

**Report of Internal Audit
Business Tax Follow-Up Report
March 13, 2014**

**City of Charlotte
City Auditor's Office
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Audit Purpose

The purpose of this audit was to follow up the findings and recommendations of our February 24, 2012, report entitled “Business Taxes Received Via County.” The 2012 audit reviewed the completeness of the City’s business tax revenues. Those revenues are collected for the City by Mecklenburg County’s Office of the Tax Collector (OTC), pursuant to an inter-local agreement.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This report is intended for the use of the City Manager’s Office, City Departments, and the City Council’s Governance and Accountability Committee.

Scope and Methodology

In conducting our follow-up related to the 2012 report; auditors employed the following procedures:

- Re-examined a previous sample of ARRA contractors and vendors used by the City, using the County’s web portal to determine the current status of their compliance with local privilege license requirements
- Selected more samples of recently used vendors from City payment files for comparison to the County portal, including samples of additional ARRA vendors, high dollar City vendors, and vendors of commodity type goods
- Requested the County’s OTC to confirm our findings regarding the samples compared to the portal
- Examined recent purchase orders and contracts issued by the City to determine whether the vendors and contractors are in compliance with local privilege license requirements
- Interviewed City Finance and other staff concerning the implementation of the report’s recommendations
- Interviewed OTC staff to obtain an update on recommendations related to taxpayer database matching and the County’s use of an outside compliance auditor

Conclusion

The County OTC continues to collect significant business tax revenues for the City, with collections of this type growing to \$87.7 million in FY 2013, from \$76.2 million in FY 2011, an aggregate increase of 15%.

Despite the inability of this audit to connect specific actions taken with increased revenues, we have concluded that the County has addressed the concerns we raised in 2012. As the specific audit findings address below, the County has improved upon an already effective identification and collection process for business taxes.

Summary Results

The 2012 audit report concluded that some revenues may go uncollected due to non-compliance by companies that are required to self-report their taxable incomes. The report also stated that tests indicated additional revenues in the range of 5-15% may go uncollected in some categories of Business Taxes. This follow-up report points to several actions taken by the County which may have contributed to increased collections. However, it is also possible that a changing business environment and improved economy had an equal or greater impact related to the rising revenue collections for the City.

Based upon our samples, BPLT compliance appears to have improved (see finding #1 below). From a total of 400 City vendors reviewed by City Internal Audit and the County's Office of the Tax Collector (OTC), 67% were found to be registered and current. Thirty-one percent were determined to be exempt, leaving six businesses requiring further review.

A review of County operations found that the OTC has taken additional steps since our previous audit to improve the effective collection of business taxes for the City (finding #2). The OTC is regularly comparing its business tax system data to other databases and has contracted with a new compliance auditor whose emphasis is on both compliance and discovery. The discovery efforts have resulted in the addition of 381 new accounts. As detailed below, the new accounts have resulted in minimum payments totaling \$19,050. Estimated annual revenues could exceed \$150,000, if the new accounts are consistent with recent average payments of other entities.

Background

The Business Tax Collections Unit of the Mecklenburg County Office of the Tax Collector (OTC) collects business taxes for both the County and the City. The City's share of taxes is transmitted to the City daily for the privilege license tax and monthly for other business taxes. The following details the revenues received or budgeted by the City from OTC for the five major sources of business taxes (in \$Millions):

	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>	<u>FY14 (Est.)</u>
Room Occupancy	\$29.4	\$32.6	\$35.2	\$34.2
Prepared Food/Beverage	20.4	22.5	22.5	23.8
Business Privilege License	15.4	16.4	17.7	18.1
Vehicle Rental (incl. U-Drive It)	10.8	11.6	11.8	12.5
Heavy Equipment Rental	<u>0.2</u>	<u>0.4</u>	<u>0.5</u>	<u>0.3</u>
Totals	\$76.2	\$83.5	\$87.7	\$88.9

Room Occupancy taxes are received from hotels and motels that charge an 8% tax for room rentals (which includes 2% for the NASCAR Hall of Fame Museum). Prepared Food and Beverage Taxes are received from establishments that are required to charge customers 1% of subject sales. Business Privilege License Taxes (BPLT) are paid by individuals or companies doing business within Charlotte. (The minimum BPLT is \$50 and the maximum is \$10,000, based upon a tax rate of 60 cents per \$1,000 gross revenues.) Vehicle Rental Taxes, including the U-Drive It Tax, are derived from a 6.5% tax levied upon vehicle rental revenues. The Heavy Equipment Rental Tax began in FY10, and is 0.8% of the gross receipts from the rental of heavy equipment.

Findings and Recommendations

1. BPLT compliance appears to have improved.

During this follow-up audit, we selected samples of City vendors totaling 400 businesses. To determine whether the vendors were compliant with the requirement to obtain a business license unless exempt, we attempted to locate the vendor using an on-line portal provided by the OTC on the County Government website. The portal provides a list of all businesses that have secured a current license to conduct business in Charlotte.

We determined that 301 of the 400 vendors sampled were either listed (225) on the portal as having a business license or, if not listed, appeared to be an exempt entity (76), such as a law, architectural or engineering firm. We sent a list of the remaining 99 vendors sampled to the OTC for follow-up. The following reflects our original findings (IA), our referral of 99 items to the OTC for follow-up, and the results of the OTC's review.

	<u>IA</u>	<u>OTC</u>	<u>Totals</u>
Exempt	76	45	121
Licensed (portal, or per County)	225	34	259
Recently out of business	-	12	12
More research necessary	99	6	6
Discovery – New Account	<u>-</u>	<u>2</u>	<u>2</u>
Totals	<u>400</u>	<u>99</u>	<u>400</u>

Combining our results with those of the OTC, about 98% of the sample of 388 (400, less 12 out of business entities) appear to be compliant with the business license requirement or are otherwise exempt. The six requiring more research combined with the two discoveries comprise just over 2% of the sample.

The results outlined above reflect a significant increase in compliance with BPLT requirements, as compared to our findings in the audit dated February 24, 2012, as follows:

- City vendors – a sample of 25 determined a rate of business license non-compliance of 60% or more.

- Food and beverage establishments – a sample of 25 determined a business license non-compliance rate of 38%.

Note: Our samples for the 2012 audit and the present follow-up audit were judgmentally selected, i.e., non-statistical. Therefore, no causation can be determined to explain the improved results from one period to the next (i.e., non-compliance rates of 38% and 60% from sample sizes of 25 each reported in 2012 versus a non-compliance rate of about 2% from a sample size of 388 in the current period). Factors could include improved conditions in the general economy, more regular database matching and follow-up by the OTC, a new outside compliance auditor contracted by the OTC, and new purchase order language in use by the City, in addition to variations in the sample selections.

2. The County's Office of the Tax Collector (OTC) has taken positive steps to further improve the effective collection of business taxes for the City.

In 2012, we concluded that the County's efforts, along with voluntary compliance from the business community with Business Tax requirements, had resulted in the majority of business taxes being collected in a timely manner. In that report, we observed many positive and effective steps taken by the County to discover non-compliant businesses and continually monitor and improve overall compliance levels. We also noted two additional actions which could be taken to improve the effort:

First, our audit compared various databases to identify potential businesses for further review – leading to our recommendation that City Finance discuss a program of database matching that the County could conduct regularly.

Second, our audit noted that the County's approach to auditing business taxes focused on the accuracy of reports filed by compliant companies – we recommended that City Finance encourage the County to focus on the discovery of non-reporting businesses instead.

The City and County informally discussed database matching in 2013, with the County agreeing to perform the matching each October. The County had engaged a new vendor (TMA) in 2012 to conduct more focused discovery audits. (See 2.B. below for additional information.) This audit noted positive steps taken by the County which addressed our concerns, as described below.

A. The Office of the Tax Collector is regularly comparing its business tax system data to other databases.

- Health Department Database of Restaurants and Other Food & Beverage Preparers – The database includes approximately 2,500 establishments. During our follow-up, the OTC indicated that quarterly updates are electronically mailed by the Health Department to the OTC's Business Tax Unit, and business tax accounts are opened or updated as needed. The OTC provided the following results of its full database match

conducted in October 2013; which resulted in 844 non-matches, and were addressed as follows:

- 156 businesses were found to be exempt (18%).
 - 342 accounts were found in Biz Tax under another business name (41%).
 - 13 were out of business (2%).
 - 178 new accounts were set up in Biz Tax (21%).
 - 155 were mailed questionnaires to assist in a determination (18%).
- County Vendor Database – This database includes approximately 760 County vendors. During our follow-up, the OTC provided details related to an October 2012 match of this database to the business tax database (Biz Tax). Initially a total of 631 non-matches were found, i.e., that number of businesses was listed in the vendor database that were not present in Biz Tax. The following details the OTC's reported results from its analysis of the 631 businesses:
 - 282 businesses were found to be exempt (45%).
 - 38 accounts were found in Biz Tax under another business name (6%).
 - 21 were out of business (3%).
 - 82 new accounts were set up in Biz Tax (13%).
 - 208 have not responded to mailed questionnaires (33%).

The OTC conducted another match of these databases in October 2013. Below are the results from the OTC's research of 613 non-matches:

- 306 were found to be exempt (50%).
 - 129 accounts were found in Biz Tax under another business name (21%).
 - 4 were out of business (1%).
 - 23 new accounts were set up in Biz Tax (3%).
 - 151 were mailed questionnaires to assist in a determination (25%).
- City Vendor Database – The OTC performed a match of the City's vendor database (with 2,513 active vendors) and Biz Tax in December 2013. Results of the match are as follows:
 - 570 vendors found to be exempt (23%)
 - 979 accounts were found in Biz Tax with an existing account (39%)
 - 334 vendors were closed based on updated information (13%)
 - 532 vendors were sent letters to obtain more information (21%)
 - 98 new accounts were set up as "discovered" accounts (4%)

OTC has indicated agreement with City Finance that a City vendor match will be performed on a regular basis in October of each year going forward, focusing particularly on new vendors added and reporting back to Finance on the results.

Aggregate Database Comparison Results – The OTC’s efforts to address non-matches identified in the four database comparisons detailed above yielded the following results:

- 381 accounts became current on BPLT due the City. If each account remains current with the minimum payment of \$50, annual revenue will increase by \$19,050. If the new accounts are consistent with our findings in 2012 that average accounts paid \$400, annual revenues will increase by over \$150,000. (It is not practical to obtain individual payments for the purpose of this audit.)
- 1,046 entities were identified by the OTC for further review.
- Business personal property tax database – During our follow-up, the OTC provided the following description of an additional matching technique now being utilized:

Our newest vendor, Tax Management Associates (TMA) has begun matching the Biz Tax database to the 2012 Business Personal Property tax listings from the Assessor's Office. A process is in place to review the information received from this match to validate the results and "discover" accounts, when appropriate.

TMA is under contract for three years with two one-year renewal options. The tax listings include approximately 11,310 businesses that own taxable personal property located within Charlotte. Initial results from this process are discussed, in B, below.

B. The Office of the Tax Collector has contracted with a new compliance auditor and the emphasis is on both compliance and discovery.

The OTC provided a report that details the first six-month performance of a new compliance auditor, Tax Management Associates (TMA). According to the report provided by the OTC, TMA began work in January 2013. The following highlights are excerpted from the report:

- The report covers the performance period January through June 2013.
- A total of 157 businesses were audited.
- The 157 businesses included a total of 237 licenses audited (as some required both a regular business license as well as others, such as occupancy tax, prepared food or vehicle rental licenses).
- The most frequent rates of non-compliance were identified among the prepared food and beverage (PFB) entities (61% non-compliant) and room occupancy (RO) entities (73% non-compliant).
- The overall projected recovery from all 157 entities is \$116,669, or an average of \$743 per entity and \$492 per license.
- In its discovery program work, which included matching the Business Personal Property and Biz Tax databases, the OTC reports that the TMA discovery process has yielded 243 “new” discovered accounts being opened in Biz Tax.

Recommendation

Database matching, along with the efforts of the new compliance auditor, have proven to be effective tools that supplement other discovery techniques employed by the OTC. City Finance should request and review County results on a regular basis. The City and County should formalize the reporting feedback which will be supplied and agree to work together to periodically reassess the cost-effectiveness of all efforts used to enforce BPLT compliance.

City Finance Department Response

City Finance agrees. We have discussed this with the County and they have agreed to provide us with the necessary report on a regular basis.

3. New language regarding business licenses has been implemented for Purchase Orders.

Effective in March 2012, the terms and conditions of City purchase orders began including the following provision:

“Seller confirms it has purchased a Business Privilege License to sell goods or services within Charlotte. Otherwise, Seller agrees to do so prior to completion of this order, and may contact the Tax Collector within the County government for instructions.”

Our review of 20 purchase orders for commodities noted that the new language for the business license requirement was included in the purchase order terms and conditions, without exception.

No further recommendation