opportunities exist for the City to better coordinate and share existing data with the County Assessor to help more efficiently assess and review business property.**

As discussed above, many businesses are assessed directly by field appraisers, some are required to self-report the value of their business personal property, and others may not be assessed at all. If a business's personal property has an aggregated cost of \$100,000 or more, the business must file an itemized property statement with the County Assessor. However, unless specifically required to do so by the County Assessor, businesses with business personal property with an aggregate cost under \$100,000 are not required to provide a detailed listing. These businesses are either assessed directly by field appraisers or are required to declare the aggregate value of their business personal property. Businesses that report business personal property valued at \$2,000 or less are not placed on the assessment roll.

#### County Assessor's Process

The County Assessor reviews the self-reported declarations of business personal property costs during a two month window each year through May 7, the due date for businesses to file their business personal property statements without penalty. Besides reviewing these documents for reasonableness and possible misrepresentations, between 46 and 50 certified appraisers and appraisal clerks physically canvas every major

business district in the county between August and January of each year to conduct at least a visual check of businesses and potentially identify any major discrepancies between declared values of business personal property and actual equipment and supplies on site.

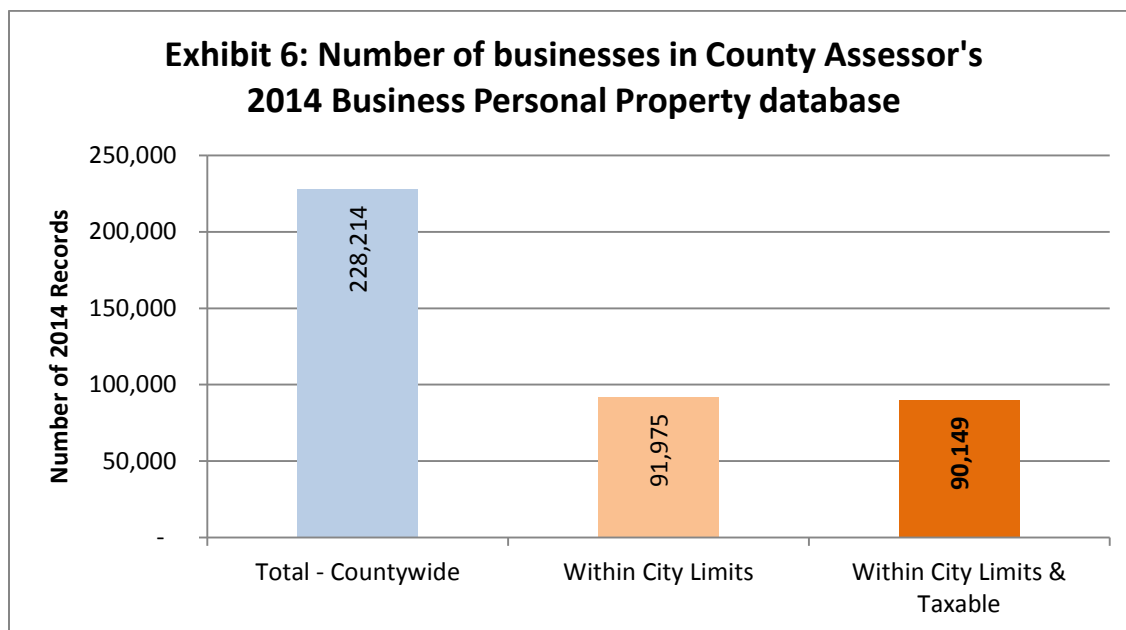
*Direct Assessment Method*

The County Assessor reports its field canvassers commonly use a direct assessment method to appraise the businesses it visits. In these cases a certified appraiser will quickly assign a value to businesses using rough approximations of visible property and the canvasser's personal understanding of the property's cost and age. The County Assessor states that during this process properties are appraised to the "...500<sup>th</sup> or 1000<sup>th</sup>, according to the judgment of the appraiser". This method sounds practical in light of the limited time they have available to appraise each business in person during their field canvassing efforts. The process does not seem to allow sufficient time for detailed inspection of facilities and equipment and supplies on site.

*Distribution of Businesses' Values*

An audit team review of the County Assessor's 2014 Business Personal Property abstracts found that the Assessor's Office had 228,214 records in its countywide database of business locations assessed with business personal property for the 2014 Unsecured Property Tax Rolls, 91,975 of which were for locations within the boundaries of the City of Los Angeles (the City). Of the records with locations within the City's boundaries, 90,149 records are designated as fully taxable, while 1,026 are designated as either partially or fully non-taxable. The partially or fully non-taxable records were excluded from this analysis. These amounts are illustrated in Exhibit 6 below.





Source: County Assessor's Business Personal Property Database

### Rounding of Assessed Values

Of the 90,149 taxable business records within City limits, 38,076, or 42.2 percent, report business personal property values that are multiples of 1,000, with at least three zeros at their end.<sup>17</sup> These values appear to be rounded to the nearest thousand because in standard number sets multiples of 1,000 are expected to occur only 0.01% of the time.<sup>18</sup> Many auditing, accounting and fraud detection manuals suggest rounded numbers can be an indicator of fraud or constructed numbers.<sup>19</sup> The businesses with rounded values represent \$599.5 million of assessed value or \$899,222 in 2014 City General Fund revenue. The majority, 98.3 percent, of the rounded values are reported as below \$100,000 in value. The lower the value reported, the higher the probability the digits in the value are rounded to the one-thousandth place. This pattern does not in and of itself indicate that property is routinely undervalued and is in line the County Assessor's stated practice of rounding. This practice suggests the opportunity for undervalued

<sup>17</sup> HMR analysis of LA County Assessor's 2014 Business Personal Property Abstracts. -

<sup>18</sup> "Digital Analysis Tests and Statistics" Mark J. Nigrini PH.D., 2002

<sup>19</sup> 1) "Fraud Examination For Managers And Auditors" 2003 by Jack C. Roberston, PHD, CPA, CFE. Chapter 15 Analysis of Digit and Number Patterns, 2) "[AU-C Section 240 Consideration of Fraud in a Financial Statement Audit](#)" American Institute of CPAs, , accessed on January 8, 2015, 3) "[Reducing Fraud with Technology](#)" Thomas G. Stephens, Jr., CPA.CITP accessed on January 8, 2015



properties, but the existence and precise level of potentially under-valued property is unknown.

#### Zero Values

According to the County Assessor's 2014 Business Personal Property abstracts, 593 of the City's taxable businesses report business personal property value of \$0. This excludes all businesses noted as exempt and partially exempt. 212 of the businesses are categorized as "TELECOM CO ISP, CELL" which may be locations leased for use as cellular telephone transmission towers. Similarly, 30 are categorized as "ADVERTISING OUTDOORS" which may be leased billboard space.

The other 351 listings are from a wide variety of other business categories, such as restaurants, shoe stores, a machine shop to wholesalers. These other examples of businesses reporting zero value do not as easily lend themselves to obvious explanation, and are possible instances of under-reporting.

#### Low Values from Sample Categories

Review of the 10 businesses with the lowest reported business personal property values in three business sector classifications from the County Assessor's database indicate that some businesses may be underreporting their values and going undetected. Thirty businesses classified as dental offices, restaurants, and printing facilities were selected for this review by the audit team because they have relatively straightforward operations, presumably with some amount of business equipment, and had a reasonable chance of being identified by the audit team on search engines and Internet tools such as Google Maps and Google Street View.

The 30 businesses reviewed ranged in reported business personal property value from \$0 to \$2,500, substantially below the median values of between \$16,000 and \$25,616 for their business sector classifications. One dental office and two restaurants each reported values of \$0, highly unlikely for their types of businesses.

The 30 lowest value businesses were researched to determine if they still appeared to be open at their reported locations and if the value of their business personal property appeared to be consistent with the values they reported to the County Assessor, as best as could be determined from Internet sources.

All of the 30 businesses reviewed were well below the values of their respective business sector classification average and median values, as shown in Exhibit 7. Information about the 30 businesses reviewed by the

audit team indicates that business personal property values reported by most of the businesses are likely understated.

#### Limitations of Sample

Despite this finding, it is difficult to truly evaluate these businesses' assessments without additional data and insight. The medians that their values are compared to are derived from the same population of assessments in question. What is missing is a separate comparison population of assessed business property that is known to be accurately assessed by an independent source. Without full access to the sampled businesses and an advanced understanding of the County Assessor's appraisal expertise the audit team is unable to independently appraise these samples. However, by using the lowest valued businesses in the sampled industries the audit team is able to see a selection of clear outliers that may be indicative of potential broader issues.

### Exhibit 7: Ten Businesses with the Lowest Reported Business Personal Property Values in Three Business Sector Classifications

	Dental Offices	Restaurants	Printing
<b>Number of Listings In Assessor's Database</b>	1,890	4,154	491
<b>Number of Case Study Samples</b>	10	10	10
<b>Median Value of Businesses In Sector</b>	\$25,616	\$16,000	\$20,000
<b>Range of Reported Values in Sample</b>	\$0 to 2,000	\$0 to 1,000	\$1,500 to 2,500
<b>Number Appearing Open For Business on Internet as of 1/1/14</b>	10	10	8
<b>Number Appearing Undervalued</b>	9	9	5

Source: County Assessor database

The basis for selecting the three business sector classifications reviewed and examples of some results of the research on these businesses are as follows.

#### Dental Offices

Dental offices provide a good case study because they are easily understood businesses that often require a number of highly specialized pieces of equipment and tools, or business personal property. One guidebook for dental clinics suggests a small 3 chair/operator will cost \$185,234 in large equipment, and another \$52,218 in supplies, instruments and small equipment. Even more conservatively, a purely portable dental operation is estimated to spend \$47,301 on equipment.<sup>20</sup>

<sup>20</sup> "Safety Net Dental Clinic Manual – Chapter 2 Facilities and Staffing", dentalclinicmanual.com, accessed on January 9, 2015.

In some instances dental equipment may be assessed as a fixture, such as a chair or x-ray machine that is bolted to the building. For assessment purposes, fixtures are property that is considered annexed in to the building as an improvement with the “intent that it remain annexed indefinitely”.<sup>21</sup> The assessment of fixtures versus business personal property is complex, nuanced and steeped in many court cases guiding these definitions. Given the complexity of estimating fixture value, the audit team conservatively assumed that all of the large equipment might be assessed as a fixture. However, small equipment, which would clearly be assessed as business personal property, still has a value of \$52,218.

In all ten of the sample dental offices reviewed, their values are significantly lower, with the highest reported value at only \$2,000, and one even reporting \$0. In all of these cases their reported value is far below what would be reasonable to assume for dental offices.

### Restaurants

Similar to dental offices, restaurants are generally easily understood businesses that often require specialized pieces of equipment and tools. However, unlike dental offices, it is easier to imagine some restaurants with only minimal equipment and facilities.

Restaurants have the same issue of understanding the nature of a business’s fixtures versus business personal property. For example, a built-in refrigerator would be assessed as a fixture, whereas a standalone refrigerator would be business personal property. Without visual access to a restaurant’s kitchen it is difficult to speculate on their likely amount of fixtures versus business personal property. However, many of the restaurants reviewed had visual evidence of property in their dining area that suggested their reported values might be low. This is especially true of the two restaurants that reported a value of \$0. There would be at least some minimal value to the free stranding furniture visible on online photos of the restaurant and likely even trivial value to equipment in the kitchen such as pots and pans.

There is a wide range of information available on the cost of opening a restaurant. These costs range from thousands to millions of dollars depending on the size and type of restaurant. A mid-ranged example from a guide on Inc.com for starting a franchise restaurant suggests tables and furniture could cost \$40,000 and tableware, utensils, dishes, kitchen, and

<sup>21</sup> Assessor’s Handbook Section 504 “Assessment of Personal Property and Fixtures” Page 13, updated October 2002.

bar equipment another \$80,000.<sup>22</sup> On the low-end, an article from Forbes.com describes one example of a restaurant owner that opened a business which sells “global street food” for as little as \$13,000.<sup>23</sup>

#### *Printing*

Unlike dental offices and restaurants, the activities of the printing category are diverse ranging from smaller retail print shops such as Kinko’s to larger scale commercial printing facilities. The ten lowest valued businesses in this category included both types. We chose this category assuming that if we could find specific equipment that we could estimate the used value of and gauge the magnitude of any possible discrepancy.

#### *Potential Causes of Low Values*

The low and rounded values observed in the County Assessor’s 2014 rolls could be explained by the County Assessor’s process and limitations of their systems. The County Assessor’s Office reports that it prioritizes assessing and auditing only large-sized businesses with values over \$1.9 million. This is driven by the expense of assessing business property, which the County Assessor reports is as much as seven times more expensive than assessing real property in Los Angeles County. The County Assessor also reports that its systems cannot efficiently review many self-reported and direct assessed values. County Assessor staff report this is attributed to limited time, limited staff resources, and a paper-based process that does not allow for efficient filtering and reviewing of values before manually entering assessed values on the rolls. Further, the County Assessor confirmed that most assessments from field canvassing are done using direct assessment, a process they describe as reliant on the appraiser’s visual review and personal understanding of the value of a business.

These assertions are supported by the observation that 38,076, or 42.2 percent, of the values of all businesses are rounded to the one-thousandth place, which is often a sign of constructed numbers. It suggests that these assessed values receive little scrutiny or attention to their precision and accuracy, which seems in line the County Assessor’s practices. Further, this process provides very limited controls to prevent fraudulent or inaccurate

<sup>22</sup> “The Cost of Starting Up a Restaurant” Inc.com by Gina Pace, <http://www.inc.com/articles/201111/business-start-up-costs-restaurant.html>, accessed on January 9, 2015.

<sup>23</sup> “Bootstrap Startup: Inside A \$13K Restaurant Opening” Forbes.com, by Carol Tice, published 11/24/2013, [www.forbes.com/sites/caroltice/2013/11/24/bootstrapstartups13krestaurantopening/](http://www.forbes.com/sites/caroltice/2013/11/24/bootstrapstartups13krestaurantopening/), accessed on January 9, 2015.

reporting by businesses or by the field canvassers performing direct assessments.

*Reliance on Field Canvassing*

As discussed above, an agreement is not in place between the City and County Assessor to share confidential business certificate data. Without this secondary data source the County Assessor is reliant on costly canvassing efforts to enroll businesses and appraise them using the seemingly imprecise direct assessment method. The County Assessor may not have sufficient time and information dedicated to examining and possibly correcting the direct assessed values or the self-reported values that appear under-reported by businesses.

*Potential Revenue From Collaboration*

Closer collaboration between the City and County Assessor could yield additional revenue for both parties, and lend greater operating efficiency to the County Assessor. Without more data and insight it is difficult to estimate the amount of this potential revenue. A simplified approach is to take the 38,071 businesses with business personal property value in numbers ending with 000s. These values appear to be products of the County Assessor's direct assessment method. Since this method provides very limited time and precision, as noted by the County Assessor's practice of routinely rounding values, the estimate assumes half of these values could be underreported by as much as 50 percent. This would result in an estimated \$394,159 in Unsecured Property Tax revenue that was foregone for the City in 2014, as shown in Exhibit 8.

### Exhibit 8: Estimated Revenue Effects of Potential Businesses Under-Valued Business Personal Property Tax

Assumption	Number of Businesses	Contribution to Assessed Value	Contribution to 2014 City General Fund Revenue
Half of Rounded Businesses Under-Valued	19,036	\$149,870,250	\$394,159
By an average of 50%			

#### Limitations of Estimate

Due to the limited data and insight available to the audit team these revenue estimates are very limited in nature. They provide a look at potential revenues that could be gained from closer collaboration and data sharing between the City and County Assessor. The audit team is unable to conclusively identify the true size of the tax gap and foregone revenue without more data and insight.

The estimated forgone revenue is low because as noted previously, most of the businesses that appear to be rounded and subject to the direct assessment process are often low-value. Given their smaller property values and potential revenue they may offer only marginal benefit for the County Assessor to more precisely appraise. The biggest value may be in the potential for the County Assessor to more efficiently discover, assess and bill business personal property that is identified using data shared by the City. This could potentially free staff resources within the County Assessor's Office to pursue higher-value business property.

#### Other Indicators

The theory that some businesses are under-valued is supported by the audit team's review of case studies from the dental, restraint and printing industries. The review included 30 businesses that reported the lowest value business personal property in their business sector classification. These businesses had values that were several magnitudes lower than the minimum expected values for their categories. For example, the dental offices comprising the case studies reported values ranging from \$0 to

\$2,000, in stark contrast to estimates from professional sources that suggest the smallest dental offices require \$52,218 in supplies, instruments and small equipment. Even accounting for older depreciated equipment the reported values are magnitudes lower than the values one would expect to find.

Finally, 58.8 percent of the businesses assessed do not report rounded numbers and may in fact be providing accurate information on the value of their business personal property. Businesses in compliance with the law are disadvantaged compared to their counterparts who may not be paying their full share of the tax. The result is a potentially unfair business environment where a significant portion of the businesses may not be paying their full share of taxes.

#### *Other Opportunities to Collaborate*

Beyond the recommendations that the City share data and collaborate with the County Assessor, there are other areas for potential collaboration. The County Assessor in particular may find valuable data with other governmental agencies and may benefit from increased collaboration with those agencies and other local governments. For example, the Los Angeles County Recorder's Office maintains records of Uniform Commercial Code financing statements, which record assets for loan agreements that use personal property as collateral. These agreements are recorded in the County if real property is affected.

In some cases, businesses with debt may have made filings that could provide insight into a company's previously unknown assessable business property. Outside of the County, state agencies such as the Board of Equalization or the Franchise Tax Board may have data available and opportunities to collaborate on mutually beneficial enforcement. Some models for this already exist, such as the Board of Equalization's Municipal Revenue Enhancement Program, which works with cities and counties to improve Sales and Use Tax enforcement. Another is the Franchise Tax Board's City Business Tax Program Data Exchange, which provides a secure data clearinghouse to compare cities' business certificates against the State's corporate income tax records and identify discrepancies on both sides.



**Recommendations:**

**The Office of Finance should:**

- 2.1 Collaborate with the County Assessor's Office to determine the data each entity has and what would be useful to each other in the interest of identifying businesses whose assessable business property values are likely underreported.**
- 2.2 Prepare an internal analysis of how Office of Finance business tax registration certificate records could be analyzed by industry, area and other characteristics to help identify businesses with likely under-reported business personal property valuations.**
- 2.3 In collaboration with the County Assessor's Office, determine other City, County and other government entities with whom data sharing opportunities exist in the interest of improved assessment and collection of property taxes.**

*Data Limitations and Issues*

Both findings rely heavily on the data purchased from County Assessor's database of Business Personal Property for the 2014 Unsecured Property Tax Rolls. This is the commercially available database listing taxpayer information and assessment amounts for all business personal property tax assessed in the 2014 tax year. The first finding was identified using an analysis investigating if any taxpayers were missing. To draw a comparison, a database of active businesses registered with the City's Office of Finance business tax registration certificate (businesses certificate) program was used. The second finding is drawn from an analysis investigating if the values in the County Assessor's 2014 database are accurate. Both findings were informed by a robust dataset and analysis. However, they were limited by the lack of access to Assessor's Office data and limited communications with County Assessor's Office staff.

Special attention was paid to filtering data by the appropriate geographical areas when using data from both the City's and County's databases. The County Assessor's database in particular was examined to review only businesses with locations within the legal boundaries of the City of Los Angeles. In the case of the City's business certificate data, only businesses with locations within the City limits were included. For example, some businesses conduct activity within the City and register but do not have a physical location within the City. These remote businesses were excluded from the analysis. All of the resulting analysis focused only on businesses with a physical location within City limits.

*County's Internal Database and Leased Equipment*

As noted earlier, the County Assessor has subsequently noted that several businesses and assessment records that do not appear in their commercially available database do in fact appear in their internal database and system. Part of this could be explained by what is assumed to be the County Assessor's system containing more sophisticated records of leased property. This information may not be fully accounted for in their commercially available database. If this is true then some of the discrepancies identified by the audit team may be explained. As such, all estimates maintain conservative assumptions to account for the possibility that some of the seemingly missing or under-valued businesses are in fact accounted for and fully assessed.

## Section II: Opportunities for Improving Real Property Tax Assessments and Collections

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### Reduced Property Tax Revenues Resulting from Lack of Data Sharing

Most of the City's real property tax receipts are derived from the one percent tax on the taxable value of property, as determined by the County Assessor. Therefore, if the Assessor's Office lacks information necessary to determine the value of property, property tax receipts will be affected.

This finding highlights information held by the City and the County of Los Angeles that is not shared with the Assessor's Office but that the Office needs in order to establish accurate taxable property values. The sections below describe how the Assessor's Office values properties that are the subject of this finding.

#### Valuation of Major Hotels

The County Assessor reports that it uses the "income approach" to determine the assessed value of major hotels (those with 50 or more guest rooms). Hotel income is estimated by the Assessor's Office for the year following the date of valuation. Expenses are also estimated and deducted from the income to arrive at the Net Operating Income (NOI) attributable to the property. The NOI is then capitalized by dividing it by a market-derived capitalization rate (roughly speaking, the return on investment of similar properties in the market). The result is the estimated market value of the real property as of the valuation date. To the extent that Net Operating Income is over- or under-estimated, property tax receipts will be affected.

#### Re-Appraisal of Properties Due to Change of Ownership

When a change in ownership has occurred, Proposition 13 requires the County Assessor to reassess the property to its current fair market value *as of the date ownership changed*. When a property owner dies, the date of ownership change is the date of death. The Assessor is required by law to re-appraise the property as of the date of death, unless the re-appraisal is specifically exempt by State law. A detailed listing of change-of-ownership re-appraisal exemptions is provided as Exhibit 9.

Since property taxes are based on the assessed value of a property at the time of acquisition/death, a current market value that is higher than the previously assessed Proposition 13 adjusted base year value will increase the property taxes. Conversely, if the current market value is lower than the

previously assessed Proposition 13 adjusted base year value, then the property taxes on that property will decrease.<sup>24</sup>

**Finding No. 3: The City does not share data with the County Assessor that would facilitate accurate valuation of major hotels, and the County of Los Angeles Recorder does not share sufficient data with the Assessor that would result in accurate and timely reassessment of certain properties that may reduce property tax revenue to the City and other County taxing entities.**

To properly appraise the value of major hotels, the County Assessor needs to know the subject hotel's income. The City collects hotel gross income information on its business tax forms and hotel revenue from its taxable room rentals due to collection of transient occupancy taxes. Although the Assessor has other resources available to estimate a hotel's income, not sharing this information with the Assessor increases the risk of substantial revenue -reductions. For example, the Assessor furnished the audit team information regarding five appeals of the value of major hotels in early 2015. The assessed value of these properties was nearly \$1 billion, or almost \$200 million each. A five percent under-estimate of just one of these hotels' assessed value, or \$10 million in underassessment, would result in a revenue loss to the City of approximately \$25,300.

Although specific losses cannot be estimated, since the City has more than 500 major hotels, the fact that the City does not share the hotel income information it collects increases the risk that property tax receipts will be materially less than they would have been if the information been shared.

To reassess to market value property that has transferred as a result of the death of the owner, the County Assessor must have the date of the owner's death. The County Recorder shares date of death information with the Assessor's Office pursuant to a Memorandum of Understanding (MOU). However, the shared information is usually too limited to enable the Assessor's Office to match a decedent to a

<sup>24</sup> Source: Board of Equalization, <http://www.boe.ca.gov/proptaxes/faqs/changeinownership.htm#2>.

**property. By expanding the scope of shared information to include addresses and other identifiers, the County Recorder would facilitate the Assessor's legal mandate to bring such properties to market value.**

**For each City property not reassessed as of the owner's date of death, the City General Fund loses an estimated \$378 in ongoing annual revenue. If 50 percent of the 4,388 properties transferred in 2012 were not reassessed timely, the City lost an estimated \$830,100 in property tax revenue. For the County, the loss is estimated at \$773,000 per year.**

## **Sharing City Information on Hotel Income with the Assessor**

### City Hotels

According to the U.S. Census Bureau's 2007 Economic Census of the United States (the most recent data available), 37 percent of hotels and motels in the County of Los Angeles were located in the City of Los Angeles. The Census showed that City hotels and motels took in 17.2 percent more receipts per establishment than the average County establishment. Based on information through 2013 published by the Los Angeles Convention and Visitor's Bureau, the volume of rooms rented per night Countywide has increased by an estimated 14 percent since that census was taken. According to the County Assessor, there are 555 "major" hotels with more than 50 guestrooms in the City.

### Valuing City Hotels

As previously described, the Assessor uses the "income approach" to determine the value of major hotels. Unless the hotel owner has supplied income information, the Assessor's Office estimates income based on the best available information whenever it must re-assess the properties, such as when they are sold, when they are reassessed due to return-to-value following assessed value reductions<sup>25</sup>, and for purposes of assessment appeals. Based on the Assessor's reported 27 major hotel reassessments for Fiscal Year 2014-15 as of December 2014, we estimate the County will reassess about 59 major Los Angeles hotels in FY 2014-15. According to the Assessor, in many cases, the incomes of these hotels are estimated since the County Assessor does not have actual receipts data.

<sup>25</sup> "Proposition 8" permits a temporary reduction in assessed value when real property suffers a decline in value, as happened in 2008 when the housing market collapsed.

Due to the volume of major hotels, the ongoing growth in nightly rentals, and the higher-than-average incomes of City hotels, inadequate hotel income data increases the opportunity for inaccurate assessments. In response to the draft of this report, Assessor's Office management stated that hotel income is volatile, such that there may be material changes from one year to the next. Management reported that when hotel income is rising, hotels are more likely to refuse to provide their income to the Assessor's Office. While the revenue effect of lack of hotel income information cannot be quantified with data furnished for this audit, it is likely that the full taxable value of hotel properties may not be captured each year, particularly when economic conditions are improving.

Scale of Assessed Value at Risk

According to data furnished by the Assessor's Office, in early 2015, appeal hearings were scheduled for five major hotels in the City of Los Angeles with an aggregate assessed value of nearly \$1 billion, or an average of nearly \$200 million per hotel. Even a one percent difference in assessed value on the average of these hotels equates to \$20,000 of annual revenue to the County's taxing entities. Just a five percent underestimate of one of the hotel's assessed values, or a difference of \$10 million, would result in approximately \$25,300 in lost City revenue.

We estimate that there will be 59 reassessments to City hotel properties in FY 2014-15. Even small variances in the assessed value due to estimated versus actual hotel income would equate to hundreds of thousands of dollars in revenues to the County's taxing entities. Over the course of a few years, hundreds of hotel reassessments are likely to occur, increasing the cumulative exposure to potential revenue reductions, particularly during periods of increasing hotel revenues.

We requested data for hotel valuation changes based on estimated versus actual income, but the Assessor's Office did not provide the information. We then requested redacted examples of specific instances of valuations that were materially affected by lack of income information, but none were received. However, based on the appeals data that was furnished, the City's exposure to property tax losses due to under-assessment of hotels due to under-estimation of those properties' income or successful appeals of over-assessed properties due to over-estimation of income is substantial. Although it is likely that both over- and under-estimates occur, over-valuations may be corrected by property owners through the appeals process, while under-valuations are not subject to a systematic corrections

process. The most likely outcome of the lack of income information by hotel is therefore loss of revenue to the City and other taxing entities.

*The City's Hotel Income Records*

The City of Los Angeles has two types of records that capture hotel receipts. The best source is the City business tax application, which requires reporting of annual gross receipts. The second is transient occupancy tax ("bed" tax) payments by hotels to the City. This tax is a percentage of the rate charged by the hotel for the room.<sup>26</sup>

The reported gross receipts is a far better source for use by the Assessor's Office, as it captures not just taxable room charges, but hotel receipts from all charges, including parking, meal services, etc. In addition, transient occupancy taxes are only collected on taxable rooms. Some room sales, such as those to government employees traveling on official business, are not taxable.<sup>27</sup>

Currently, the City shares neither hotel tax receipt data nor reported gross receipts data with the Assessor's Office. The City should ensure that property tax receipts from hotel properties are maximized and equitable by sharing both its gross receipts income data and its transient occupancy tax data by individual hotel with the County Assessor.

In its response to a draft of this report, officials with the City Office of Finance objected to sharing this information with the Assessor's Office for two reasons. First, they said that sharing this information is prohibited by the City's Municipal Ordinance Code Section 21.17. Subsection "a" does prohibit disclosure generally. However, subsection "b," part 2, states:

"Nothing in this section shall be construed to prevent ... the disclosure of information to or the examination of records by ... the tax officials of another city or county, or city and county, if a reciprocal arrangement exists..."

We recommend that the City Attorney determine whether provision of the records in question to the County Assessor would be illegal or not.

Second, the Office of Finance management expressed concern that providing income information would hurt the City's Business Tax compliance and revenue collection, as it would make businesses reluctant to provide

<sup>26</sup> This tax is imposed on occupants of hotels. The current tax is 14 percent of the room rate, per City ordinance code Section 21.7.3.

<sup>27</sup> Section 21.7.4 b of the code states that the tax does not apply to federal and state employees who are staying in the hotel while conducting official business.



accurate information to the Office of Finance. They noted that it could be construed as “unfriendly” to business.

While some hotels may be more motivated to understate their income if it is shared with the Assessor, the current practice effectively provides the opportunity for a property tax break to hotels that do not furnish income information to the Assessor’s Office.

Such hotels are better off relative to: a) other types of property taxpayers, including other types of businesses that cannot as easily conceal property value, and b) competing hotels that may disclose their income to the Assessor’s Office. Prioritizing certain taxpayers over others is a common feature of tax codes approved by taxpayers’ representatives. For the City to indirectly aid certain taxpayers raises questions of equity that are not addressed by the City’s ordinances and therefore may or may not reflect taxpayers’ priorities.

## **Sharing County Information that Triggers Re-assessment of Property**

### *Change of Property Ownership Affects Property Tax Receipts*

Many properties are not assessed at their fair market value because California law<sup>28</sup> restricts increases in assessed value to two percent or less per year, regardless of what the property is worth. By law, this gap between the taxable value and the market value of property is supposed to be eliminated when there is a change in ownership. When property is acquired by a new owner, County Assessors are required to re-assess the property to its fair market value as of the date of acquisition, unless the property is specifically exempt from reassessment under State law.

When a property owner dies, the date of death is the date of change in ownership, and the date of the new valuation of the property. The personal representative of the deceased is supposed to file a statement with the Assessor in each county where the decedent owned property at the time of death to notify the Assessor of the change in ownership that triggers reassessment.<sup>29</sup>

### *Reassessment Exemptions*

Once the Assessor’s Office determines the date of death, the property is required to be reappraised to fair market value as of that date unless it is specifically exempt from re-appraisal by State law. A listing of specific

<sup>28</sup> Proposition 13.

<sup>29</sup> Title 18, Public Revenues California Code of Regulations, Division 1, Chapter 1, Subchapter 4, Article 4, Rule 462.260 (C) and Section 480(b) of the California Revenue and Taxation Code.



exemptions from re-appraisal is provided as Exhibit 9. For example, if one spouse dies, the surviving spouse does not face reassessment of the couple's home. However, many exemptions associated with the death of the property owner are not automatic. They require an heir to file a claim for exemption from reappraisal and the claim must meet the criteria for exemption.

For example, in FY 2012-2013, the most recent year for which data is available, 12,839 claims were filed in Los Angeles County for reassessment exemptions due to property having been inherited by children or grandchildren.<sup>30</sup> Most of these were approved, but 852 – or 6.6 percent – were denied. That is, at least 852 County properties were reassessed despite having been inherited by the decedent's immediate family. Per the methodology described later in this section, these reassessments generated an estimated \$1.23 million in new, ongoing annual revenue for all of the County's taxing entities.

#### City General Fund Estimated Revenue Reductions

Despite the legal requirement for representatives of the deceased to notify the Assessor of the death of property owners, the Assessor's Office reports that such representatives often fail to file such reports. As a result, the Assessor is unable to reassess these properties as required by law.

We estimated the lost revenue from the inability to appraise due to lack of dates of death as follows. According to the Los Angeles County Assessor's 2014 Annual Report, 141,000<sup>31</sup> properties in the County were reappraised in 2013. Based on data in the report, each of these reappraised properties added an average of \$143,860<sup>32</sup> in new assessed value to the 2013 roll. Thus, we estimate that for each re-appraisable City property that transferred due to death in 2013, the City General Fund should have received about \$378<sup>33</sup> in additional, ongoing revenue (at the one percent rate).

Based on U.S. Census Bureau housing data and mortality data from the Los Angeles County Public Health Department, we estimate that at least 4,388<sup>34</sup>

<sup>30</sup> A Report on Budgets, Workloads, and Assessment Appeals Activities 2012-13, Board of Equalization, Table F, propositions 58/193

<sup>31</sup> Report page 11, reappraisable deeds.

<sup>32</sup> Report page 8, \$20.3 billion in additional value due to properties sold/transferred divided by 141,000 reappraisable sales/transfers.

<sup>33</sup>  $\$143,860 \times .01 = \$1,438.6$  \*  $26.3\% = \$378.35$ . Actual receipts would be higher due to property tax allocations in lieu of sales tax and motor vehicle license tax.

<sup>34</sup> Per the Census Bureau, the homeownership rate on City households is 37.6 percent. Homeownership rate is defined as owner-occupied households divided by all households. Therefore, 37.6 percent of 1,320,960 households, or 496,681 households, are owned by residents. Per the County Public Health Department, there were 57,045 deaths in the

City homes were transferred upon the death of the resident homeowner in 2012 (the most recent mortality data available). We have not been able to estimate the number of non-resident occupied homes or businesses that transferred due to death of the owner.

*For each one percent* of these 4,388 homes (or approximately 43.88 homes) that should have been reappraised as of the date of the homeowner's death but were not reappraised due to lack of awareness of the death by the Assessor, the City General Fund lost an estimated \$16,602 in that year and every year thereafter (43.88 homes x \$378.33 in incremental revenue). (Again, this estimate does not include properties that transfer due to death that are not occupied by an owner, such as vacant homes, businesses, second homes and rental property.) Therefore, if 50 percent of the 4,388 homes transferred were eligible for reassessment, the City General Fund revenue loss each year going forward is estimated at  $50 * \$16,602$  (the estimated lost revenue for every one percent of the homes x 50), or \$830,100 in lost revenue; if 75 percent were eligible for reassessment, the revenue loss each year going forward is estimated at  $75 * \$16,602$  or \$1,245,150 and so on. We are unable to estimate the rate of properties of the deceased that qualify for an exemption. However, as previously noted, even properties on which immediate relatives have claimed exemptions, at least 6.6 percent are reappraised. For the County of Los Angeles, the loss if 50 percent were eligible for reassessment would be \$773,291.

Upon discovery of an unrecorded deed due to death, the Assessor is able to go back eight years to reappraise. If the Assessor gained access to timely death information as a result of this audit, the ability to retroactively reappraise could ultimately result in new, one-time tax receipts, and a larger tax base going forward. This is in addition to reducing the extent of properties that are subject to reappraisal due to death in the future but that may not be discovered timely.

#### Role of the County Recorder's Office

At our request, the Los Angeles County Registrar-Recorder/County Clerk (Recorder) furnished copies of two MOUs between the Recorder and the Assessor related to sharing information from the Recorder's "YODA" database. A 2009 memorandum of understanding (MOU), amended in 2011, grants the Assessor's Office access to the Real Property Index in the YODA

County of persons 25 or older in 2012. Based on Census reports of the total number of persons in the County aged 25 or older, this equates to 0.9 percent death rate. Applying this rate to the estimated City population of owner-occupied households, results in an estimate of 4,388 City residents who owned their homes and died in 2012.

system. A 2010 MOU grants the Assessor access to YODA's Vital Records Index. Access to the Vital Records index enables the Assessor's Office to obtain a decedent's name, date of birth and date of death. However, the Assessor's Office reports that the level of detail that is shared is usually insufficient to enable the Assessor's Office to match a decedent to a property. For example, according to the Assessor's Office, a decedent's address is not provided.

Without the ability to match a date of death to a decedent and a property, the Assessor cannot reappraise a property that has transferred due to that death.<sup>35</sup> On average, it remains on the roll at \$143,860 less than its market value. If the Assessor had access to identifying information from the death certificate, its Appraisers could immediately determine the lien date for reassessments due to death. To reappraise the property, the Assessor's Office would then investigate ownership and whether the property was subject to or exempt from reassessment.

However, management of the Los Angeles County Recorder's Office stated that death certificate -images cannot be released to the Assessor's Office due to confidentiality requirements of State law. Applicable portions of California Health and Safety Code Sections 103525 through 103528 restrict distribution of death certificate information to "authorized" persons, which is defined by Section 103526 (c) 2 (c) to include

"...a representative of another governmental agency...who is conducting official business."

Therefore, we believe that the Assessors' Office's access to decedents' information for the purpose of carrying out a task mandated by State law is permissible under the confidentiality statute. In a written response to a draft of this audit report, the Recorder stated that the office is "open to discussing expanding the YODA access where applicable pursuant to legislation for the City or Assessor." In its response, the Assessor also noted that the issue is under review by the Recorder. The City has an existing agreement with the Recorder for the collection of the City's Real Property Transfer Taxes. We recommend that the City either amend that agreement or enter into a new agreement to require the Recorder to furnish access to complete images of death certificates of City property owners to the Assessor to enable the Assessor to properly value properties transferred upon death.

<sup>35</sup> The Assessor's staff reports contacting heirs when feasible but that the heirs often do not respond to Assessor inquires.

Although we have made estimates of losses primarily of City General Fund property tax receipts, this issue affects the receipts of every taxing entity in the County.

### **Recommendations**

**The City Office of Finance and the City Attorney should:**

- 3.1 Facilitate entering in to a Memorandum of Understanding with the County Assessor's Office to: 1) track transient occupancy tax receipts by hotel and furnish this information monthly to the County Assessor's Office, and 2) supply annual gross receipts as reported for City business tax purposes to the Assessor's Office upon receipt.**
- 3.2 Amend the existing real property transfer tax agreement between the City and County Recorder, or enter into a new agreement, with the County Recorder to require the Recorder to furnish access to complete images of death certificates of City property owners as needed by the County Assessor's Office to fulfill its duty to reassess property effective on the date of the owner's death.**
- 3.3 Approach the County Public Health Department for access to death information records for purposes of reassessment of property upon the death of the property owner if such an arrangement cannot be made with the County Recorder.**

## Exhibit 9: State Board of Equalization Listing of Property Changes in Ownership Excluded by Law from Re-Appraisal

If a transfer of real property results in the transfer of the present interest and beneficial use of the property, the value of which is substantially equal to the value of the fee interest, then such transfer would constitute a change in ownership unless a statutory exclusion applies. While a transfer of real property may constitute a change in ownership, the legislature has created a number of exclusions so that some types of transfers are **excluded**, by law, from the definition of change in ownership. Thus, for these types of transfers, the real property will not be reappraised.

An **exclusion** occurs when the assessor does not reassess a property because the property or portions of the property are automatically excluded from reassessment or is eligible to be excluded if the owner properly files a claim. The following list covers most changes in ownership that are excluded from reassessment, either automatically or by claim; however, there may be other excludable qualifying transactions not listed here.

Changes in ownership that require a **claim to be filed** to avoid reassessment include the following:

- Transfers of the principal place of residence between parents and their children (there is no limit on the value of the residence) if a completed application is filed timely with the county assessor's office (Proposition 58).
- Transfers of up to \$1 million of real property between parents and their children, other than a principal place of residence, if a completed application is filed timely with the county assessor's office (Proposition 58).
- Transfers of a principal place of residence from grandparents to their grandchildren, but not vice versa (and the transfer of up to \$1 million of other real property from grandparents to their grandchildren) provided that:
  - the transfer occurs on or after March 26, 1996;
  - the grandchild(ren)'s parent (grandparent's child) died on or before the date of transfer; and
  - a completed application is timely filed with the county assessor's office (Proposition 193).

- Transfers of the principal residence between two cotenants that occur upon the death of one of the cotenants, provided that:
  - The two cotenants together owned 100 percent of the property as tenants in common or joint tenants.
  - The two cotenants must be owners of record for the one-year period immediately preceding the death of one of the cotenants.
  - The property must have been the principal residence of both cotenants for the one-year period immediately preceding the death of one of the cotenants.
  - The surviving cotenant must obtain a 100 percent interest in the property.
  - The surviving cotenant must sign an affidavit affirming that he or she continuously resided at the residence for the one-year period preceding the decedent cotenant's date of death.
  
- The purchase of a replacement dwelling by a person who is 55 years of age or older, where the replacement dwelling will be that person's principal place of residence and is equal or lesser in value than the original residence. In such cases, the base year value of the previous home may be transferred to the new home so that the new home will not be reassessed to its current fair market value but will be able to retain the old home's base year value. The original and replacement residences must generally be located in the same county; however, as of May 2008, seven counties allow a transfer of the base year value from the original property located in another county to a replacement dwelling located in that county (Proposition 60/90).
  
- The purchase of a replacement property if the original property was taken by governmental action, such as eminent domain or inverse condemnation.
  
- The purchase of a new principal residence by a person who is severely disabled (Proposition 110-same as Propositions 60/90).
  
- Transfers of real property between registered domestic partners that occurred between January 1, 2000 and January 1, 2006 (section 62(p) of the Revenue and Taxation Code). County assessors are required to reverse any reassessments that resulted from any transfers of real property between registered domestic partners that occurred during this time period if the taxpayer files a timely claim. However, relief for such a reversal is applied

only on a prospective basis. The registered domestic partners will not receive any refunds.

Changes in ownership that are automatically excluded from reassessment include the following:

- Transfers of real property between spouses, which include transfers in and out of a trust for the benefit of a spouse, the addition of a spouse on a deed, transfers upon the death of a spouse, and transfers pursuant to a divorce settlement or court order (section 63 of the Revenue and Taxation Code; Rule 462.220).
- Transfers of real property between registered domestic partners that occur on or after January 1, 2006, which include transfers in and out of a trust for the benefit of a partner, the addition of a partner on a deed, transfers upon the death of a partner, and transfers pursuant to a settlement agreement or court order upon termination of the domestic partnership (section 62(p) of the Revenue and Taxation Code).
- Transactions only to correct the name(s) of the person(s) holding title to real property or transfers of real property for the purpose of perfecting title to the property (for example, a name change upon marriage).
- Transfers of real property between coowners that result in a change in the method of holding title to the property without changing the proportional interests of the coowners, such as a partition of a tenancy in common.
- Transfers between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, or a partnership to a corporation, that results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and the transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remains the same after the transfer.
- The creation, assignment, termination, or reconveyance of a lender's security interest in real property or any transfer required for financing purposes only (for example, co-signor).
- The substitution of a trustee of a trust or mortgage.
- Transfers that result in the creation of a joint tenancy in which the transferor remains as one of the joint tenants.

- Transfers of joint tenancy property to return the property to the person who created a joint tenancy (i.e., the original transferor).
- Transfers of real property to a revocable trust, where the transferor retains the power to revoke the trust or where the trust is created for the benefit of the transferor or the transferor's spouse.
- Transfers of real property into a trust that may be revoked by the creator/grantor who is also a joint tenant, and which names the other joint tenant(s) as beneficiaries when the creator/grantor dies.
- Transfers of real property to an irrevocable trust for the benefit of the creator/grantor or the creator/grantor's spouse.



### **Section III: Real Property (Documentary) Transfer Tax**

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State law provides for the collection by counties of Documentary Transfer Taxes, at a rate of \$0.55 per \$500 of taxable real property value transferred. In most cases, a transfer occurs when there is a change of ownership. Transfers are taxable unless they are exempt. For example, if a property owner has a name change, the law exempts from taxation the recording of the property under the new name.

Unless a city has established its own transfer tax that is not in conformity with the State tax amount<sup>36</sup>, counties share (50/50) these revenues with the cities in which the transfer occurred. Under the law, legal documents supporting the transfer may not be recorded at the county recorder unless the Documentary Transfer Tax is paid.

In some cases, charter cities establish their own, separate taxes on transfers of real estate. These taxes are related to Documentary Transfer Tax in the sense that each tax applies to the *same transactions*, but they are not the same tax. City real property transfer taxes are imposed by City ordinance, with rates, exemptions, and collections practices established by the cities, and with all net revenue going exclusively to the establishing city. The two taxes are legally separate, and, as described in detail later in this section, taxpayers who pay the Documentary Transfer Tax have the right to recordation of the transfer whether they pay the City tax or not. In practice, according to Los Angeles County Recorder's Office management, since 2007, the Recorder's computer system will not allow recording of a transfer unless *both* taxes are paid.

Section 11933 of the California Revenue and Taxation code specifies that County Recorders *shall not* record transfers subject to the Documentary Transfer Tax, *unless the Documentary Transfer Tax is paid at the time of recording*. In other words, the taxpayer must pay the Documentary Transfer Tax to record the transfer.

Section 27201(a) of the California Government Code states that the Recorder *shall, upon payment of proper fees and taxes*, accept for recordation any instrument that otherwise meets the requirements of the law. In other words, once "proper fees and taxes" are paid, the Recorder *must* record an acceptable document. Based on our research, the standard

<sup>36</sup> Per Revenue and Taxation Code Section 11931.

interpretation is that once the Documentary Transfer Tax is paid, the transfer must be recorded, whether the City tax has been paid or not.

As stated in Section 10.9, "City Tax", of the Los Angeles County Recorder's policies:

"Basically the cities' tax regulations are the same as those of the State imposed tax [Documentary Transfer Tax], except for the rate and the fact that the *Recorder does not have the right to refuse a document for recording if the city tax is not paid.*" (Emphasis added.)

The policy describes the procedure to notify cities with their own transfer tax in Los Angeles County that a document has been recorded without payment of the City tax.

Further, Section 2 of the agreement that governs the County's collection and remittance of the City tax specifically requires the County to "transmit to City copies of the documents which indicate the tax was unpaid at the time of recordation. The responsibility of thereafter collecting the tax shall be that of the City."

The agreement further states that only the City shall issue refunds of its tax, and the City will handle any disputes related to its tax. Section 21.9.11 (b) of the City's ordinance code specifically authorizes the Director of Finance, acting as the City's tax collector, to seek payment of unpaid City Real Property Transfer Taxes through assessments.

The City of Los Angeles has established its own City Real Property Transfer Tax ordinance. The current rate is \$4.50 per \$1,000 of value transferred.

If a city establishes its own transfer tax at a different rate than the Documentary Transfer Tax, it collects revenues from this source but does not receive County Documentary Transfer Tax receipts<sup>37</sup>. Typically, cities that have imposed their own taxes contract with the county to collect and remit the city taxes. However, once the County Documentary Transfer Tax is paid, under State law, the documents must be recorded, whether the city tax is paid or not.

Under Section 21.9.11 (b) of the City of Los Angeles Municipal Code, if the County does not collect the City's tax due, the City Director of Finance:

<sup>37</sup> The City budget documents and the remittance from the County Recorder use the term "Documentary Transfer Tax," but the revenues the City receives are from Real Property Transfer Taxes imposed by City ordinance. The City does not receive Documentary Transfer Tax per Revenue and Taxation Code Section 11931.

"...shall have the power and duty to enforce all of the provisions of this article. In such case the City tax is due prior to recordation with the County of Los Angeles of any written instrument subject to the tax and the Director of Finance may make an assessment for taxes not paid...."

Cities with their own tax ordinances may impose higher tax rates than counties and/or make other changes that affect application of the tax.

Pursuant to a contract with the City, this Real Property Transfer Tax revenue is collected by the Recorder Division of the Office of the Los Angeles County Registrar-Recorder/County Clerk (Recorder's Office). Under the contract, the Recorder's Office imposes an administrative fee of \$3.85 for collection service, and remits all City tax collections, minus the fee expense and other adjustments, to the City. In FY 2014-15, the City's net receipts from Real Property Transfer Tax was projected at \$196.8 million.

**Finding No. 4: The City's Real Property Transfer Tax receipts are estimated to be \$4.5 million less annually as a result of 1) the City exempting liens and encumbrances from its tax, 2) the lack of verification of these liens and encumbrances and other exemptions - by the County Recorder, and 3) case law that makes certain changes in real property ownership tax exempt. In addition, the City loses an additional estimated \$7.3 million in annual property tax receipts due to those same tax-exempt changes in property transfers.**

The City's Real Property Transfer Tax ordinance exempts the value of instruments impinging on the full value of the property, known as "liens and encumbrances". Based on actual receipts in three California cities in which such liens and encumbrances are subject to the transfer tax, the City of Los Angeles foregoes an estimated minimum of \$394,389 in General Fund revenues per year.

The City does not require that the Recorder obtain or furnish taxpayer documentation of liens or encumbrance amounts or any other exemption to verify the tax amounts paid. This is an internal control weakness that could facilitate errors or intentional under-payment of taxes due to the City. Based on data from another

**county, this lack of control costs the City \$809,759 per year.**

**When a legal entity such as a company owns property and the company is sold to new owners, as long as no one person (buyer) owns more than half of the company, the property is not considered by California courts to have changed ownership for tax purposes and is not subject to transfer tax or reassessment for property tax purposes. This costs the City an estimated \$3.3 million per year in transfer taxes, and \$7.3 million per year in property taxes. The comparable losses for Los Angeles County would be \$160,600 and \$1.46 million, respectively.**

### **Exemption in City's Real Property Transfer Tax Ordinance Reduces City Revenue by an Estimated \$394,389 per Year**

#### *Responsibility for Collections*

The Los Angeles County Recorder is responsible for collection of City Real Property Transfer Taxes pursuant to 1) an agreement between the Recorder and the City, 2) County ordinance, and 3) City ordinance.

Section 21.9.9 of the City Municipal Code requires the County Recorder to administer the City's transfer tax ordinance "in conformity with the provisions of Part 6.7 of Division 2 of the Revenue and Taxation Code and the provisions of any County ordinance adopted pursuant thereto."

The Code also states that if the Recorder does not collect the tax due under the City's ordinance, the City's Office of Finance is empowered to do so.

#### *Imposition of the Tax: City Exemption*

The City ordinance does not impose transfer taxes on the value of "liens and encumbrances" that transfer with real property. "Liens and encumbrances" includes assumed mortgages<sup>38</sup>, recorded abstracts of judgment, unpaid real property taxes, tax liens, easements, or anything else that may impinge on the property value.

<sup>38</sup> A process by which a buyer is permitted by a lender to take over or "assume" the existing loan balance and loan terms – including the interest rate – on a given property. The buyer must meet all of the lender's requirements as if the loan were newly originated.

### *Basis for the City's Exemption*

The City's exemption is allowed by and consistent with the Documentary Transfer Tax language in the California Revenue and Taxation Code and relevant County ordinance.<sup>39</sup> The liens and encumbrances exemption in the City's ordinance mirrors the language that is found in State law, which is applicable to counties and general law cities, and in the Los Angeles County Code, which is applicable to Los Angeles County. The mirroring language in the City's ordinance was most recently modified in 1991.

Five years after the City ordinance was last amended, California voters approved Proposition 218 (Cal. Constitution XIII C), imposing a new requirement of voter approval for tax increases. The requirement that a majority of voters approve elimination of the exemption is likely the main reason it remains in effect. At least five California cities do not have this exemption: San Jose<sup>40</sup>, Oakland<sup>41</sup>, San Francisco<sup>42</sup>, Mountain View<sup>43</sup> and Palo Alto<sup>44</sup>.

### *Estimated Annual Revenue Reductions*

We requested information from the Recorder to enable us to determine how much revenue the City foregoes as a result of its liens and encumbrances exemption. The County Recorder reports collecting payments provided by taxpayers based on their reported taxable values, a practice which is permissible under the State Documentary Transfer Tax law. The City does not impose any requirements regarding documentation related to its tax. The Recorder reports that it has no data regarding differences between the value of City property and the value that taxpayers use to compute and pay the City's tax on transfers. Therefore, we were unable to estimate the amount of revenue the City foregoes each year as a result of liens and encumbrance exemptions based on City property transfer data. We also requested data regarding any other exemptions that payers of the City tax may claim and how those claims are determined to be valid.

On July 20, 2015 we received data from the Recorder indicating that, Countywide, 60,379 exempt transfers (upon which no tax was paid) were recorded during FY 2013-14. The system from which the data was obtained contains document images and grantor/grantee indices. The Recorder does

<sup>39</sup> Real Property Transfer Tax Ordinance of the City of Los Angeles – Chapter II, Article 1.9 Real Property Transfer Tax, Section 21.9.2., CA R&T Section 11911 (a), L.A. County Code 4.60.020. 2.34.020.

<sup>40</sup> San Jose Code of Ordinances, Section 4.58.100

<sup>41</sup> Oakland Code of Ordinances Sections 4.20.010 to 4.20.030

<sup>42</sup> San Francisco Ordinance Code Article 12-C, Section 1102

<sup>43</sup> Mountain View Code of Ordinances, Section 29.63

<sup>44</sup> Palo Alto Ordinance Code Section 2.34.020

not have data regarding the value of the property, the address or city in which the property is located, or the type of property (single family, commercial, etc.). According to the Recorder, that information is captured by the Assessor's Office after the transfer occurs.

Of these exempt transfers, 180 were coded<sup>45</sup> as exempt from transfer tax because the sum of liens and encumbrances claimed equaled or exceeded the value of the property. Note that this figure does not capture properties on which the tax payment was simply *reduced* due to a claimed lien or encumbrance, only those properties on which the liens and encumbrances were so large that they resulted in no tax due.

According to the Los Angeles County Assessor's 2014 Annual Report, the most recent data available, the median value of single family houses that transferred in the County in Calendar Year 2013 was \$399,000. Using this value as a proxy for the unknown value of the 180 properties that transferred without payment of transfer tax due to large liens and encumbrances, the estimated value of those properties is \$71.8 million. The exempted Documentary Transfer Tax on these properties is estimated to be approximately \$79,000 Countywide.<sup>46</sup>

The value of the City tax exempted depends on the extent to which these properties were located in the City and therefore subject to the City tax. If one-third of the properties (60) were located in the City of Los Angeles, City General Fund revenue was approximately \$108,000 less in 2013 due solely to transfers of property whose liens and encumbrances exceeded their value.

We also requested information regarding the extent to which taxpayers pay the Documentary Transfer Tax, but decline to pay the City's Real Property Transfer Tax. Section 11933 of the California Revenue and Taxation Code specifies that County Recorders *shall not* record transfers subject to the Documentary Transfer Tax, *unless the Documentary Transfer Tax is paid at the time of recording*. In other words, the taxpayer must pay the Documentary Transfer Tax to record the transfer.

Section 27201(a) of the California Government Code states that the Recorder *shall, upon payment of proper fees and taxes, accept for recordation any instrument that otherwise meets the requirements of the law*. In other words, once "proper fees and taxes" are paid, the Recorder

<sup>45</sup> Many other exemption categories exist, and we have not tested the accuracy of the coding process.

<sup>46</sup>  $(\$71,820,000/\$1,000)*\$1.10=\$79,002$ .



*must* record an acceptable document. Based on our research, the standard interpretation is that once the Documentary Transfer Tax is paid, the transfer must be recorded, whether the City tax has been paid or not.

As shown above and stated in Section 10.9, "City Tax", of the Los Angeles County Recorder's policies:

"Basically the cities' tax regulations are the same as those of the State imposed tax [Documentary Transfer Tax], except for the rate and the fact that the *Recorder does not have the right to refuse a document for recording if the city tax is not paid.*" (Emphasis added.)

The policy describes the procedure to notify cities with their own transfer tax in Los Angeles County that a document has been recorded without payment of the City tax.

Further, Section 2 of the agreement that governs the County's collection and remittance of the City tax specifically requires the County to "transmit to City copies of the documents which indicate the tax was unpaid at the time of recordation. The responsibility of thereafter collecting the tax shall be that of the City."

The agreement further states that only the City shall issue refunds of its tax, and the City will handle any disputes related to its tax. Section 21.9.11 (b) of the City's ordinance code specifically authorizes the Director of Finance, acting as the City's tax collector, to seek payment of unpaid City Real Property Transfer Taxes through assessments.

Although other county Recorders in California reported that they report such non-payments to cities within their jurisdictions, the Los Angeles County Recorder's Office reported that it will not record a document unless both taxes are paid. According to Recorder's Office management, the Office's computer system that has been in place since 2007 will not permit recording of a transfer unless both City and County taxes are paid. As a result, according to management, there are no records furnished to the City regarding non-payment of the City tax as required under the agreement between the City and the County.

Pursuant to Section 6 of the agreement between the Recorder and the City regarding collection of the City tax, we requested from the Recorder during the course of the audit access to data and/or documentation that supports the amounts collected and the amounts exempted from the City tax for FY 2013-14. These requests included a detailed written request on January 14, 2015. On March 3, 2015 we received a response from the Recorder's Office

that included a summary of taxes remitted to the City, by month, and a count of transfer documents, by month. The requested documentation to support these collections and any amounts exempted from the tax was not furnished.

On July 20, 2015, the Recorder furnished a listing of document numbers corresponding to exemptions on Countywide transfers. On July 27, 2015 we were informed that the Recorder could develop a special report showing document numbers for all of the transactions on which the City tax was paid. With the document numbers, it would be possible to research transfers to determine the extent, type and value of exemptions granted, the sufficiency of documentation supporting tax payments, and to review taxpayers' calculations to determine whether errors affect City revenues. In addition, we would have been able to test whether there were any instances in which the County tax was paid but the City tax was not.

We did not perform these procedures since document numbers, datasets or hardcopy records were not furnished during the field work phase of this audit. However, we recommend that the City continue to pursue these records which we believe is required to be furnished to the City pursuant to Section 6 of the existing agreement between the two agencies. Further, the agreement requires the Recorder to notify the City if City taxes are not paid at the time of recording. Although the Recorder has stated that the City tax is always collected at the time of recording, the fact that we could not test this is the basis for our recommendation that the City take steps to ensure that on each taxable transfer, the City tax is being collected.

Due to the lack of data for the City of Los Angeles, we turned to other jurisdictions to estimate the financial effect of exemptions and other factors affecting transfer tax receipts. As previously described, per State law, counties exempt liens and encumbrances from Documentary Transfer Tax collections but charter cities have discretion over exempting liens and encumbrances from their City-imposed transfer taxes. Since there are cities that do not exempt liens and encumbrances, a comparison of tax payments made *on the same transfers* to the county and any such cities reveals the foregone revenue due to the exemption.

We were provided every transfer tax payment made in October 2014 for three cities<sup>47</sup> in Santa Clara County that *do not* exempt liens and encumbrances. We obtained the Documentary Transfer Tax payments *on*

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<sup>47</sup> San Jose, Palo Alto and Mountain View.



*these same transactions* to the county<sup>48</sup> in which each of these cities is located. (As previously described, counties must exempt liens and encumbrances). The difference between the amount paid to the county and the amount paid to the cities on the same transactions represents the difference in revenue between exempting versus taxing liens and encumbrances. For the October 2014 transactions<sup>49</sup>, the difference between the payments was 0.2 percent<sup>50</sup>. Therefore, we estimate that the City of Los Angeles loses 0.2 percent of its potential transfer tax receipts due to exempting liens and encumbrances.

We applied this rate to the City of Los Angeles' proposed annual transfer tax receipts to estimate the City's loss in the current year. Applying this loss rate to the City's Real Property Transfer Tax estimate of \$196.8 million, the City of Los Angeles foregoes an estimated \$394,389 in General Fund revenues per year by exempting liens and encumbrances.

We believe this estimate is extremely conservative, for the two reasons described below:

- 1) The County of Santa Clara only provided data for a single month – October 2014 for three comparatively small cities. Due to the size of the cities, the one month's worth of data may not have captured real estate transactions from other months that may have been of higher value and would have resulted in a higher impact on the cities' transfer tax collections over a longer period of time.
- 2) Interest rates for new mortgage loans in October 2014 were very low, meaning that there would have been little incentive for buyers to assume an existing low-interest loan. Therefore, a potentially significant encumbrance subject to exemption - assumed loans - was not likely much of a factor in October 2014.

#### *Estimated Past Revenue Reductions Due to Assumed Loans*

To estimate the revenue foregone due to *past* assumed loans, we obtained U.S. Census Bureau published data on owner-occupied housing units in Los Angeles County and on mortgage characteristics within the County.<sup>51</sup> These reports identify properties and the nature of their mortgages, such as the

<sup>48</sup> The County of Santa Clara.

<sup>49</sup> We were unsuccessful in obtaining data for additional months.

<sup>50</sup> The City rates are three times higher than the County rates. The .02 percentage is the "true" difference after accounting for the difference in the rate between the three cities and the County.

<sup>51</sup> American Housing Survey – Owner Occupied Units – Select Metro Areas (C-14b-00-M) and American FactFinder 2011, Additional Mortgage Characteristics, Selected Metro Areas (C-146-00-M).

amount of the mortgage and whether the mortgages are through the Federal Housing Administration or the Veterans Administration as such loans are legally assumable.

Assumed loans are encumbrances that are exempt from taxation by the City. Each loan that is assumed when property is transferred results in lost revenue to the City. Census data also identify the number of owner-occupied units with assumed loans. Using these data and other Census reports on the number and nature of County housing units within the City, we estimated the number of properties with assumed loans as of 2011, the year for which the most recent data is available, and the amount of those loans based on the loan amounts for owner-occupied units. We multiplied the estimated number of assumed loans in the City by the average loan amount in the Census reports to derive the estimated amount of monies not collected by the City as a result of the exemption on assumed mortgages as of 2011. This estimate is detailed in Exhibit 10.

**Exhibit 10: Estimated Aggregated Cumulative Uncollected City Revenue through 2011 Due to Exemption of Assumed Loans from Real Property Transfer Tax**

Estimated City properties with assumed loans as of 2011 (a)	Loan amount of owner-occupied units per Census (b)	Estimated Value of Untaxed Transfers (c)	City Tax Rate (d)	Estimated lost revenue on city property as of 2011 due to assumed mortgages (c)/\$1,000 x (d)
11,440	\$244,000	\$2,791,284,369	\$4.50 (per \$1,000)	\$12,560,780

Sources: Analysis of U.S. Census Bureau reports

As Exhibit 10 shows, as of 2011, the City had foregone an estimated \$12.6 million, cumulatively, as a result of just the exemptions on assumed loans.

Since loans have been assumed in the past, and their values exempted from the City's real property transfer tax, we assume that if interest rates for new loans rise, buyers will actively seek properties on which loans may be

assumed. In short, the City is probably losing relatively little to assumed mortgages presently, but this could change in the future.

Based on the 2011 Census reports, there are at least 207,000 loans on properties in the City that are legally assumable. At an average loan value of \$244,000, this equates to \$50.6 billion of property value Citywide that could legally transfer without being subject to the City transfer tax. At the City's transfer tax rate of \$4.50 per \$1,000 of value, this translates in to \$227,250,000 in potential City revenue if all loans were assumed at the time of property transfer.

In summary, while the estimated current foregone revenue for liens and encumbrance exemptions are relatively low, the City has foregone revenue from the past and has significant exposure to potential future losses as a result of the liens and encumbrances exemption. The data upon which the annual current loss estimate is based is limited in that it comes from much smaller jurisdictions and represents a single month of transactions. If an average of 20 percent of all assumable loans were actually assumed over a 15 year period, the City would lose an average of approximately \$3 million in revenues per year (\$50.5 billion in assessed value divided by \$1,000 x \$4.50 x 20% divided by 15 years).

### **Internal Control Weaknesses Cost the City an Estimated \$809,759 per Year**

#### *Role of the County Recorder*

The County Recorder collects and remits the Real Property Transfer Tax on behalf of the City for a fee of \$3.85 per recorded transaction, pursuant to the undated "Agreement for the Collection of Taxes" (Agreement) between the two agencies.

The County Recorder may exercise judgment regarding whether to require documentation of taxable amounts from taxpayers for both the City and County transfer taxes. As previously indicated, the City ordinance that established the City tax (and the Agreement) requires that it be managed in keeping with the State law and the County Ordinance Code for Documentary Transfer Taxes. State Revenue and Taxation Code section 11933 states, in relevant part:

"If a county has imposed a tax pursuant to this part ... a declaration of the amount of tax due, signed by the party determining the tax or his or her agent, shall appear on the face of the document in compliance with Section 11932, and the recorder *may rely* on that declaration *if*

*the recorder has no reason to believe that the full amount of the tax due has not been paid (emphasis added)."*

Section 4.60.160 of the County Ordinance Code authorizes - but does not require - the Recorder to seek proof of taxable amounts:

*"Whenever the county registrar-recorder has reason to believe that the full amount of tax due under this chapter has not been paid, he may, by notice served upon any person liable therefor, require him to furnish a true copy of his records relevant to the amount of the consideration or value of the interest or property conveyed."*

Deliberate misrepresentation of the taxable amount is a misdemeanor under Section 4.60.170 of the County Code.

#### Role of the City

Section 21.9.11 (b) of the City Municipal Code states:

*"If the County of Los Angeles does not collect the tax due under this article, then the Director of Finance shall have the power and the duty to enforce all of the provisions of this article."*

Section 6 of the Agreement specifies that the County agrees to allow the City to review records and processes related to the collection of the City taxes.

#### Internal Control Deficiencies

We requested and received policies and procedures related to the internal controls the Recorder uses to ensure the City taxes are properly assessed and collected.

Taxpayers must sign under penalty of perjury that their declaration of the amount due is correct. In multiple meetings with officials from the Recorder's Office, management stated that, aside from system-flagged errors and the Preliminary Change of Ownership Report (PCOR), they do not have processes in place to verify liens and encumbrances or other exemption amounts on which the tax is computed as provided by the property owner (or representative) paying the tax.

Based on 1) the statements of Recorder management that documentation of claimed exemptions is not required or reviewed, and 2) the lack of data regarding tax exemptions or payments made, by property, we conclude that there is no mechanism to ensure that the City tax is properly calculated or remitted by the taxpayer. For example, more than one-quarter of all Los Angeles County exempt property tax transfers in FY 2013-14 (15,918

transfers) were coded as not taxed due to the taxpayer's assertion that the property was given away rather than purchased. Given the lack of procedures to either investigate or track the details of such transactions, the potential for abuse of claimed exemptions is greater than it would be with stronger controls. The City should establish these controls through its contract with the Recorder. Lack of verification of taxpayer-reported amounts is an internal control weakness.

*Internal Control in Other Counties*

According to interviews, at least two other California county recorder's offices (Riverside and Santa Clara counties) allocate staff specifically to verification of taxable amounts either before or after recording documents.

In contrast, it appears that in Los Angeles County, a taxpayer could assert without any documentation that there is a lien or encumbrance on a property equal to the entire amount of the property value, pay no City transfer tax, and the City would not be notified.

According to the Los Angeles County Recorder's Office, the County does follow up on certain payment discrepancies. For example, the Recorder's computer system will "flag" any City real property transfer tax payment that is not divisible as it should be based on the tax rate.

When these systems "flag" payment errors, the Recorder's Office reports following up with taxpayers by issuing bills for underpayments and issuing refunds for overpayments. We requested information from the Los Angeles Recorder's Office regarding the amounts adjusted for the City of Los Angeles real property transfer tax as a result of its efforts to address errors identified by Recorder and Assessor systems. The Recorder furnished documentation showing that all adjustments were refunds, with \$21,772 refunded to taxpayers in FY 2013-14. These refunds were netted against each month's disbursement to the City, even though Section 4 of the agreement between the City and the Recorder states "County will refer to City for disposition any requests for refund of the tax paid. County, under no circumstances, will make a refund."

The Los Angeles County process is in contrast to the processes in place in some other counties. For example, in Riverside County, any recorded document that should have resulted in a transfer tax payment is routed to an accounting unit in the Recorder's Office for review. That review encompasses both calculations as well as review for appropriate documentation supporting any exemption that was claimed at the time the tax was paid.

To estimate the City of Los Angeles's unrealized revenue due to lack of verification of taxable amounts, we used information reported to us by the County of Riverside. The Riverside County Recorder's Office reports that it actively *audits tax payments after the fact*. An Accounting Assistant II is assigned to this task. Riverside County reported net recoveries from this program of about \$86,000 in FY 2012-13, \$133,000 in FY 2013-14 and \$34,739 through January of FY 2014-15. These recoveries include under-payments of the County tax that occurred for any reason.

Applying Riverside County's recovery rate relative to its total secured roll to the City of Los Angeles's secured roll and then adjusting that for the City's incremental real property transfer tax (\$4.50 per \$1,000 of assessed value in the City vs. \$1.10 per \$1,000 of assessed value in Riverside County), we estimate that these amounts are equivalent to annual revenue foregone to the City of Los Angeles of \$809,759, as shown in Exhibit 11.

### Exhibit 11: Estimated Annual Loss to the City of Los Angeles from Under-Payment of City Real Property Transfer Tax Based on Recoveries by the County of Riverside

	FY12-13	FY13-14	FY14-15 to mid January	FY 14-15 Estimated	Estimated Three- Year Average
<b>Riverside County Secured Roll</b>	\$197,099,539,145	\$205,288,091,104	N/A	\$221,741,016,977	\$208,042,882,409
<b>City of Los Angeles Secured Roll</b>	\$411,465,062,866	\$436,639,975,453	N/A	\$458,471,974,226	\$435,525,670,848
<b>Riverside Net Audit Recoveries @ \$1.10 per \$1,000 (Riverside Rate)</b>	\$85,986	\$133,250	\$34,344	\$63,311	\$94,182
<b>Recoveries as % of Riverside Roll</b>	0.00004%	0.00006%	N/A	0.00003%	0.00005%
<b>Riverside Recovery Percent applied to LA Roll</b>	\$179,504	\$283,418	N/A	\$130,902	\$197,941
<b>Estimated Recoveries @ \$4.50 per \$1,000 (Los Angeles Rate)</b>	\$734,334	\$1,159,436	N/A	\$535,507	<b>\$809,759</b>

Sources: Annual Reports and Roll estimates prepared by the Counties of Riverside and Los Angeles; Reported net recoveries by the County of Riverside Recorder management; tax rates per ordinance codes of each agency.

These Riverside County recoveries are in spite of the Riverside County Recorder's requirement of completion of an affidavit under penalty of perjury when an exemption is claimed. Further, if a City transfer tax is not paid at the time of recording, the Riverside County Recorder issues either a bill or an automatic debit to the delinquent party's bank account<sup>52</sup> and follows up to secure payment.

In the County of Santa Clara, Recorder management reports that documentation of amounts is required up front, at the time of recordation.

<sup>52</sup> Riverside County reports that about half of its transfer tax payees have established bank accounts to enable the County to debit transfer tax payments.



Further, if a taxpayer declines to pay any city taxes, the Recorder actively notifies the city of each instance.

We provided a draft of this section of this report to the management of the Riverside and Santa Clara County Recorders, both of which responded in writing that the information above pertaining to their operations is accurate. We recommend that the City of Los Angeles amend the existing Agreement or enter into a new agreement with the Recorder's Office to require verification of exempted amounts, and that it enforce the existing requirement of notification of non-payment of City tax.

### **Definition of Change of Ownership May Cost the City an Estimated \$10.6 Million Annually**

According to a September 2014 appellate court decision in favor of Los Angeles County, Section 11911 of the Revenue and Taxation Code permits a real estate transfer tax when a transfer of interest in a legal entity results in a "change of ownership" within the meaning of Revenue and Taxation Code section 64, subdivision (c) or (d).<sup>53</sup> However, the same court ruled against Los Angeles County in June 2014<sup>54</sup>, determining that even though 100 percent of an entity was sold, a *change in ownership* of the entity's real property did not occur because *no one person* obtained more than 50 percent of the entity. In short, legal entities may legally avoid transfer taxes (and re-assessment of the real property for property tax purposes) by transferring a legal entity to multiple new owners. As a result, the City is not collecting Real Property Transfer Tax revenue in instances when a legal entity that owns property is transferred to multiple owners, but no one individual owns more than half of the entity. Assembly Bill 2372, which died in a State Senate committee, was intended to eliminate the corresponding property tax exemption, which we believe would also eliminate the effective tax exemption on real property transfers.

#### *Estimated Annual Costs to the City and County*

The State Board of Equalization (BOE) estimates that eliminating the tax break as proposed in Assembly Bill 2372 would result in an increase to local property tax revenues statewide of \$73 million annually, according to a May 13, 2014 analyses of the bill by the State Assembly Committee on Revenue and Taxation. The bill analyses noted that the BOE remarked on the difficulty

<sup>53</sup> 926 N. Ardmore Avenue, LLC v. County of Los Angeles, September 2014.

<sup>54</sup> Ocean Avenue LLC v. County of Los Angeles, June 2014.



of making this estimate and its shortcomings. The BOE itself would also have incurred material costs to implement the change.

The bill analyses did not make an estimate of transfer tax losses. However, using the BOE estimate of \$73 million in foregone property tax revenues statewide produces a base assessed value of those properties of \$7.3 billion (\$73 million in foregone property tax revenues divided by the property tax rate of 1 percent). The statewide foregone real estate transfer tax revenue for each jurisdiction would thus be \$7.3 billion in assessed value divided by \$1,000 (the denominator in all real estate transfer taxes) multiplied by each jurisdiction's transfer tax rate, which is \$4.50 for the City of Los Angeles.

We do not know how much of the estimated statewide loss is associated with City of Los Angeles property. However, the City's FY 2013-14 taxable secured roll assessed value was about ten percent of the statewide amount (\$436,639,975,453, compared to \$4,424,806,277,000). If ten percent of the statewide untaxed legal entity transfer assessed values were in the City of Los Angeles, the assessed value of the City's affected properties would thus be \$730 million. For every \$1,000 of this amount, the City's real estate transfer tax rate of \$4.50 would be applied, resulting in a total loss of \$3,285,000 annually (\$730,000,000 divided by \$1,000 = \$730,000 x \$4.50 = \$3,285,000).

For Los Angeles County, applying its 2014 assessed value of \$89,340,570,468 in the unincorporated area, or two percent of the statewide secured roll assessed value of \$4,424,806,277,000, to the statewide assessed value loss of \$7.3 billion, and applying the county Documentary Transfer Tax rate of \$1.10 per \$1,000 of value results in a value of \$146 million, divided by \$1,000 x \$1.10 = \$160,600 in lost annual revenue.

In addition, again assuming ten percent of the statewide loss in real property tax receipts occurred in the City of Los Angeles, the City would forego \$7.3 million per year in property tax receipts as a result of this same tax break. For Los Angeles County, with two percent of the statewide assessed value in the unincorporated area, foregone property tax would be \$1,460,000.

## Recommendations

**The Office of Finance should confer with the City Attorney to plan to:**

- 4.1 Amend the City's tax collection agreement with the County Recorder's Office, and, if necessary, the City of Los**

**Angeles Municipal Ordinance Code, to require the Recorder to obtain documentation of all instances in which City Real Property Transfer Tax is calculated on an amount less than the full value of the property transferred (due to claimed exemptions) and to furnish this information to the Office of Finance on at least a monthly basis.**

- 4.2 Work with the County Recorder's Office to ensure that protocols are in place to ensure the office's compliance with the provision in its agreement with the City requiring the Recorder's Office to notify the City of instances of non-payment of City transfer tax receipts.**
  
- 4.3 Collaborate with the Recorder's Office to ensure its compliance with Section 6 of the agreement between the Recorder and the City that requires that the Office provide details on the real estate transfer tax amounts collected by the Office on behalf of the City.**

## Section IV: Sales and Use Taxes

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In California, sales and use tax is collected by the state Board of Equalization. The state levies 7.5 percent on most purchases of tangible personal property, with some exemptions such as unprepared food. Additional levies, up to a 10.0 percent total maximum, can be added by local jurisdictions with voter approval. Considering just the base 7.5 percent levy, 6.5 percent goes to the state and 1.0 percent goes to local governments for general operational use in their General Funds.<sup>55</sup> Transactions within the City of Los Angeles are taxed at a voter-approved rate of 9.0 percent, 1.5 percent above the State's base. However, the City only receives 0.75 percent as unrestricted revenue for its General Fund. In fiscal year 2012-13, the State collected and remitted \$343.7 million in sales and use taxes to the City's General Fund based on approximately \$45.8 billion of reported taxable transactions in the City.<sup>56</sup> Revenue from sales and use taxes represented 7.6 percent of all of the City's General Fund revenues in fiscal year 2012-13.

**Finding No. 5: Though the City has programs in place to help identify and recover sales and use tax revenue misallocated to other jurisdictions and to curb taxpayer noncompliance, the City still forgoes an estimated \$17.2 to \$19.2 million of annual sales and use tax revenue due to noncompliance. For the County, the annual loss is estimated to be \$5.75 million. A newly announced partnership between the City and State should help close this tax sales and use tax gap.**

**The City's sales and use tax gap is due to noncompliance and tax evasion among businesses and unpaid use tax on out-of-state Internet sales, excluding uncollected tax due to illegal activity. The City's current efforts to lower the tax gap could be enhanced through partnerships with State agencies to share data, to fund investigative staff, and to better educate the City's taxpayers. One**

<sup>55</sup> ["Tax Information for City and County Officials , Local Sales Use Trans Actions \(Sales\) and Use Tax – Publication 28"](#), Board of Equalization, March 2011

<sup>56</sup> City of Los Angeles Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2013.

**such program between the City and the State of California was announced while field work for this audit was underway.**

### State-wide Tax Gap

The State Board of Equalization (BOE) estimated that \$42.2 billion of revenue went uncollected statewide in Fiscal Year 2010-11, representing an estimated loss of over \$2.3 billion in sales and use tax revenue for the State and local governments combined. The figures were calculated based on a sales and use gap of untaxed transactions of approximately five percent of all legal transactions in the state.

These BOE estimates exclude “any taxes that should have been paid on sales relating to illegal activities that are part of the underground economy”. The BOE estimates that such illegal transactions account for an additional \$7.0 billion in revenue annually, but are excluded from the analysis below.<sup>57</sup>

The sales and use tax gap appears to be driven by two distinct causes: 1) intentional tax evasion and 2) businesses and individuals with a lack of knowledge about their tax liability. However, without more data and a better understanding of the illicit activities that may occur in the City, the distribution of these sales and use tax gap between these causes cannot be definitively determined.

### Intentional Evasion

The BOE’s report attributes 25 percent of the \$2.3 billion sales and use tax gap, or \$584 million in lost revenue, to businesses that evade sales taxes completely and do not file tax returns. They cite examples of businesses including occasional vendors at events, e-commerce sales, and fulltime retail stores that have failed to register with the BOE and do not file tax returns. However, some portion of this group may be due to very small businesses that may be uninformed of their duty to register and file their sales tax liability.

Another 24 percent of the BOE’s estimated sales and use tax gap, or approximately \$560 million of revenue, is attributed to businesses that file but underreport sales. Supporting this estimate is a recent study based on hundreds of confidential interviews with small businesses and accountants across the country. The study respondents reported a variety of practices and techniques they use to intentionally underreport their sales and evade income taxes and, by extension, evade sales taxes. These methods include

<sup>57</sup> Board of Equalization. “Addressing the Tax Gap: Fiscal Years 2011-2012 through 2013-2014.”

underreporting cash transactions, so-called “zapper” software on point of sale units that automatically reduce revenue recorded, and the use of culpable accountants to maintain fraudulent records.<sup>58</sup>

### Lack of Knowledge

The remaining 51 percent of the estimated statewide \$2.3 billion sales and use tax gap in FY 2010-11, or \$1.2 billion of uncollected revenue, is attributed to out-of-state transactions in the BOE report. The use of e-commerce and online purchases has grown rapidly in recent years. In the third quarter of 2014, online sales were estimated to account for 6.6 percent of all retail transactions nationwide. Many online transactions occur between customers and businesses in different states. These out-of-state transactions are subject to use tax paid by individual household consumers or by businesses located outside of California but deemed to have a presence or “nexus” in the state. On a seasonally adjusted basis, online sales have grown by over 275 percent since the US Department of Commerce began tracking them in 2005.<sup>59</sup> In these instances businesses may not collect tax from their out of state customers. In turn, customers living in California may not know to report these transactions and pay their use tax liability.

Certainly some of the use tax gap is due to intentional evasion, just as some of the sales tax gap is due to lack of knowledge about the tax liability. Given the overlap of these causes, both education and enforcement may have a role to play in reducing the tax gap and improving City revenues.

### No City Education Programs

The City of Los Angeles has no program to educate businesses overall about sales and use tax compliance. No information or handouts are provided to businesses when applying for City business registration tax certificates, or business certificates. Such an effort could be a relatively cost-effective way for the City to reduce the tax gap by educating the over 400,000 businesses that are certified by the City annually. It would help educate business that are unaware of their legal obligation and cultivate a culture of compliance among businesses that may be intentionally evading the tax.

The City's Office of Finance is responsible for collection of various revenues of behalf of City departments, with business registration and collection of the City's business tax the primary functions of the Office. The Municipal Code

<sup>58</sup> Susan Morse, Stewart Karlinsky, and Joseph Bankman, “Cash Businesses and Tax Evasion”, Stanford Law & Policy Review, Vol. 20: I, January 2009

<sup>59</sup> US Department of Commerce “Quarterly Retail E-Commerce Sales 3rd Quarter 2014” US Census Bureau News, November 2014.

authorizes the Office of Finance to audit the financial records of any business operating within City limits to determine if it has paid the correct business tax. Sales and use tax underpayments are not the primary focus of these audits but may be detected in some instances.

Collection of sales and use tax is not a responsibility of the Office of Finance as that function is performed by the State's Franchise Tax Board. However, the City's portion of sales and use tax revenue collected by the State is remitted to the Office of Finance throughout the year. Office auditors and staff review and analyze the accuracy and completeness of amounts remitted to the City. In addition, the Office contracts with a private vendor, MuniServices, LLC, who conducts sales and use tax allocation reviews primarily for the purpose of identifying misallocations that have occurred such as funds due the City being mistakenly allocated to another jurisdiction, point of sale errors (incorrect identification of where a sale occurred) and other types of misallocation errors. Office of Finance staff is also provided access to MuniServices' system and can inquire about sales and use taxes paid by any taxpayer in the City.

While the primary focus of the Office's audit efforts is business tax payments, the Office has tools to analyze sales and use tax underpayments. The Office reports that through its contact with MuniServices, LLC and efforts of its own audit staff, it recovered \$14.7 million between FY 2009-10 and FY 2013-14, or an average of \$2.7 million per year. The Office could not provide a breakout of how much was recovered from misallocations and how much was due to sales and use tax underpayment. While the City's sales and use tax misallocation and audit has recovered funds for the City, the efforts are limited in scope. Other jurisdictions, such as the City and County of San Francisco, operate enforcement units that maintain multi-agency partnerships with State agencies in California. San Francisco's Investigations Unit within the Treasurer and Tax Collector's Office is staffed by one Principal Investigator and ten Investigators. The unit works to ensure that taxpayers comply with City and County and State tax regulations. The unit performs a wide range of enforcement activities including: surveys, surveillance, seizures, summary judgments, collection of third party taxes, notices of violations, and citations. In Fiscal Year 2013-14, the unit's 11 staff members recovered \$15.4 million dollars of escaped tax revenue for San Francisco, a portion of which came from sales and use tax.

The BOE recommends that cities work to better educate businesses on their duty to register for and file sales and use taxes.<sup>60</sup> They recommend that cities consider two options. The first is the option to add the following language to cities' business certificate applications:

"Sales or use tax may apply to your business activities. You may seek written advice regarding the application of tax to your particular business by writing to the nearest BOE office."

The second recommendation is for cities to distribute a copy of the BOE's publication #107, "Do You Need a California Seller's Permit?" to businesses and business certificate applicants.

#### Limited State Enforcement Resources

The sales and use tax gap and resulting lost revenue for the City of Los Angeles remains at an estimated five percent of the amount collected annually because few resources and efforts are dedicated to closing it further. The State's BOE enforcement staff consists of only 85 people for the entire state and the City has limited staff supporting compliance, enforcement, or taxpayer education. Enforcement staff in the BOE and the City and County of San Francisco collect far more lost revenue than their staffing costs.

The BOE operates a number of compliance and enforcement programs pertaining to sales and use tax, but, overall, the staffing of these programs is limited. Despite their limited staffing, all of the BOE programs recover revenues that far exceed their expenditures. The BOE reports that of its approximately 85 staff members, roughly half are dedicated to tobacco and cigarette tax enforcement and the other half focus on felony and misdemeanor-level enforcement. Of those, approximately 20 allocate some of their time to misdemeanor-level enforcement, mainly in retail locations. In the greater Los Angeles metropolitan area, the BOE has 17 staff members at its Norwalk office dedicated to compliance and enforcement programs.<sup>61</sup>

While the BOE does not publish figures related to its specific field units, it did note that in Fiscal Year 2012-13 all of its sales and use tax audit programs statewide "received more than \$155 million in sales and use tax audit refunds<sup>62</sup>." In a separate report, the BOE projected that its combined sales

<sup>60</sup> California State Board of Equalization, "Tax Information for City and County Officials Local Sales and Use Tax Transactions (Sales) and Use Tax" Publication 28, March 2011.

<sup>61</sup> Call with Randy Silva, Chief Investigations & Special Operations, California State Board of Equalization. November 17, 2014.

<sup>62</sup> California State Board of Equalization, "Annual Report FY 2012-13" .



and use tax enforcement efforts would generate 4.6 times more revenue than its expenditures on the programs in Fiscal Year 2012-13.<sup>63</sup>

Beyond pure enforcement efforts, the BOE also reports collecting “\$984 million in delinquent sales and use taxes” through education and outreach efforts. These gains alone exceed the BOE’s entire annual sales and use tax enforcement expenditures of \$379 million in the same year.<sup>64</sup>

#### *Municipal Resource Revenue Enhancement Program*

The BOE currently administers two initiatives with opportunities for participation by municipalities but the City of Los Angeles has not been participating in either. The first is the Municipal Resource Revenue Enhancement Program (MRREP), which was launched in early 2014. On the BOE website, BOE Chairman Jerome Horton, who represents the BOE district covering the City of Los Angeles, describes the initiative as:

“A collaboration effort with local municipalities to educate businesses, ensure that businesses are operating legally, and protect state and local tax revenue and businesses certificate funds.”<sup>65</sup>

On January 14, 2014, Chairman Horton sent a letter to the City proposing exploration of a partnership under the initiative to better collaborate, educate taxpayers, and share data. Specifically, use of the City’s business certificate data was proposed as a potentially beneficial tool. The letter proposed the City’s business certificate data could be matched against the State’s data to identify potential noncompliant businesses that either did not register with the BOE, underreported their sales tax liability, or failed to register their business with the City.<sup>66</sup>

While field work for this audit was underway, the City announced, on May 27, 2015, that it will participate in a reciprocal data sharing agreement with the BOE. The agencies will share limited taxpayer non-financial business, with BOE providing data to the City to assist in identifying businesses that have are operating without business tax registration certificate.

<sup>63</sup> California State Board of Equalization “Addressing the Tax Gap Fiscal Years 2011 – 12 Through 2103-2014”.

<sup>64</sup> California State Board of Equalization “Annual Report FY 2012-13” .

<sup>65</sup> California Board of Equalization, Chairman Jerome Horton’s Initiatives, [boe.ca.gov/members/horton/initiatives/index.html](http://boe.ca.gov/members/horton/initiatives/index.html), accessed January 22, 2015.

<sup>66</sup> PDF copy of Letter from California Board of Equalization, Chairman Jerome Horton to City of Los Angeles Mayor Eric Garcetti, dated January 14, 2014.



### *Tax Recovery and Criminal Enforcement*

The BOE's recently organized Tax Recovery and Criminal Enforcement program (TRaCE) was authorized by Assembly Bill 576, the Revenue Recovery & Collaborative Enforcement Team Act enacted in October 2013. The bill authorized the creation of a pilot program and team of State agencies to collaborate on enforcing tax compliance, closing the tax gap and reducing the criminal underground economy. Building on that authorization, the TRaCE program is a partnership between State and federal agencies and local community partners. The primary idea of the program is that, through cooperation, the various partners can achieve the mutually beneficial goals of reducing crime and improving tax compliance.<sup>67</sup>

Developing a partnership between the City and BOE could yield improved compliance and increased tax revenue for the City, the State and other jurisdictions. The depth of such a partnership could range from simple data sharing to the City funding and deploying staff to support enforcement efforts.

### *Data Sharing Can Aid Enforcement*

The City's business tax registration certificate (business certificate) program is administered by the Office of Finance. In addition to business name(s), owner name(s), mailing address and location address, annual gross receipts derived from the businesses' operations within the City's boundaries is recorded for each business. The gross receipts information, in conjunction with other factors, is used to calculate the business certificate tax fees the City levies on businesses.<sup>68</sup> The gross receipt data is redacted from the business certificate records posted on the City's public data clearinghouse website, data.lacity.org.<sup>69</sup>

Business data collected annually by the City's Office of Finance as part of the business tax registration certificate program could be useful if shared with the BOE in identifying businesses that are underreporting or not filing sales and use tax.

The City's Charter does permit the City to share confidential information from its business certificate records.<sup>70</sup> This would include information such

<sup>67</sup> California Government Code Section 15910-15924 .

<sup>68</sup> City of Los Angeles Office of Finance's website, finance.lacity.org, accessed January 16, 2015.

<sup>69</sup> DataLA, data.lacity.org, accessed January 16, 2015.

<sup>70</sup> Los Angeles City Charter, Article 1 Business Taxes, SEC. 21.17. CONFIDENTIAL CHARACTER OF INFORMATION OBTAINED – DISCLOSURE UNLAWFUL. (Amended by Ord. No. 180,380, Eff. 1/5/09.)

as businesses' unique identification numbers, reported gross receipts and the date of business closures if available. This data could aid the BOE in its audits, compliance investigations, and offer potential red flags using threshold monitoring. Reciprocally, the State's data could be used by the City to identify businesses that may be filing sales and use tax but have failed to register business certificates with the City.

The cost of a data sharing partnership could be minimal. Once an agreement was made, it would require a small amount of administrative time, simply extracting and sending the information to the BOE at a regular interval. A more sophisticated technology solution could be implemented to provide protected and secure real-time access to the data. However, real-time access might offer only limited gains, add cost, and increase the risk of confidential data being exposed by any security vulnerabilities.

#### Lost Revenue

Beyond the statewide estimates, no studies or information exists specifically investigating the untaxed transactions and sales and use tax gap for the City of Los Angeles. Without more data and a better understanding of the illicit activities that may occur in the City, the distribution of the sales and use tax gaps between these causes cannot be definitively determined. Instead the audit team estimated the City's sales and use tax gap using two methods that rely on the most recent report on the topic published by BOE in 2011, with results ranging from \$17.2 million to \$19.2 million in lost sales and use tax revenue for the City. These estimated losses are in addition to funds being recovered through the current Office of Finance sales and use tax allocation review program.

#### Five Percent Tax Gap Model

The first estimate uses the BOE's theory that the sales and use tax gap is approximately five percent of all reported transactions and resulting revenue. In Fiscal Year 2012-13 approximately \$45.8 billion in total reported City-wide taxed transactions occurred. This generated \$343.6 million in revenue from sales and use taxes to the City's general fund. Applying five percent to the amount based on BOE's estimate of the sales and use tax gap results in \$2.3 billion of unreported and untaxed transactions. At the City's sales and use tax allocation rate of 0.75 percent, this amounts to an estimated \$17.2 million of lost fiscal year 2013 revenue.<sup>71</sup> For Los Angeles County, the loss would be \$5,750,000 using the county sales and use tax allocation rate of 0.25 percent.

<sup>71</sup> City of Los Angeles Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2013.

Proportional Population Model

The second approach uses the City's share of population to weight its proportional share of the estimated tax gap. This method is used because the BOE's five percent estimate may not fully capture the impact of the difference due to the City's population and size. For example, it may be more difficult to enforce sales and use tax compliance given the City's large population and geographic spread than in smaller communities and could potentially account for a higher sales and use tax gap than other areas in the state. Thus, using population may more appropriately capture the weighted per-capita activity and the potential tax gap within the City's larger population.

According to California Department of Finance estimates, the state's population was 38.3 million in 2013, and the City's was 3.9 million, or 10.1 percent of the state. Using this measure, the City's share of the BOE's estimated tax gap is \$2.6 billion in untaxed transactions. At the City's sales and use tax allocation rate of 0.75 percent, this amounts to an estimated \$19.2 million in lost revenue for the City in fiscal year 2012-13.

Illegal Shadow Economy is Excluded from Estimations

Both estimation models exclude the \$7.0 billion in annual statewide revenue not collected on illegal transactions estimated by the BOE. While technically taxable activities, they are criminal in nature and likely undesirable regardless of the potential tax revenue they could generate. These include a variety of activities such as the sale of illicit drugs, the sale of counterfeit goods, human trafficking, or other criminal commercial activities. Policy considerations, likely separate from the City's consideration of general fund revenues exist related to the shadow economy.

**Recommendations**

**The Mayor and the Office of Finance should:**

- 5.1. Collaborate with the State Board of Equalization as part of its newly signed agreement to identify the data each agency has and what would be useful to each other in the interest of identifying businesses that have not registered with the City and that are under-reporting or not filing sales and use tax to the State.**
  
- 5.2. Conduct an internal analysis of the City's business tax registration certificate systems and data to determine**

how it could best extract and assemble data for sharing with the State Board of Equalization.

- 5.3. Request that the City Attorney prepare an amendment to the City's Agreement for State Administration of Local Sales and Use Taxes to allow for data exchange between the Office of Finance and the State Board of Equalization.

The Office of Finance should:

- 5.4 Provide digital and physical copies of the BOE's publication 107, "Do You Need a California Seller's Permit?" to all business registration tax certificate applicants.
- 5.5. Add the following State-approved language to its physical and digital business certificate application forms:

**"Sales or use tax may apply to your business activities. You may seek written advice regarding the application of tax to your particular business by writing to the nearest BOE office."**

The Mayor and City Administrative Officer should:

- 5.6 Determine City funding and staffing needed for an investigative unit to support enforcement of City taxes and fees, and third-party taxes and fees that are remitted to the City and recommend funding levels for this function to the City Council.
- 5.7. Analyze the costs and benefits of the City participating in the BOE's Municipal Resource Revenue Enhancement Program (MRREP) and Tax Recovery and Criminal Enforcement program (TRaCE) and recommend their conclusion to the City Council.

## Section V: Distribution of Court-Ordered Debt Revenues

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The City receives court-ordered debt revenues from traffic and criminal cases where the arresting officer is employed by the City of Los Angeles.

**Finding No. 6: The City does not receive sufficient information from the Los Angeles Superior Court to be able to monitor and evaluate court-ordered debt revenues distributed to the City which have decreased by 49 percent from \$19.0 million in FY 2010-11 to \$9.6 million in FY 2013-14.**

**The major reason for the decrease in court-ordered debt revenues is fewer citations filed in Los Angeles Superior Court and the elimination of the City's Red Light Photo Program in 2011. The City previously received monthly reports from the Los Angeles Superior Court that detailed revenue by type of violation, and the City's percentage share of revenues by violation, allowing the City to monitor these revenues in detail, but the reports that the City now receives show only the total distribution to the City by fund (General Fund and Traffic Safety Fund). The City Controller should work with the Los Angeles Superior Court to develop court-ordered debt distribution reports that provide sufficient detail to allow the City to monitor revenues.**

Court-ordered debt revenue consists of all fines, fees, forfeitures and penalty surcharges assessed by the Superior Court based on State codes. California state law defines criminal and traffic violations and sets fine amounts. For example, California Penal Code Section 1463.001 defines various criminal offenses, sets the amount of the fines, and details distribution of fine revenues to the State, courts, counties and local jurisdictions. The Los Angeles Superior Court collects court-ordered debt and the Los Angeles County Auditor-Controller distributes court-ordered debt revenues to the City through a memorandum of understanding between the two jurisdictions.

## **Distribution of Court-Ordered Debt Revenues**

The California State Controller issues distribution guidelines each year to the county superior courts and county controllers. Court ordered debt revenues are distributed to court, state, county and local jurisdictions depending on the code violation, the location of the violation, and the arresting officer. The Los Angeles Superior Court programs the distribution criteria into the Court's Payment Revenue Distribution System, which allocates receipts to the appropriate code violation, fund, and jurisdiction.

When the Court forwards monthly collection receipts to the County Auditor-Controller, the Court provides a report detailing the total amount collected by violation and fund, and the amount to be distributed to each local jurisdiction. While the report details the amount to be distributed to each local jurisdiction by fund (General Fund, Traffic Safety Fund), the report does not provide the actual amount distributed by violation. The County Auditor-Controller forwards the designated amount of receipts to the City with a summary of the amount allocated to the General Fund and Traffic Safety Fund.

## **Decrease in Court-Ordered Debt Revenues Distributed to the City**

Court-ordered debt revenues distributed to the City decreased by almost 50 percent from FY 2010-11 to FY 2013-14. These revenues are allocated to the City's Traffic Safety Fund and General Fund, depending on the code violation. From FY 2010-11 to FY 2013-14, distribution of court-ordered debt revenues to the Traffic Safety Fund decreased by 39 percent and to the General Fund decreased by 70 percent, as shown in Exhibit 12.

**Exhibit 12: Decrease in Court-Ordered Debt  
Revenues to the City**

<b>Fiscal Year</b>	<b>Traffic Safety Fund</b>	<b>General Fund</b>	<b>Total</b>
FY 2010-11	\$12,702,020	\$6,292,041	\$18,994,061
FY 2011-12	\$9,953,542	\$4,106,299	\$14,059,841
FY 2012-13	\$8,835,984	\$2,332,780	\$11,168,764
FY 2013-14	\$7,766,095	\$1,891,012	\$9,657,107
Decrease	-\$4,935,926	-\$4,401,029	-\$9,336,954
<b>Percent Decrease</b>	<b>-39%</b>	<b>-70%</b>	<b>-49%</b>

Source: Los Angeles City Controller Financial Analysis and Reporting Division

The City does not receive sufficient information on the causes of the decrease in revenues, and therefore cannot evaluate the reasons for the decrease or verify if the City is receiving the appropriate amount of revenues. The City previously received monthly reports from the Los Angeles Superior Court that detailed revenue by type of violation, and the City's percentage share of revenues by violation<sup>72</sup>, but the reports that the City now receives show only the total distribution to the City by fund.

**Decrease in Citations and Associated Court-Ordered Debt Revenue**

The decrease in court-ordered debt revenues to the City is likely due to a decrease in traffic and non-traffic misdemeanor and infraction citations. According to the State Judicial Council, both traffic and non-traffic misdemeanor and infraction citations fell statewide between FY 2010-11 and FY 2012-13. As shown in Exhibit 13 below, traffic and non-traffic misdemeanor and infraction citations in Los Angeles County fell by 26 percent between FY 2010-11 and FY 2012-13.

<sup>72</sup> According to the Superior Court these reports were created to track the City's Red Light Photo Program revenues but are no longer maintained.

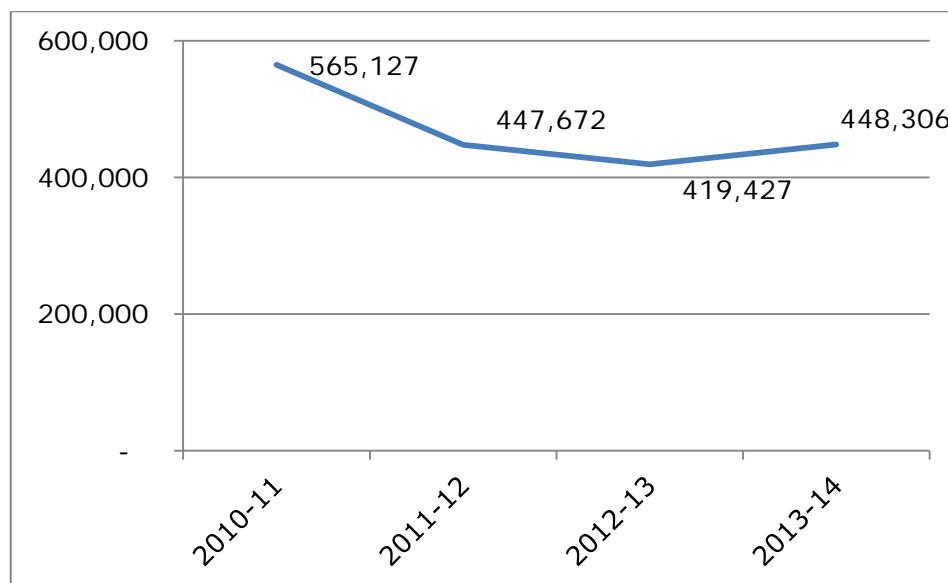
**Exhibit 13: Traffic and Non-Traffic Misdemeanor and Infraction Citations in Los Angeles County**

	Non-Traffic		Traffic		Total
	Misdemeanors	Infractions	Misdemeanors	Infractions	
FY 2010-11	175,006	107,434	320,166	1,764,861	2,367,467
FY 2011-12	116,576	98,569	278,133	1,525,273	2,018,551
FY 2012-13	112,687	38,981	215,458	1,393,384	1,760,510
Decrease	-62,319	-68,453	-104,708	-371,477	-606,957
<b>Percent</b>	<b>-36%</b>	<b>-64%</b>	<b>-33%</b>	<b>-21%</b>	<b>-26%</b>

Source: California Judicial Council Court Statistics Reports 2012, 2013, and 2014

The number of citations issued by the Los Angeles Police Department (LAPD) decreased by 21 percent from 565,127 in FY 2010-11 to 448,306 in FY 2013-14, as shown in Exhibit 14 below.

**Exhibit 14: Decrease in Citations Issued by the LAPD**



Source: LAPD Application Development and Support Division

Court-ordered debt revenues to the City decreased by 45 percent from \$18,727,000 in FY 2010-11 to \$10,262,000 in FY 2013-14, as shown in Exhibit 15 below. The decrease in court-ordered debt revenues to the City of Los Angeles is greater than the decrease in court-ordered debt revenues to other cities in Los Angeles County.



### Exhibit 15: Reduction in Distribution of Court-Ordered Debt Revenue (in thousands)<sup>73</sup>

	Available for Distribution	State & County	Cities	Los Angeles
FY 2010-11	\$566,877	\$508,010	\$58,867	\$18,727
FY 2011-12	\$523,501	\$476,700	\$46,801	\$13,979
FY 2012-13	\$494,593	\$452,856	\$41,737	\$11,272
FY 2013-14	\$479,311	\$440,046	\$39,265	\$10,262
Decrease	-\$87,566	-\$67,964	-\$19,602	-\$8,465
<b>Percent</b>	<b>-15%</b>	<b>-13%</b>	<b>-33%</b>	<b>-45%</b>

Source: Los Angeles Superior Court Financial Services Administration

While the Los Angeles Superior Court, the County Auditor-Controller, or the City Controller could not document the precise reason for the City's greater decrease in court-ordered debt revenue compared to other cities in Los Angeles County, the assumed cause is the termination of the City's Red Light Photo Program in August 2011. Revenues to the City from the Red Light Photo Program in FY 2010-11 were \$3.6 million, of which 60 percent were General Fund and 40 percent were Traffic Safety Fund. The City continued to receive some Red Light Photo Program revenues in FY 2011-12 and FY 2012-13 for infractions that incurred prior to the Program termination in August 2011.

### Statewide Problems in Distribution and Collection of Court-Ordered Debt

The 2007 California Performance Review, commissioned by Governor Schwarzenegger, recommended simplifying and consolidating the more than 3,100 separate court fines, fees, surcharges, penalties and assessments, spanning 27 different State codes that are levied on offenders. The California Performance Review also found that California's system for distributing these revenues was overly complex. In response, the State established the Court-Ordered Debt Task Force in 2011 to evaluate and make recommendations to the Judicial Council and the Legislature for consolidating and simplifying the imposition and distribution of court-ordered debt revenues. To date, the major action of the Task Force was to establish a Revenue Distribution Training Program conducted by the State Controller's Office and the Administrative Office of the Courts.

The California Legislative Analyst's Office identified a number of weaknesses in the current court-ordered debt collection process in a November 2014

<sup>73</sup> The difference in the City of Los Angeles' court ordered debt revenues in Exhibit 13 and Exhibit 15 is due to different reporting periods.

report.<sup>74</sup> The identified weaknesses included (1) a lack of clear fiscal incentives for programs to collect debt in a cost-effective manner or to maximize the total amount of debt that they collect; (2) inadequate information and reporting on how programs collect debt, making it difficult to comprehensively evaluate and compare the performance of existing collection programs; and (3) a statutory division of collection responsibilities between counties and courts that can undermine the oversight and modification of collection programs, thereby making it difficult to make improvements. The Legislative Analyst made several recommendations to the State Legislature to improve the debt collection process, including: (1) restructuring statutory responsibility for debt collection to the county superior courts (the county controllers are currently responsible for debt collection); and (2) improving data collection and measurement of performance.

**Recommendation:**

- 6.1. The City Controller should work with the Los Angeles Superior Court to develop court-ordered debt distribution reports that provide sufficient detail to allow the City to monitor revenues.**

<sup>74</sup> *Restructuring the Court-Ordered Debt Collection Process*, California Legislative Analyst, November 10, 2014.

## Section VI: Improving Revenue Budgets

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**Finding No. 7: The City's single largest General Fund revenue – Property Tax receipts – is projected for the subsequent budget year with minimal current-year secured receipts and without benefit of assessed value estimates issued by the County Assessor on May 15 of each year.**

**Although it is possible to make adjustments later and in some cases adjustments occur, the City's revenue estimating timelines generally limit the amount of information available for revenue projections, thereby reducing the chances of accurate forecasting. Since City staffing and operations may be affected by over- or under-estimated revenues, the City should amend the budget calendar to facilitate budgeting with the most up-to-date revenue information possible.**

### **Budget Accuracy**

#### *Charter and Budget Calendar Timing Requirements*

The City's major General Fund revenue estimates for the upcoming budget year must be completed by late March-of the current year to comply with the City's budget calendar and the City's Charter, which requires issuance of the proposed budget on April 20.<sup>75</sup> Sometimes, the City's budget calendar establishes earlier deadlines than those imposed in the Charter, such as the April 14, 2014 deadline for issuance of the proposed FY 2014-15 budget.<sup>76</sup>

This budget schedule requires staff to project major revenues predicated on February and March economic forecasts and actual receipts, necessitating a projection period of 15 -months.<sup>77</sup> More importantly, the City's single largest General Fund revenue – Property Tax receipts – is projected for the coming year without benefit of assessed value estimates issued by the County Assessor on May 15<sup>78</sup> of each year, and with only receipt of first-quarter current-year secured tax payments.<sup>79</sup> In response to a draft version of this

<sup>75</sup> Los Angeles City Charter Section 312.

<sup>76</sup> FY 2014-15 City of Los Angeles budget schedule.

<sup>77</sup> Revenue projection worksheets furnished by the Office of the City Administrative Officer.

<sup>78</sup> California Government Code Section 27421.

<sup>79</sup> County Auditor's Property Tax distribution schedule.

report, CAO staff noted there are instances in which the City Council does amend proposed major revenue budgets. However, changes based on the best information available between the proposed and final budgets do not occur consistently or systematically. For example, proposed property tax receipts for FY 2014-15 were increased by 0.9 percent (\$14.5 million) through City Council action. However, adjustments to the initial proposed budget are not typical and systematic on an annual basis, as we recommend. In most recent years, no adjustments were made to reflect the availability of improved information on May 15. CAO personnel stated that they seek to be “conservative” in their estimates, as there is “no margin of error” if projected revenues fail to materialize.

Pursuant to City Charter Section 312, the Mayor must submit the proposed budget to the City Council by April 20, and the Council must adopt the budget by June 1. These requirements, coupled with the fact that the budget calendar does not provide for updates to major revenue estimates after April, results in the City’s budget schedule not being coordinated with the availability of the best information for revenue projections.

CAO staff note that if there is “excess” revenue above what is budgeted, it is booked and available to the City.

#### Best Practices

The Government Finance Officers’ Association (GFOA) publishes best practices in municipal budget and finance. Recommended Budget Practice 9.2 states:

“Revenue projections should generally strive for accuracy by coming as close as possible to the actual outcome.”

Recommended Budget Practice 9.2d states:

“A government should develop a process for achieving consensus on the forecast of revenues used to estimate available resources for a budget... Governments may need to reach consensus ...across different governments (e.g., in cases involving intergovernmental coordination on budgetary decisions). The process developed to achieve consensus should recognize where problems are likely to emerge and *be structured accordingly.*” (emphasis added).

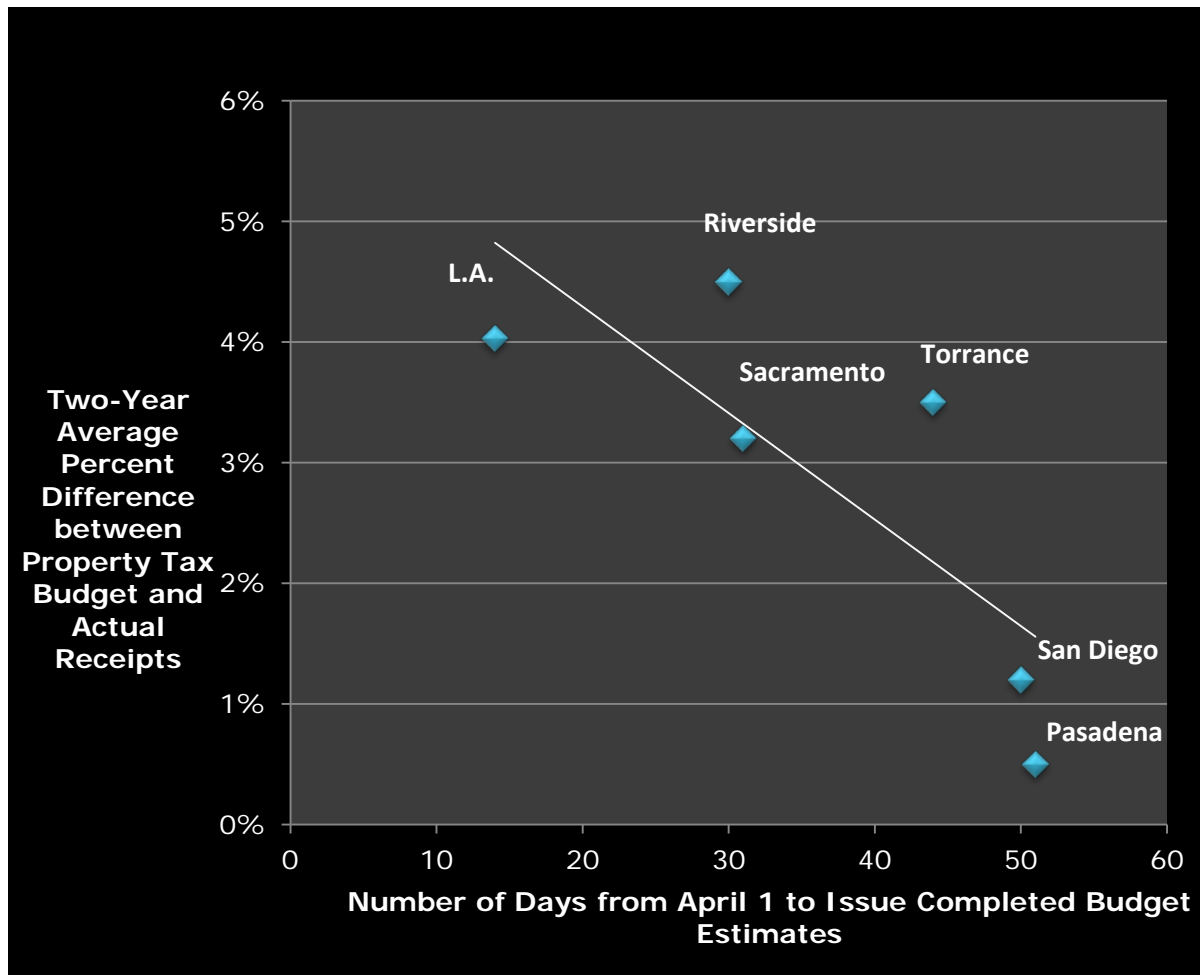
The practice in some other cities allows for preparation of revenue estimates closer to budget adoption. For example, the City of Pasadena provides for an additional month to issue the proposed revenue budget, and the City of San Diego, even though it has an even earlier Charter deadline for releasing the

proposed budget than does the City of Los Angeles, its budget calendar provides a much longer revenue estimation period. Since changes in assessed value are not available from the Los Angeles County Assessor's Office until May 15 each year, the accuracy of property tax estimates is particularly sensitive to budget schedules.

Comparison Cities

Of six cities compared, the cities of Riverside and Los Angeles have the earliest budget deadlines, and had the largest two-year average percentage discrepancies between actual property tax receipts and budgeted property tax receipts (FY 2011-12 and FY 2012-13) among comparison cities. The cities with the latest deadlines for budgeting major revenues – Pasadena and San Diego – had the lowest budget-to-actual property-tax discrepancies for the same two year period. These comparisons are illustrated in Exhibit 16. Note, again, that San Diego issues its proposed budget earlier than Los Angeles, pursuant to its Charter, but unlike Los Angeles, its internal budget schedule provides for May revisions.

**Exhibit 16: Accuracy of Property Tax Estimates Appear Related to Length of Estimation Periods**



Source: City Budget Calendars and City Actual Receipts

There is a strong correlation between shorter estimation periods and higher budget forecast error rates, though there are other factors that could also be strongly associated with the accuracy of estimates. Chief among these is the extent of the underlying change being measured. When the revenue amounts change significantly from one year to the next, estimates are more likely to differ from actual receipts to a material degree regardless of the budget calendar. The information from the chart above is represented in Exhibit 17.

### Exhibit 17: Deadlines to Issue Proposed General Fund Revenue Budgets and Average Property Tax Budget Discrepancies FY 2013-14

City	Issue Date for Proposed Budget	Revised Budget Issue Date	Two-Year Average Property Tax Budget Discrepancy
Riverside	End of April **	N/A	4.50%
Los Angeles	April 14*	N/A	4.00%
Torrance	14-May	N/A	3.50%
Sacramento	1-May	N/A	3.20%
San Diego	15-Apr	20-May	1.20%
Pasadena	3 <sup>rd</sup> Monday in May	N/A	0.50%

\*The latest date under the City Charter is April 20.

\*\*The City of Riverside's budget calendar shows general timelines rather than specific dates. It also shows preparation of revenue projections in November.

The City of Riverside reported that its discrepancy was not due to budget timing, but rather to the effects of former Redevelopment Agency receipts.

The City of Los Angeles's budgeted General Fund revenue remitted by other governmental agencies, particularly property tax revenue, is not as accurate as it could be. For example, the early estimate prepared by the City Administrative Officer for FY 2014-15 put the growth in assessed property value at 4.06 percent compared to FY 2013-14 values. This estimate – although reasonable and appropriate given the availability of information at the time it was prepared – was outdated as of May 15, when the County Assessor released its projection of County-wide growth in assessed value of 5.1 percent, a 25.6 percent increase over the City's early estimate.<sup>80</sup>

<sup>80</sup> County-wide valuation is not equivalent to the assessed values within the City of Los Angeles. In recent years, the City's growth rates in assessed values have been somewhat larger than those of the County as a whole. In addition, assessed value is one variable among many that affect a given year's actual receipts. In short, knowledge of the County-wide assessed value estimate is useful and important for revenue estimation accuracy, but it is not a "guarantee" of accuracy.

Pursuant to the City's budget calendar, however, the revenue estimate based on the early 4.06 percent figure was nonetheless adopted. Data on actual FY 2014-15 property tax receipts available at the time of this report does not allow for determination of the impact of the CAO's assumptions and forecast. However, the Assessor's 2014 Annual Report shows the actual growth in the City's assessed value was 6.0 percent.

**Exhibit 18: Estimated and Projected Assessed Property Value Growth FY 2014-15 for the City and Countywide**

City Estimated Growth (April)	Assessor Projected Growth (May)	Difference
4.06%	5.10%	25.6%

*Sources: Los Angeles Proposed FY 2014-15 Budget and Assessor Projected Roll Growth*

*Budget and Program Effects of Early Budget Calendar*

The effect of better information is clearly illustrated by the City of San Diego, which increased its proposed FY 2014-15 budgeted property tax revenues by 1.7 percent on May 20, after the Assessor released the projected assessment roll growth. To put this in perspective, if Los Angeles's FY 2014-15 property tax budget had been increased at this rate in May 2014, it would have either enabled appropriation of nearly \$28 million of additional General Fund revenue or reduced the use of reserves in the current year.

The effect of less information on the budget process is illustrated by the City of Los Angeles's recent history. The City estimated FY 2013-14 *assessed value* growth of 2.88 percent, using the best available information from February. The Assessor's May 15 2013 projection was for an increase of 4.23 percent, *Countywide*. Actual roll growth for the City was 5.07 percent, according to the Assessor's Annual Report.<sup>81</sup>

Based on the 2.88 percent assessed value estimate, the City budgeted a 2.2 percent increase in property tax revenue. However, that 2.2 percent increase over current-year estimated revenues was applied to projected current-year totals, which were of necessity estimated early in the year. Therefore, the FY 2013-14 budget "increase" was not an increase relative to final FY 2012-13 actual receipts, but rather equal to the previous year's

<sup>81</sup> Page 9: 2013 Assessed Valuation – City of Los Angeles. Excludes state-assessed properties.



receipts. But the City's budget calendar did not provide for revisions to the estimate prior to its adoption. Actual City assessed values grew by more than 5.0 percent and actual General Fund property tax receipts for FY 2013-14 exceeded the adopted budget by \$40.4 million, or 2.6 percent.<sup>82</sup>

### Exhibit 19: Impact of Early Property Tax Estimates on FY 2013-14 Budget

FY 2012-13		FY 2013-14				
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Est. Actual	Actual Revenue	Adopted Budget	Budget vs. Prior Year Est. Actual	Budget vs. Prior Year Actual	Actual Receipt	Actual vs. Budget
			$(c-a)/a$	$(b-c)/c$		$(f-c)$
\$1.517 Billion (April)	\$1.550 Billion (June)	\$1.550 Billion (June)	2.2%	0.0%	\$1.590 Billion	\$40.4 million

Adopting early budget estimates may result in unnecessary cuts to programs and staff or budgeting a level of positions and services beyond what available resources can provide. In addition, City Administrative Officer staff expressed a desire to budget conservatively.

During the exit conference, City staff stated that lower-than-actual revenue budgets simply result in windfall receipts. They stated that any excess is still booked and that they are trying to be conservative.

However, it is possible for low revenue estimates to simply shift the date of cuts from sometime during the fiscal year to July 1. For example, in the Proposed Budget for FY 2012-13, page 1 of the Mayor's budget letter to the Los Angeles City Council states:

*"While many difficult choices and necessary sacrifices have already been made, we must continue to directly address the city's major cost drivers. Regrettably, this will entail workforce reductions. Since 2008, the general fund civilian workforce has been cut by one-third, from nearly 14,000 positions to roughly 9,000 positions. This year, I am proposing the elimination of an additional 669 authorized positions. This represents one of the most difficult decisions in this year's budget, especially since 231 of these positions are currently filled and eliminating them will result in lay-offs."*

<sup>82</sup> City of Los Angeles Preliminary Financial Report for FY 2013-2014, Schedule IV.

According to the proposed budget document, staff were to be laid off in order to balance expenditures to revenues.

That year, the General Fund revenues within the scope of this review were *underestimated* by \$156 million, including \$93.4 million in property tax, an amount that would have easily covered the 231 filled positions and at least some of the vacant positions as well, assuming those positions were General Fund-funded positions. In our opinion, it is possible that better estimates may have preserved staff.

City Administrative Officer management stated in the exit conference that there were no layoffs, and that elimination of filled positions occurred due to “policy decisions,” not lack of revenue. Management reported that even if revenue estimates had been closer to actual receipts, this “would not have changed” recommended staffing levels.

In addition, staff indicated that there would be no real value to changing the budget calendar, since there is already the potential to change revenue estimates and because making adjustments later would not necessarily improve the estimates.

### **Property Tax Budget Presentation**

The City’s proposed budget presents property tax estimates by the following categories of receipt:

- Secured
- Unsecured
- Homeowner exemption
- Supplemental
- Redemptions
- County Administrative Charges
- Refunds
- Adjustments
- CRA Adjustments
- Property tax in lieu of sales tax and vehicle license fees

The City’s estimates are not prepared for each type of receipt shown above. Rather, the City Administrative Officer’s office prepares an estimate of *total* anticipated property tax receipts, generally based on expectations of changes in assessed value. Changes in assessed value are one factor

affecting actual receipts but there are many other factors, such as real estate market changes that affect supplemental receipts.

Staff apportion the estimated total change amount across various categories of property tax receipts so that the total of the distribution equals the estimated figure. At the exit conference, City Administrative Officer staff reported that “individual trend analysis” is done, but that the sum of each category nonetheless will be established in the proposed budget at an amount equal to the predetermined “total.” This method has generally yielded reasonable estimates for property tax overall, and in some years, the estimates have been within one percent of actual total receipts. In other years, the estimates have varied from actual by as much as nine percent, with weaker estimates – not surprisingly – coinciding with years in which there have been large changes in the actual receipts compared to the prior year. Exhibit 20 shows the difference between estimated and actual property tax receipts for FYs 2010-11 through 2012-13.

### **Exhibit 20: City of Los Angeles Property Tax Budget vs. Actual Receipts FYs 2010-11 through 2013-14**

	<b>Proposed Budget</b>	<b>Actual</b>	<b>Difference</b>	<b>Percent</b>
<b>FY 2010-11</b>	\$1,408,529,000	\$1,434,152,093	\$25,623,093	1.8%
<b>FY 2011-12</b>	\$1,436,363,000	\$1,438,840,154	\$2,477,154	0.2%
<b>FY 2012-13</b>	\$1,451,222,000	\$1,550,388,715	\$99,166,715	6.8%
<b>FY 2013-14</b>	\$1,549,568,000	\$1,589,982,943	\$40,414,943	2.6%
	<b>Final Budget</b>	<b>Actual</b>	<b>Difference</b>	<b>Percent</b>
<b>FY 2010-11</b>	\$1,408,529,000	1,434,152,093	\$25,623,093	1.8%
<b>FY 2011-12</b>	\$1,436,363,000	\$1,438,840,154	\$2,477,154	0.2%
<b>FY 2012-13</b>	\$1,457,022,000	\$1,550,388,715	\$93,366,715	6.4%
<b>FY 2013-14</b>	\$1,549,568,000	\$1,589,982,943	\$40,414,943	2.6%

*Source: Preliminary Financial Reports and Proposed Budgets for Listed Years*

### **Resources and Focus of Efforts Related to Revenue Budgeting**

City resources devoted to revenue budgeting are very limited, particularly compared to other cities. It is possible that some other cities have more resources allocated to property tax estimates than the City of Los Angeles has devoted to *all* of its major estimates.<sup>83</sup> Specifically, the City’s major

<sup>83</sup> The City of Los Angeles does employ contractors to estimate City Real Property Transfer receipts and to assist with sales and use tax estimates.

General Fund receipts are largely estimated by one analyst in the City Administrative Officer's office, with some assistance from another CAO analyst. The cities of Torrance, Long Beach, Riverside, Pasadena and San Diego all reported using outside consultants and contractors in addition to City staff to provide assistance in estimating property tax receipts, and most cities in Los Angeles County use specialized consultants to assist with other estimates, such as sales tax.

The City of Los Angeles budget calendar appears to make no consideration for the availability of revenue information. In contrast, the City of San Diego provides for updates of revenue estimates in late May in their budget process. Lastly, as further described below, City officials and staff are generally not focused on revenues though slight adjustments are sometimes made between the time the revenue budget is proposed and the budget is adopted. Estimated revenues are published in a separate document from the proposed budget and assumptions upon which major revenue estimates are based are not always clearly documented in published or unpublished records, and there appears to be no requirement for such documentation. Documentation of assumptions upon which revenue estimates are based is consistent with best practices.

### **Multiple Estimation Processes and Presentation of Revenues**

The City Controller must submit revenue estimates to the Mayor, City Council and City Administrative Officer (CAO) by March 1 for the fiscal year that begins the subsequent July 1 according to the City Charter.<sup>84</sup> The Controller's revenue projections are included as an appendix to the proposed budget, with no explanation in the document, but are not the same as the proposed budgeted revenues prepared by the City Administrative Officer and presented in a separate budget document issued in April of each year. Although City Administrative Officer staff take into consideration information furnished by the Controller, due to the very early date of the estimates, the CAO prepares its own forecasts for budget purposes using newer information. In short, two different offices prepare two different sets of estimates of the same major General Fund revenues, with the Controller's estimates appearing as an appendix to the proposed budget document, while the proposed budget estimates prepared by the CAO are shown in a separate Revenue Outlook document.

Other than fulfilling a Charter requirement, there is no clear purpose for the Controller's estimates given that the City Administrative Officer's office estimates are used for the City's budget. CAO staff report that the two

<sup>84</sup> City Charter Section 311.

estimates are not redundant, but rather that there is value in having “early” estimates presented to elected officials, and also that there is information shared between the two offices that is helpful to the CAO in preparing estimates.

Budget documents should present resources clearly and should not contain conflicting amounts for the same items. The preparation of different estimates by different departments wastes resources, particularly given that one of those estimates is not used for the proposed budget. In addition, presentation of revenue estimates in the proposed budget that are not the proposed budget revenues is confusing and unnecessary.

### **Recommendations**

#### **The City Administrative Officer should:**

- 7.1        Revise the annual budget calendar to require major General Fund revenue estimate updates in the third week of May, thereby ensuring the revenue budget is based on Assessor’s Office estimated assessed values, and the most up-to-date actual receipts and economic forecasts available.**
  
- 7.2        Determine if adequate resources are in place for the City’s revenue forecasting and agree to changes in the City Administrative Officer’s FY 2016-17 budget to provide for additional staff and/or consultants to assist in revenue estimation and documentation of proposed and final revenue assumptions, as warranted.**

#### **The City Controller and the City Attorney should:**

- 7.3        Evaluate the level of detail legally required for the March 1 revenue estimates produced by the Controller’s Office pursuant to the City Charter, and, if possible, reduce the level of detail in the estimates, and do not include them in attachments to proposed budgets as they conflict with the “official” proposed amounts.**

## Acknowledgements

The audit team would like to thank the following organizations for their assistance with this audit:

- The City of Los Angeles Controller
- The City of Los Angeles City Administrative Officer
- The City of Los Angeles Department of Finance
- The City of Los Angeles Department of Building and Safety
- The City of Pasadena
- The City of Riverside
- The City of Sacramento
- The City of San Diego
- The City of Torrance
- The Los Angeles County Assessor
- The Los Angeles County Registrar-Recorder/County Clerk
- The Los Angeles Superior Court
- The Los Angeles Police Department
- The City of Pasadena
- The City and County of San Francisco Office of the Assessor-Recorder
- The County of Santa Clara Recorder
- The County of Riverside Assessor-County Clerk-Recorder
- The Sacramento County Clerk/Recorder
- The County of San Diego Assessor/Recorder/County Clerk
- The California Board of Equalization
- The Franchise Tax Board
- The State Controller
- The Judicial Council of California

# Glossary of Key Terms

**Adopted Budget** is the Mayor and Council approved plan of financial activity for a specified fiscal year indicating all planned revenues and appropriations for the year.

**Assumed Loan (Mortgage)** A process by which a buyer is permitted by a lender to take over or “assume” the existing loan balance and loan terms on a given property. The buyer must meet all of the lender's requirements as if the loan was newly originated, and the transfer is recorded in the new owner's name.

**Budget Calendar** A schedule for the production of an adopted budget that establishes time periods by which each element must be completed or approved, based on agency preference and legal requirements.

**Documentary Transfer Tax** A tax established by state law of \$1.10 per each \$1,000 of property value that is transferred within the County of Los Angeles. The City of Los Angeles receives none of this revenue (see Real Property Transfer Tax for explanation of City's revenue).

**General Fund** is for deposit of general receipts which are not restricted, such as property, sales and business taxes and various fees.

**Income Approach** A method of determining the value of income-producing real properties, such as hotels. The income is estimated by the Assessor's Office for the year following the date of valuation. Estimated expenses are deducted from the income to arrive at the Net Operating Income (NOI) attributable to the property. The NOI is then capitalized by dividing it by a market derived capitalization rate (essentially, the return on investment of similar properties in the market). The result is the estimated market value of the real property as of the valuation date.

**Liens and Encumbrances** includes assumed mortgages, recorded abstracts of judgment, unpaid real property taxes, tax liens, easements, or anything else that may impinge on the property value.

**Business Personal Property Tax** is the tax on the “unsecured” property owned by a business, such as its equipment and furnishings.

**Real Property Transfer Tax** A City tax of \$4.50 per each \$1,000 of property value that is transferred within the City of Los Angeles. It is distinct from Documentary Transfer Tax, although City budget documents refer to this tax as “Documentary Transfer Tax.”

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
Section I Business Personal Property Tax				
Finding 1	The Office of Finance should:			
	41 1.1	Collaborate with the County Assessor's Office to determine the data each agency has and what would be useful to each other in the interest of identifying businesses that have not filed property statements with the County Assessor's Office and that have unpaid business personal property tax liabilities.	Office of Finance	High
	41 1.2	Conduct an internal analysis of its business registration tax certificate systems and data to determine how it could best extract and assemble data for sharing with the County Assessor.	Office of Finance	Medium
	41 1.3	Collaborate with the County Assessor's Office about the City utilizing the County's unique identification system in its taxpayer databases, or both parties transitioning to a more universal standard such as the Internal Revenue Services' electronic identification numbers (EIN).	Office of Finance	Medium



Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
	41 1.4	Request that the City Attorney prepare a formal agreement for the City to provide its full business certificate data, including gross receipts, to the County Assessor's Office in exchange for access to the County Assessor's Office's Business Property Abstracts.	Office of Finance	Medium
	42 1.5	Collaborate with the County Assessor's Office about establishing a task force to improve assessment and revenue collection. Consider opportunities to partner with third-parties such as the California Franchise Tax Board and the California Secretary of State's Universal Commercial Code (UCC) filings system.	Office of Finance	High
	42 1.6	Make formal arrangements for the City to provide digital and physical copies of the County Assessor's Business Property Statement, BOE-571-L which requires details on a business's equipment and supplies if their aggregate costs are \$100,000 or more, to all business certificate applicants in-person, by mail and online.	Office of Finance	Medium

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
	42	1.7 Communicate with the County Assessor’s Office about any additional ways the City can communicate with businesses and residents to encourage further compliance and subsequent e-filing of the Business Personal Property Statements.	Office of Finance	Medium
Finding 2		The Office of Finance should:		
	54	2.1 Collaborate with the County Assessor’s Office to determine the data each entity has and what would be useful to each other in the interest of identifying businesses whose assessable business property values are likely underreported.	Office of Finance	Medium
	54	2.2 Prepare an internal analysis of how Office of Finance business tax registration certificate records could be analyzed by industry, area and other characteristics to help identify businesses with likely under-reported business personal property valuations.	Office of Finance	Medium
	54	2.3 In collaboration with the County Assessor’s Office, determine other City, County and other government entities with whom data sharing opportunities exist in the interest of improved assessment and collection of property taxes.	Office of Finance	High

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
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**Section II: Opportunities for Improving Real Property Tax Assessments and Collections**

Finding 3		The City Office of Finance and the City Attorney should:		
	65	3.1 Facilitate entering in to a Memorandum of Understanding with the County Assessor’s Office to: 1) track transient occupancy tax receipts by hotel and furnish this information monthly to the County Assessor’s Office, and 2) supply annual gross receipts as reported for City business tax purposes to the Assessor’s Office upon receipt.	Office of Finance and City Attorney	Medium
	65	3.2 Amend the existing real property transfer tax agreement between the City and County Recorder, or enter into a new agreement, with the County Recorder to require the Recorder to furnish access to complete images of death certificates of City property owners as needed by the County Assessor’s Office to fulfill its duty to reassess property effective on the date of the owner’s death.	Office of Finance and City Attorney	Medium

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
	65 3.3	Approach the County Public Health Department for access to death information records for purposes of reassessment of property upon the death of the property owner if such an arrangement cannot be made with the County Recorder.	Office of Finance and City Attorney	Low

**Section III: Real Property (Documentary) Transfer Tax**

Finding 4		<p>The Office of Finance should confer with the City Attorney to plan to:</p> <p>Amend the City’s tax collection agreement with the County Recorder’s Office, and, if necessary, the City of Los Angeles Municipal Ordinance Code, to require the Recorder to obtain documentation of all instances in which City Real Property Transfer Tax is calculated on an amount less than the full value of the property transferred (due to claimed exemptions) and to furnish this information to the Office of Finance on at least a monthly basis.</p> <p>Work with the County Recorder’s Office to ensure that protocols are in place to ensure the office’s compliance with the provision in its agreement with the City requiring the Recorder’s Office to notify the City of</p>	<p>Office of Finance and City Attorney</p> <p>Office of Finance and City Attorney</p>	<p>High</p> <p>Medium</p>
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Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
		instances of non-payment of City transfer tax receipts.		
	87	4.3 Collaborate with the Recorder's Office to ensure its compliance with Section 6 of the agreement between the Recorder and the City that requires that the Office provide details on the real estate transfer tax amounts collected by the Office on behalf of the City.	Office of Finance and City Attorney	Low

**Section IV: Sales and Use Taxes**

Finding 5

The Mayor and the Office of Finance should:

97	5.1 Collaborate with the State Board of Equalization as part of its newly signed agreement to identify the data each agency has and what would be useful to each other in the interest of identifying businesses that have not registered with the City and that are under-reporting or not filing sales and use tax to the State.	Mayor and Office of Finance	High
97	5.2 Conduct an internal analysis of the City's business tax registration certificate systems	Mayor and Office of Finance	High

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
		and data to determine how it could best extract and assemble data for sharing with the State Board of Equalization.		
	97	5.3 Request that the City Attorney prepare an amendment to the City’s Agreement for State Administration of Local Sales and Use Taxes to allow for data exchange between the Office of Finance and the State Board of Equalization.	Mayor and Office of Finance	High
	97	5.4 The Office of Finance should: Provide digital and physical copies of the BOE’s publication 107, “Do You Need a California Seller’s Permit?” to all business registration tax certificate applicants.	Office of Finance	Low
	97	5.5 Add the following State-approved language to its physical and digital business certificate application forms: “Sales or use tax may apply to your business activities. You may seek written advice regarding the application of tax to your particular business by writing to the nearest BOE office.”	Office of Finance	Medium

Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
	97	<p>The Mayor and City Administrative Officer should:</p> <p>Determine City funding and staffing needed for an investigative unit to support enforcement of City taxes and fees, and third-party taxes and fees that are remitted to the City and recommend funding levels for this function to the City Council.</p>	Mayor and City Administrative Officer	Medium
	98	<p>Analyze the costs and benefits of the City participating in the BOE’s Municipal Resource Revenue Enhancement Program (MRREP) and Tax Recovery and Criminal Enforcement program (TRaCE) and recommend their conclusion to the City Council.</p>	Mayor and City Administrative Officer	Medium

**Section V: Distribution of Court-Ordered Debt Revenues**

Finding 6	104	6.1 The City Controller should work with the Los Angeles Superior Court to develop court-ordered debt distribution reports that provide sufficient detail to allow the City to monitor revenues.	City Controller	Low
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Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
<b>Section VI: Improving Revenue Budgets</b>				
Finding 7		The City Administrative Officer should:		
	115	7.1 Revise the annual budget calendar to require major General Fund revenue estimate updates in the third week of May, thereby ensuring the revenue budget is based on Assessor’s Office estimated assessed values, and the most up-to-date actual receipts and economic forecasts available.	City Administrative Officer	Medium
	115	7.2 Determine if adequate resources are in place for the City’s revenue forecasting and agree to changes in the City Administrative Officer’s FY 2016-17 budget to provide for additional staff and/or consultants to assist in revenue estimation and documentation of proposed and final revenue assumptions, as warranted.	City Administrative Officer	Low
		The City Controller and the City Attorney should:		
	115	7.3 Evaluate the level of detail legally required for the March 1 revenue estimates produced by the Controller’s Office pursuant to the City Charter, and, if possible, reduce the level of detail in the estimates, and do not include them in attachments to proposed budgets as	City Controller and City Attorney	Low



Finding	Page	Recommendation	Entity Responsible for Implementation	Priority
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they conflict with the “official” proposed amounts.

**A –High Priority** - *The recommendation pertains to a serious or materially significant audit finding or control weakness. Due to the seriousness or significance of the matter, immediate management attention and appropriate corrective action is warranted.*

**B –Medium Priority** - *The recommendation pertains to a moderately significant or potentially serious audit finding or control weakness. Reasonably prompt corrective action should be taken by management to address the matter. Recommendation should be implemented no later than six months.*

**C –Low Priority** - *The recommendation pertains to an audit finding or control weakness of relatively minor significance or concern. The timing of any corrective action is left to management's discretion.*

**N/A** - *Not Applicable*

Finding/Recommendation	Page	Category	Financial Impacts
1 Finding 1, all recommendations	30	Increased Revenue	Amount Undetermined
2 Finding 2, all recommendations	44	Increased Revenue	\$394,159 Ongoing
3 Finding 3, all recommendations	59	Increased Revenue	\$830,100 Ongoing
4 Finding 4, all recommendations	73	Increased Revenue	\$1.2 Million Ongoing
5 Finding 5, all recommendations	88	Increased Revenue	\$17.2 million to \$19.2 million Ongoing
6 Finding 6, all recommendations	99	Cost Savings & Efficiencies	\$0
7 Finding 7, all recommendations	105	Cost Savings & Efficiencies	\$0

**Cost Recovery:** Monies that may be recoverable.

**Cost Savings and Efficiencies:** Cost savings opportunity and process enhancements.

**Cost Avoidance:** Monies that are lost but are avoidable in the future.

**Increased Revenue:** Revenue opportunities.

**Wasted Funds:** Monies that are lost and not recoverable due to reckless act or mismanagement of funds.

We strive to identify and recommend actions that will result in real financial impact, whereby the City can achieve significantly more through cost savings and/or increased revenue than the cost of the audit function. The above dollar estimates are dependent upon various factors, such as full implementation of audit recommendations and should not be used as guaranteed amounts.

# APPENDIX III – SCOPE & METHODOLOGY

## SCOPE

The audit scope was limited to General Fund revenues remitted by other governmental entities – specifically: property tax, former redevelopment tax increment monies, sales and use tax, documentary (real property) transfer tax, tobacco settlement monies, court fines and motor vehicle license fees. The audit excluded restricted intergovernmental revenue, such as grants. The receipts within the scope of the audit are collectively are budgeted at \$2.3 billion for FY 2014-15, or 44.2 percent of all budgeted General Fund revenues. Although the audit reviewed revenue budgeting methods and outcomes, the primary focus of the audit was to identify process changes to maximize actual City receipts and those of other taxing entities within the County of Los Angeles.

## METHODOLOGY

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) set forth in the 2011 revision of the “Yellow Book” of the U.S. Government Accountability Office. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. In accordance with these requirements, we performed the following management audit procedures:

### **Entrance Conferences**

Entrance conferences were held in mid-May 2014 with offices of the City Controller, the City Administrative Officer, and the Department of Finance.

### **Fieldwork**

Our fieldwork began in June 2014 and consisted of interviews, survey work, and data collection and analysis, as detailed below:

#### Interviews:

We interviewed representatives of the following agencies:

- The City of Los Angeles Controller, regarding preparation of March revenue estimates and monitoring of revenues;
- The City of Los Angeles City Administrative Officer, regarding preparation of budgeted revenue estimates;

- The City of Los Angeles Department of Finance, regarding revenue estimates and monitoring;
- The City of Los Angeles Department of Building and Safety, regarding distribution of City building permits to the Los Angeles County Assessor;
- The Los Angeles County Assessor, regarding 1) business personal property tax assessment processes, 2) assessments resulting from change in ownership and 3) assessments of hotel property;
- The Los Angeles County Registrar-Recorder/County Clerk, regarding Real Property Transfer Tax collections processes;
- The County of Santa Clara Recorder, regarding transfer tax processes and transfer tax data supplied by that office;
- The County of Riverside Assessor-County Clerk-Recorder, regarding transfer tax processes and transfer tax data supplied by that office;
- The Sacramento County Clerk/Recorder, regarding transfer tax processes (via email questionnaire)
- The County of San Diego Assessor/Recorder/County Clerk, regarding transfer tax processes (via email questionnaire)
- The City and County of San Francisco Office of the Assessor-Recorder, regarding transfer tax processes
- The Los Angeles Superior Court, regarding court fine receipts;
- The Los Angeles Police Department, regarding citations resulting in court fines;
- The California Board of Equalization, regarding sales and use tax evasion and regarding court fines;
- The Franchise Tax Board, regarding court fines;
- The State Controller, regarding court fines;
- The Judicial Council of California, regarding court fines

### Survey Work

We surveyed the following cities with regard to their revenue budgeting practices:

- The City of Pasadena
  - The City of Riverside
  - The City of Sacramento
  - The City of San Diego
  - The City of Torrance
-

Data Collection and Analysis

We obtained and analyzed the following data:

- Business personal property data purchased from the Los Angeles County Assessor;
- City business tax database from the City Department of Finance;
- Real property transfer tax payments during October 2014 obtained from the County of Santa Clara Recorder;
- Reported receipts generated by the Documentary Transfer Tax audit function performed by the Riverside County Recorder;
- Logs showing the transference of building permits from the City Building and Safety Department to the Los Angeles County Assessor;
- Publicly available business records from the California Secretary of State;
- U.S. Census Bureau data related to population, housing, hotels, loan types and amounts and mortgage assumption;
- Policies and procedures from the Los Angeles County Registrar Recorder County Clerk;
- Publicly available mortality data for the County from the Los Angeles County Department of Public Health;
- Citations issued, from the City of Los Angeles Police Department
- Actual receipts for the City of Los Angeles for the revenues within the scope of this audit from approximately 1990 to 2013, furnished by the City Administrative Officer's office;
- Publicly available reports from the Franchise Tax Board related to its court collections program and its assessments of locally operated court collections statewide.

Modification of Work Plan and Finding Development

We issued a planning memo on July 30, 2014, and met with the Controller's Office to present our preliminary observations and obtain feedback regarding potential findings. Based on this feedback, we modified the work plan and scope of the audit. We furnished draft audit findings (point sheets) and met with representatives of the City Controller in late February 2015.

Draft Report Development

On March 24, 2015, we provided a draft report to the City Controller. We shared the draft report with affected City and County Offices in April, and held exit conferences to discuss the findings and recommendations. We considered the comments and additional information and documents that were provided subsequent to the exit conferences as we revised this report. We provided a revised draft on June 18, 2015.

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## Appendix IV: Benchmarking & Best Practices

As part of this audit, we conducted a survey of other cities' revenue budgeting policies, practices, and timelines. Separately, the team gathered financial information, budgeted revenues and actual revenues, to measure various cities' revenue budgeting accuracy. These measures were compared with survey results to assess practices that appeared to produce the most accurate revenue budgeting results.

Surveyed City	In Los Angeles County?	Population <i>July 1, 2013 U.S. Census</i>
Pasadena	Yes	139,731
Riverside	No	316,619
Sacramento	No	479,686
San Diego	No	1,355,896
Torrance	Yes	147,478

Los Angeles	Yes	3,884,307
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### Survey City Selection

The City of Los Angeles is the largest city in California by population. Since there are no other near comparisons by population, and cities in other states have significantly different revenue frameworks, the audit team used a variety of selection criteria. San Diego was selected as the second largest city in the state. Cities such as Pasadena and Torrance were selected because they are geographically close to the City of Los Angeles and are within the County. Still others such as Riverside and Sacramento were selected because they are relatively large cities and had detailed financial information available.

Many other cities in California were considered. Unfortunately not all had sufficient, complete or accessible detailed financial information that would lend itself to the audit team's analysis.

Survey Results

The surveys were conducted throughout November and December 2014. Some were conducted over the phone and the responses were transcribed, others were submitted by the representatives online. In all cases responses were provided by members of the Cities' finance and budget departments. In the case San Diego, the city has a Department of Finance that reports to the executive and an Independent Budget Analyst the reports to the City Council. Responses from both offices are included below. Some responses have been modified slightly for clarity and brevity.

Question	Pasadena	Riverside	Sacramento	San Diego	San Diego – Office of the IBA	Torrance
<b>When are annual revenue forecasts prepared?</b>	At the same time as expenditures for the proposed budget	Quarterly	At the same time as expenditures for the proposed budget	At the same time as expenditures for the proposed budget	After you receive	Prior to developing expenditures for the proposed budget
<b>If revenue forecasts are prepared before or with the budget, when are your revenue forecasts due each year?</b>	March 1	n/a	April 1	April 15	n/a	February 28
<b>Notes on above answers.</b>	The due dates listed are approximate and represents delivery of requests for by the City Manager. City Charter requires that a budget hearing be held on the third Monday in May each year.	Prepare monthly expenditure forecasts and quarterly revenue forecasts. We set budget "targets" at the start of the budget process based on our projection of the next fiscal year's revenue at that time. The process starts in December and concludes in May, so during that time two additional forecasts are prepared. To the extent that the revenue forecast changes materially the budget targets are adjusted accordingly.	<i>No response</i>	<i>No response</i>	The IBA issues a review of the budget by April 27 <sup>th</sup> .  Otherwise IBA does year-round revenue monitoring. Will have 6 months of data prior to April review.	Revenue forecast continually updated & revised throughout the fiscal year.
<b>Do you regularly or periodically check remitted revenues to ensure your receipts are in fact accurate? If so which revenues and what is the process?</b>	We contract with consultants on major revenues such as property tax and sales tax revenues	<i>No response</i>	We check Property, Sales, Utility and other major taxes on a monthly basis to see if our projections are accurate. If revenues are not tracking as expected, we made adjustments as part of the midyear reporting process.	Major revenue receipts are monitored monthly and current year-end projections are updated monthly based on most recent receipts. The major revenues tracked and projected monthly include property tax, sales tax, transient occupancy tax, franchise fees, property transfer tax and safety sales tax.	<i>No response</i>	<i>No response</i>



Question	Pasadena	Riverside	Sacramento	San Diego	San Diego – Office of the IBA	Torrance
Do you have any processes in place to assist other entities in the collection of remitted revenues? Such as sharing building permit data with the Assessor's Office, or providing tips/data to the state BOE's enforcement team for sales tax collection?	Yes	No response	We have a sales tax consultant who provides quarterly updates for the City.	Yes, the City Treasurer's Office cooperates with the State on revenue collection enforcement.	No response	No response
Notes on other General Fund revenue budgeting:	No response	We utilize a Beacon Economics forecast for our major revenue sources and supplement that with HdL for sales tax and property tax. For more minor revenues, we utilize the current year estimated actuals as a starting point and then add a reasonable increase factor based on current economic conditions and/or information for similar revenues contained in the Beacon Economics forecast.	No response	No response	San Diego's General Fund revenues are influenced most by Transient Occupancy Tax (TOT) revenues and tourism.  Forecasts by local tourism boards and monthly growth of TOT revenue from Treasurers Office are monitored closely.	No response
What <u>property</u> tax revenue budgeting method do you primarily use?	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Develop projections that are independent of previous year's revenues.	Use estimated or projected actuals from current year.	Reviews calculations (used prior years amounts with inflator) Inflaters are driven by housing market and the economy.	Estimated actuals from current year +/- building activity +/- appeals + est property sales, then inflator factor for normal growth
What entities do you consult with when budgeting <u>property</u> tax revenue?	Third-party consultants, outside economists, or other contractors.	County Assessor's Office. Third-party consultants, outside economists, or other contractors.	County Assessor's Office.	Departments or agencies within the City, County Assessor's Office, Third-party consultants, outside economists, or other contractors.	Departments or agencies within city., County Assessor's Office., Third-party consultants, outside economists, or other contractors., Beacon, UCLA Anderson	Departments or agencies within the city, County Assessor's Office, Third-party consultants, outside economists, or other contractors.

Question	Pasadena	Riverside	Sacramento	San Diego	San Diego – Office of the IBA	Torrance
How much do your <u>property</u> tax forecasts rely on input and guidance from the County Assessor's Office?	Influential	Somewhat influential	Critical	Very Influential	Very Influential	Mainly used for growth factor reality check
When budgeting <u>property</u> taxes what level of detail do you prepare?	Budgeted as 2 to 3 line items. (Secured and Unsecured)	Budgeted as 4 or more line items. (Secured, Unsecured, Supplemental, Redemption, Homeowner Exemption, Adjustments....)	Budgeted as 4 or more line items. (Secured, Unsecured, Supplemental, Redemption, Homeowner Exemption, Adjustments....)	Budgeted as 4 or more line items. (Secured, Unsecured, Supplemental, Redemption, Homeowner Exemption, Adjustments....)	Budgeted as 4 or more line items. (Secured, Unsecured, Supplemental, Redemption, Homeowner Exemption, Adjustments....)	Budgeted as 4 or more line items. (Secured, Unsecured, Supplemental, Redemption, Homeowner Exemption, Adjustments....)
Notes on <u>property</u> tax Budgeting	No response	No response	No response	Property tax category includes 1.0% base property tax, MVLF backfill, RPTTF tax sharing payments and RPTTF residual payments.	Estimates becomes more concrete by time of adopted budget. Every month look at report from Assessor and Treasurer Office's, which helps inform estimate. Best projection are from period 3 (Sept) RDA dissolution caused budgeting uncertainty due to one-time funds.	No response
What <u>sales</u> tax revenue budgeting method do you primarily use?	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Use estimated or projected actuals from current year.	Review FM's quarterly projections of state's figures. Considers seasonality. Considers Triple Flip calculations.	Projected actuals +/- business openings/closings; Building permit activity; adjustments; and then growth factor
What entities (if any) do you consult with when budgeting <u>sales</u> tax revenue?	consultants	HdL Beacon Economics	MuniServices sales tax consulting	UCLA Anderson HdL LLC BOE DOF etc.	Sales tax revenue consultant = HDL (both offices use as a city-wide service)	Muni Services for reality check

Question	Pasadena	Riverside	Sacramento	San Diego	San Diego – Office of the IBA	Torrance
Notes on <u>sales tax</u> Budgeting	<i>No response</i>	<i>No response</i>	<i>No response</i>	<i>No response</i>	<i>No response</i>	Also use economic forecasts from UCLA & LAEDC, trends for Auto sales, retails sales, etc..
What <u>documentary transfer tax (DTT)</u> revenue budgeting method do you primarily use?	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Primarily use projections provided by a consultant, outside economist, or third-party firm contracted.	Use estimated or projected actuals from current year + a standard inflator or deflator.	Use estimated or projected actuals from current year.	Use month to month trends of housing sales. Close attention to large commercial transactions that might make large annual variances.	Use estimated or projected actuals from current year + a standard inflator or deflator.
What entities (if any) do you consult with when budgeting <u>documentary transfer tax (DTT)</u> revenue?	consultants	Beacon Economics	We use current year data and a regional economic forecast to determine transaction activity in the future.	County Assessor Real estate market statistics	Sometimes use CB Richard Ellis figures.	<i>No response</i>
Notes on <u>Documentary Transfer Tax (DTT)</u> Budgeting	<i>No response</i>	<i>No response</i>	<i>No response</i>	<i>No response</i>	Use month to month trends of housing sales. Close attention to large commercial transactions that might make large annual variances.	<i>No response</i>
What court fine revenue budgeting method do you primarily use?	Use estimated or projected actuals from current year + a standard inflator or deflator.	Use estimated or projected actuals from current year + a standard inflator or deflator.	No method used	Use estimated or projected actuals from current year.	Carry over budgeted revenues from current year's budget.	Use estimated or projected actuals from current year + a standard inflator or deflator.
What entities (if any) do you consult with when budgeting Court Fine revenue?	None	<i>No response</i>	Not a city revenue	<i>No response</i>	<i>No response</i>	Mainly internal departments
Notes on Court Fine Revenue budgeting	<i>No response</i>	<i>No response</i>	<i>No response</i>	<i>No response</i>	IBA only look into if proposed revenue if significantly different than previous year.	Not a large revenue source for Torrance
For all <u>other</u> General Fund revenues, what budgeting method do you primarily use?	Use estimated or projected actuals from current year + a standard inflator or deflator.	Use estimated or projected actuals from current year + a standard inflator or deflator.	Use estimated or projected actuals from current year + a standard inflator or deflator.	Use estimated or projected actuals from current year.	Carry over budgeted revenues from current year's budget.	Actuals; +/- new activity; historical trends; adjustment to those trending factors; than growth factor

Question	Pasadena	Riverside	Sacramento	San Diego	San Diego – Office of the IBA	Torrance
<b>What entities (if any) do you consult with when budgeting <u>other</u> general fund revenue?</b>	Varies based on type of revenue	Beacon Economics for major revenues sources.	<i>No response</i>	<i>No response</i>	Forecasts by local tourism boards: -average daily room nights -rooms coming online	Mainly internal departments
<b>Notes on <u>other</u> General Fund revenue budgeting:</b>	<i>No response</i>	We utilize a Beacon Economics forecast for our major revenue sources and supplement that with HdL for sales tax and property tax. For more minor revenues, we utilize the current year estimated actuals as a starting point and then add a reasonable increase factor based on current economic conditions and/or information for similar revenues contained in the Beacon Economics forecast.	<i>No response</i>	<i>No response</i>	San Diego's General Fund revenues are influenced most by Transient Occupancy Tax (TOT) revenues and tourism.  Forecasts by local tourism boards and monthly growth of TOT revenue from Treasurer's Office are monitored closely	<i>No response</i>