

Performance Audit Report

Department of Assessments and Taxation

Homestead Property Tax Credits

A Comprehensive Compliance Program Should be Established

Data System Controls Should be Enhanced and Data Matches Should be Performed to Monitor Continued Eligibility of Properties for the Credits

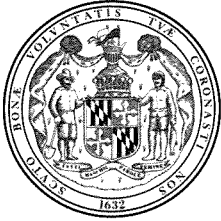
Actions Should be Taken to Maximize the Recovery of Taxes for Improperly Granted Credits

February 2013



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

February 28, 2013

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We conducted a performance audit to assess the State Department of Assessments and Taxation's (DAT) procedures for ensuring that Homestead Property Tax Credits (HTC) are only granted for eligible properties.

DAT determines eligibility for the HTC using an application process as established by law, which helps ensure that property owners do not receive HTCs for more than one property in Maryland. Homeowners eligible for an HTC who purchased their properties prior to January 1, 2008, when there was no application requirement, needed to submit an application to DAT by December 31, 2012 to continue to remain eligible for the HTC. The HTC reduces property tax increases on an owner-occupied principal residence by capping the yearly increase in taxable assessments to a fixed percentage¹ of the prior year's taxable assessment. Using DAT's records, we estimated that the HTCs will reduce property tax revenue to the State's 23 counties and Baltimore City for fiscal year 2013 by an estimated \$323.1 million, and reduce property tax revenue to the State by \$2.3 million.

Our audit disclosed that DAT has not established a formal comprehensive compliance program to administer the HTC. Specifically, DAT has not established written procedures for the processing of HTC applications, delineated the roles and responsibilities of DAT headquarters and the local assessment offices to verify continued eligibility of properties for the HTC, nor established procedures to monitor the local assessment offices' HTC related activities. Furthermore, local assessment offices were not consistently using available sources of information to help identify properties that may not be

¹ By law, the fixed percentages are set by each county and applicable municipality, and the State. The State rate is 10 percent; the county and municipal rates range from 0 percent to 10 percent.

eligible to receive the HTC, and DAT headquarters had not developed automated matching techniques using available data sources to detect ineligible properties. Certain data matches we conducted identified numerous instances in which properties were improperly designated as eligible for the HTC. Our review also disclosed that internal controls need to be improved over application processing, access to the applicable data systems, and changes made to critical system data fields affecting HTC eligibility.

DAT also needs to establish a plan to investigate the propriety of HTCs received in prior years on properties that will be removed from eligibility because an application was not submitted by the December 31, 2012 deadline or was not approved. DAT estimated that, as of January 17, 2013, it had received approximately 175,000 applications that had not been processed. However, this quantity is significantly less than the approximately 513,000 properties deemed eligible on DAT's records at that date for which an application had not been processed, including approximately 183,000 properties with HTCs valued at approximately \$87 million beginning July 1, 2013. DAT also needs to develop a policy regarding the recovery of all improperly granted HTCs as allowed by law. DAT's practice was to research the amount of improperly granted HTCs for the latest three years, even though the properties may have been ineligible for a longer period.

As part of the audit, we conducted a statistical sample of the 1,343,271 properties classified as eligible for the HTC in DAT's records as of June 1, 2012 to determine the extent to which properties were actually ineligible for HTCs. Based on the results, we are 95 percent confident that between 8,422 properties and 109,409 properties classified as eligible for the HTC were actually ineligible. Our sample was selected before the application filing deadline of December 31, 2012 had passed; therefore, some of these properties may ultimately become ineligible for the HTC due to the failure to file an application or because the application is not approved.

An executive summary of our findings can be found on page 5, and our audit scope, objectives, and methodology are explained on page 13. DAT's response is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by DAT during our audit.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Barnickel III", with a stylized flourish at the end.

Thomas J. Barnickel III, CPA
Legislative Auditor

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Executive Summary

Legislative Audit Report on the Department of Assessments and Taxation Homestead Property Tax Credits February 2013

We conducted a performance audit to assess the State Department of Assessments and Taxation's (DAT) procedures for ensuring that Homestead Property Tax Credits (HTC) are only granted for eligible properties. The audit was conducted at the direction of the General Assembly's Joint Audit Committee. Our audit had two objectives:

1. To evaluate DAT's procedures and controls for initially approving HTCs and for periodically reviewing properties' continuing eligibility for HTCs.
2. To identify automated methods and data sources DAT could use to systematically evaluate properties for continued HTC eligibility.

The audit disclosed several areas where DAT can improve its processes to ensure that only eligible properties receive an HTC and recoveries of HTCs provided for ineligible properties are maximized. Our audit also disclosed additional automated procedures are available to DAT to ensure that HTCs are provided for only eligible properties on an ongoing basis.

DAT had not developed a comprehensive compliance program to ensure that HTCs are only granted for eligible properties. Such a program should include written procedures for the processing of HTC applications, establish the responsibilities and the related processes to be performed at both DAT headquarters and the local assessment offices, and establish procedures to monitor the local assessment offices' activities. Furthermore, local assessment offices were not consistently using available sources of information to help identify properties that may not be eligible to receive the HTC.

Our review also disclosed that procedures over HTC application processing need improvement. Applications received by DAT are initially screened, which includes a comparison of the applicant's property address to the homeowner's federal tax return address to help ensure that property owners do not receive HTCs for more than one property. However, the screening process could be enhanced by comparing applicant names with the property owner names in the real property records. Also, procedures over the approval of certain applications need to be strengthened. Users' access and

capabilities for the systems that control HTC eligibility should be periodically evaluated and limited as appropriate, and changes made to critical system data fields should be independently reviewed.

DAT should also develop a policy regarding the recovery of all improperly granted HTCs as allowable under law and consider proposing legislation requiring homeowners to notify DAT regarding changes in property status that would render the property no longer eligible for the HTC. Consideration should also be given to standardizing the owner naming conventions used in DAT databases to enhance automated matching capabilities.

DAT should develop a plan to investigate the propriety of HTCs received in prior years on properties that will be removed from eligibility because an application was not submitted by the deadline or was not approved.

DAT also does not perform other automated processes to help identify, on an ongoing basis, properties that are no longer eligible for the HTC. Our audit identified several matching processes that DAT could employ to help ensure that HTCs are proper on an ongoing basis. When we performed these matches, numerous instances of ineligible properties were noted.

As part of the audit, we conducted a statistical sample of the 1,343,271 properties classified as eligible for the HTC in DAT's records as of June 1, 2012 to determine the extent to which properties were actually ineligible for HTCs. Based on the results, we are 95 percent confident that between 8,422 properties and 109,409 properties classified as eligible for the HTC were actually ineligible. Our sample was selected before the application filing deadline of December 31, 2012 had passed; therefore, some of these properties may ultimately become ineligible for the HTC due to the failure to file an application or because the application is not approved.

Background Information

Purpose of Homestead Credit

The State Department of Assessments and Taxation (DAT) is responsible for administering the State's real and personal property tax laws, including the Homestead Property Tax Credit (HTC). State Law (Section 9-105 of the Tax-Property Article of the Annotated Code of Maryland) established the HTC to help homeowners who have had large assessment increases on their principal residence. The law limits the increase in county and State taxable assessments on individual owner-occupied properties to a fixed percentage of the preceding year's taxable assessment. Every county and municipality is required to establish the limit on taxable assessment increases at 10 percent or less each year. (See Exhibit A for a list of Maryland's 24 subdivision HTC percentages.) The State limits the taxable assessment increase to 10 percent for determining the State portion of the HTC.

As an example, assume a residential property's prior taxable assessment was \$100,000 and the new assessment is \$160,000 to be phased in over three years (that is, increased \$20,000 per year during the 3-year phase-in period). The first year phase-in assessment would be \$120,000. However, a 5 percent county assessment limit over the prior year's taxable assessment would limit the first year county taxable assessment to \$105,000. The difference between \$120,000 and \$105,000 is \$15,000; the county's portion of the tax credit would apply to the taxes due on the \$15,000. If the county tax rate was \$1.04 per \$100 of assessed value, the HTC on the county's portion of the property tax would be \$156.00 ($\$15,000 \div 100 \times \1.04). Similarly, the State's portion of the HTC would be based on a taxable assessment of \$110,000 (that is, a 10 percent increase over the prior year) and the State tax rate of \$0.112 per \$100 of assessed value. Accordingly, the State tax credit for the first year would be \$11.20 ($\$10,000 \div 100 \times \0.112). The State credit is much less than the county credit because the State property tax rate per \$100 of assessed value is much lower than county rates, and the State credit is always based on a 10 percent annual taxable assessment increase whereas counties frequently use lower limits. The HTC is shown on the property tax bill as a credit reducing the total property tax owed. Exhibit B provides a sample calculation of the HTC based on certain application filing dates.

Value of Homestead Credits and Recent Trends

Based on DAT's records, we estimated that, during fiscal year 2013, the total reduction in property tax revenue from the credit for the State's 23 counties and Baltimore City will total approximately \$323.1 million. The reduction in State property tax revenue attributable to the credit during fiscal year 2013 will be approximately \$2.3 million.

Not all properties that meet eligibility requirements for the HTC will actually receive a credit in any given year, and the properties that do or do not receive a credit can change from year-to-year based on application of the relevant limits and rates. For example, no credit is received in tax years where the assessment increase over the preceding tax year is less than the limits established by the individual jurisdictions and the State.

As home values and assessments have declined in recent years, fewer homeowners are receiving an HTC on their eligible property. According to DAT's records, for fiscal year 2013, there were 1,342,991 properties eligible for the HTC but only 600,197 (44.7 percent) of the properties actually received a credit. As shown by the following two tables, which are based on DAT's records, Statewide residential property assessed values have declined considerably in recent years, and as a result the total value of all HTCs has also declined. Many of the 742,794 properties eligible for an HTC but not currently receiving one could begin receiving an HTC if their property assessment values increase.

Statewide Average Change in Residential Real Property Assessments From the Preceding Three-Year Assessment Cycle ²			
FY 2010	FY 2011	FY 2012	FY 2013
-3.4%	-20%	-22%	-17%

² Approximately one-third of residential properties are assessed each year with an estimated value as of December 31. The fiscal year 2013 change in values, for example, represents the change in property assessments from the fiscal year 2010 assessments on those same properties.

Statewide Estimated Value of Homestead Property Tax Credits to Homeowners (Reduction in Property Tax Revenue Collected)					
	FY 2010	FY 2011	FY 2012	FY 2013	Percent Change FY 10-13
County	\$1,313,455,340	\$950,462,722	\$585,177,392	\$323,124,929	(75.4%)
State	\$86,821,366	\$35,129,889	\$8,073,850	\$2,252,360	(97.4%)

HTC Eligibility Criteria and Application Requirements

According to State law, only owner-occupied residences are eligible for the credit and a property owner can only receive the credit on one property. An owner must reside at the property for at least six months of the year, including July 1 of the year for which the credit is received. Married couples are considered a single entity for HTC eligibility. Therefore, if a married couple receives the HTC on one residence, neither spouse is allowed to receive the HTC on another property in the State.

Legislation enacted by the Maryland General Assembly during the 2007 Legislative Session requires homeowners to submit an application for the HTC (which includes their social security numbers) to DAT. For all properties in which ownership was transferred after December 31, 2007, the new homeowner can only receive an HTC when a properly completed application is submitted to DAT and the information in the application indicates that the property qualifies for the HTC.

In addition, all homeowners whose properties are eligible for an HTC but had never submitted an application (generally those who purchased their properties prior to January 1, 2008 when there was no application requirement) were required to submit an application to DAT by December 31, 2012 to continue to remain eligible for the HTC. Under current law, homeowners who failed to submit an HTC application by this deadline will lose the HTC effective with the tax year starting July 1, 2013. As of January 17, 2013, according to DAT records, there were approximately 513,000 properties eligible for the HTC (including 183,000 that are receiving an HTC) for which an application had not been received by DAT. Homeowners who miss the December 31, 2012 filing deadline but file the application by June 30, 2014 can have their HTC eligibility and credit reinstated on the same assessment basis as it was previously calculated but cannot retroactively receive the credit for the tax year beginning July 1, 2013. Applications received after June 30, 2014 will result in the properties being assessed at

their full value beginning July 1, 2014 with the HTC limits applied prospectively based on the full value. This is demonstrated in Exhibit B which is an example of the calculation of the HTC based on the date an application is filed and approved.

DAT Organization and Responsibilities

DAT's headquarters is located in Baltimore and it operates assessment offices in each of the State's 24 local subdivisions. DAT headquarters maintains an HTC office currently staffed by 11 employees who are almost exclusively devoted to processing and approving HTC applications. As required by State law, DAT is reimbursed by the State's 24 subdivisions for the cost to maintain this office (according to the State records, approximately \$617,000 during fiscal year 2012).

The local assessment offices have a total of approximately 390 employees. The primary responsibility of the local assessment offices is to assess and reassess the State's approximately 2.2 million taxable real property parcels every three years. Owner data are entered in the real property records by the local assessment offices for the 23 counties upon notification of a new deed. Owner data for properties in Baltimore City are uploaded to DAT's real property records from the City Government's property system which records new deeds. When a property is transferred to a new owner as evidenced by a deed, the property should lose its HTC eligibility until a valid application for the credit is filed by the new owner. The local assessment offices perform certain procedures to help ensure ongoing compliance with HTC eligibility requirements as part of the assessment process and investigate allegations about property owners who are improperly receiving HTCs.

During the 2012 Legislative session, legislation was enacted which requires a person who has been granted an HTC for which they did not qualify to be assessed all state and local taxes that they would have otherwise paid. This legislation also states if a person is found by DAT to have willfully misrepresented facts regarding qualification for the HTC, the person shall be assessed a penalty of 25 percent of the HTC received for which the person did not qualify. Prior to the enactment of this legislation, there was no statutory provision that specifically addressed recovery of prior HTCs improperly received. However, Title 14 of the Tax-Property Article of the Annotated Code of Maryland contains a statute of limitations provision that allows for the recovery of taxes imposed under the Article owed for the most recent seven years. When DAT detects HTCs granted for ineligible properties, it generally forwards the related information to the local taxing authorities so that they

can bill property owners for the amounts attributable to the credits owners improperly received during a given period.

DAT Automated Systems and Processes

DAT headquarters maintains a Homestead Credit Application System to receive online HTC applications and to process mailed-in applications. The Application System conducts certain initial screening tests for eligibility and flags applications needing further review and information before DAT headquarters authorizes HTC eligibility in the System. On a weekly basis, the Application System updates the Assessment and Administration Valuation System (AAVS) for any changes made at DAT headquarters for HTC eligibility. AAVS is DAT's primary property database system that includes a wide range of information and history about individual properties, including assessment values. The information from AAVS is provided annually to local jurisdiction taxing authorities so they can calculate the property taxes and credits and prepare their respective property tax bills.

Within AAVS, certain data fields are used to identify HTC eligible properties. The Owner Occupancy Field, which is maintained and updated by the local assessment offices, is used to identify whether a property is eligible for the HTC based on information accumulated by the local assessor, usually during the triennial field assessment of each property. The Homestead Qualification Field is primarily maintained by DAT headquarters via updates of the HTC Application System. Both the Owner Occupancy and Homestead Qualification Fields must deem a property as HTC eligible before AAVS will calculate the reduced taxable assessment for a property needed to carry out the HTC law.

Statistical Analysis of Properties Designated as Eligible for the HTC

To estimate the number of properties that may be improperly classified as eligible for the HTC, we tested a statistical sample of properties classified as eligible for the HTC as of June 1, 2012. (This was before the December 31, 2012 deadline for homeowners to submit HTC applications, so both the population and sample included properties that had grandfathered HTC eligibility and properties that had HTC eligibility determined through the application process.) The population consisted of 1,343,271 properties classified as eligible as of June 1, 2012 for the HTC in DAT's AAVS from which we selected a random sample of 114 properties. Based on the information available to us, we determined that 5 of the 114 properties tested (4.39 percent) were improperly classified as eligible for the HTC. Three of these five properties had actually received an HTC for fiscal year 2013. For four of these five properties, we determined that the property owner was deceased and it

did not appear that the property was occupied by an assignee, survivor, or personal representative of the property owner thus making the property ineligible for the credit (since the property was not owner-occupied). For the fifth property, we determined that the property was not owner occupied (property owner was not deceased in this case). Based on identifying 5 properties ineligible for the HTC within the sample, we are 95 percent confident that between 0.63 percent (8,422 properties) and 8.14 percent (109,409 properties) of properties classified as eligible for the HTC in AAVS as of the start of fiscal year 2013 were ineligible for the HTC (percentages are rounded). The central (or best) estimate is that 58,970 (4.39 percent) properties were incorrectly listed as eligible for the HTC. The five properties that we determined to be ineligible for the HTC were referred to DAT for further investigation.

Audit Scope, Objectives, and Methodology

Scope

We conducted a performance audit to assess the State Department of Assessments and Taxation's (DAT) procedures for ensuring that Homestead Property Tax Credits (HTC) are only granted for eligible properties. The audit was conducted at the direction of the General Assembly's Joint Audit Committee. We conducted this audit under the authority of the State Government Article, Section 2-1221 of the Annotated Code of Maryland and performed it 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.

Objectives

Our audit had two objectives:

1. To evaluate DAT's procedures and controls for initially approving HTCs and for periodically reviewing properties' continuing eligibility for HTCs.
2. To identify automated methods and data sources DAT could use to systematically evaluate properties for continued HTC eligibility.

Methodology

To perform the audit, we studied the laws applicable to the HTC, and reviewed available regulations, policies, manuals, and directives of DAT. We also interviewed numerous DAT employees and obtained an understanding of DAT's procedures and the key information systems used to process and record HTCs and related records. We also used statistical sampling to estimate the error rate for properties designated in DAT's records as eligible for an HTC as of June 1, 2012. However, due to the variability of local jurisdiction's HTC rates, property values, and other factors we could not reliably estimate from our sample the total dollar value of tax credits that had been issued for all ineligible properties.

We obtained data files from DAT, other state agencies (such as the Motor Vehicle Administration), and local subdivisions and used these data files to perform various comparisons to DAT's records. We evaluated and/or tested

the files from these data sources and determined the records were appropriate and reliable for our purposes. We also determined that the data files from DAT that we used were complete.

Objective 1

We reviewed procedures and controls over the approval of HTCs at DAT headquarters and DAT policies issued to govern local assessment offices' handling of HTC matters. We also evaluated the procedures used to detect properties improperly designated as being eligible for HTCs subsequent to initial approval, and reviewed employees' access and capabilities on the systems used to record application data and other property data which designates properties as eligible for the HTC. We also reviewed procedures at the Anne Arundel County, Baltimore City and Worcester County local assessment offices, and made inquiries on specific issues at other local assessment offices as needed. The Baltimore City local assessment office was selected because it has a large dollar value of HTCs and has been the subject of several newspaper articles on properties being improperly designated as eligible for HTCs. Anne Arundel County was selected because it also has a large dollar value of credits due to its low assessment cap (that is, a maximum two percent increase over the prior year's taxable assessment). Worcester County was selected because it has a large number of non-owner occupied properties that are ineligible for the HTC.

Objective 2

We performed computer matches to various data sources and employed data mining techniques using DAT's records as recorded in the application system and real property records to identify properties potentially improperly designated as eligible to receive an HTC. We conducted these matches to determine whether these automated techniques could be worthwhile for ongoing monitoring purposes. The principal data sources used for our matching were:

- The Maryland Motor Vehicle Administration's file of individuals who surrendered their Maryland drivers' licenses during fiscal years 2010 through 2012.
- Property owners' addresses from their most recent income tax returns.
- DAT's real property records (Assessment and Administration Valuation System) to identify multiple properties with the same owner based on owners' addresses.
- Files of licensed rental properties maintained by five local governments.
- Lists of properties in foreclosure during fiscal year 2012 obtained from two circuit courts.

We subsequently selected a sample of the match results and reviewed related records and documents to determine if the properties were actually eligible for the credit. To assess the propriety of HTC eligibility and credits approved for individual properties, we reviewed homeowners' federal income tax return addresses maintained by DAT, their addresses on file with the Motor Vehicle Administration, court records such as divorce filings and recorded property deeds, rental and vacant property listings maintained by local governments, the HTC applications maintained by DAT, and a commercial database of public records. By reviewing the data sources, we were able to determine with reasonable certainty whether properties were eligible under law for HTCs. We did not contact property owners directly to obtain their representations about their properties. We did provide our findings about individual properties to DAT for its subsequent review and administrative actions. DAT had corrected the eligible status of the properties and notified the local taxing authorities for several of the properties improperly designated as eligible for an HTC while we were still performing audit fieldwork.

For individual properties we deemed ineligible for an HTC, we determined from DAT's records of applicable assessments and rates the value of HTCs granted for ineligible properties for each year the property did not qualify for an HTC (for fiscal years 2006 through 2013 as appropriate).

Fieldwork and Agency Response

We conducted our fieldwork from June 2012 to December 2012. DAT's response to our findings and recommendations is included as an appendix to our audit report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DAT regarding the results of our review of their response.

Findings and Recommendations

Objective 1

Evaluation of Procedures and Controls over the Homestead Tax Credit (HTC)

Conclusion

The State Department of Assessments and Taxation (DAT) needs to improve oversight of the HTC program and its processes to ensure that only eligible properties receive an HTC and recoveries of HTCs granted for ineligible properties are maximized.

DAT had not developed a documented comprehensive compliance program to help ensure that HTCs are only granted for eligible properties. Specifically, DAT had not established written procedures for processing HTC applications. Such a program also would formally establish the responsibilities and the related processes to be performed at both DAT headquarters and the local assessment offices and would establish procedures for the monitoring of the local offices.

Additionally, our audit disclosed that procedures over HTC application processing need improvement. In this regard, applicant names should be compared to property owner names in the real property records and procedures over the approval of certain applications need to be strengthened by ensuring independent supervisory personnel verify the propriety of the related HTC granted. Users' access and capabilities for the systems that maintain HTC eligibility information should be periodically evaluated and limited to those necessary for the employees to carry out their job duties and changes made to critical data fields should be independently reviewed.

DAT should also develop a policy regarding the recovery of all improperly granted HTCs as allowable under law and consider proposing legislation requiring homeowners to notify DAT regarding changes in property status that would affect eligibility for the HTC. Furthermore, DAT should develop a plan to investigate the propriety of HTCs received in prior years on properties removed from eligibility for not completing an application. Specifically, DAT estimated that, as of January 17, 2013, it had received approximately 175,000 applications that had not been processed, which is far less than the 513,000 properties deemed eligible for the HTC in DAT's records for which an application had not been filed (including 183,000 properties with HTCs

totaling \$87 million for the tax year beginning July 1, 2013). Finally, consideration should also be given to standardizing the owner naming conventions used in DAT databases to enhance automated matching capabilities.

Findings

Finding 1

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

Analysis

DAT had not developed a documented comprehensive compliance program establishing the responsibilities and related processes to be performed by headquarters and the 24 local assessment offices to help ensure that HTCs are only granted for eligible properties. Specifically, DAT had not established formal written procedures to be performed during the initial processing of an HTC application, nor had DAT established formal procedures to be performed to ensure the ongoing eligibility of properties for the HTC. Additionally, DAT had not performed a resource analysis to determine whether additional resources would be needed to implement an effective compliance program, and how the resources would be funded.

DAT's headquarters HTC office is responsible for initially processing and approving HTC applications. However, DAT has not established written procedures or guidance regarding the processing of the applications such as the procedures to be used to validate information on the applications, how issues noted during review of the applications are to be resolved, and the roles and responsibilities of DAT employees, including employee responsibilities for approving the applications and accessing and updating the automated real property records.

Similarly, as part of the assessment process, local assessment offices may detect HTC properties that subsequently become ineligible. However, DAT had not prepared written guidance that specifies what procedures local assessment offices should use to detect ineligible HTC properties. In this regard, while the current HTC application process provides a cost-effective means to help prevent individuals from receiving the HTC on more than one property in the State, the process is not sufficient to ensure the continued eligibility of properties. For example, a property owner receiving an HTC in Maryland could move his or her principal residence out-of-state without selling the property or notifying DAT of the change in status of the property receiving

the HTC. There is currently no requirement that property owners notify DAT of changes in circumstances that would render the property ineligible for the credit (as addressed in Finding 4). Also, DAT does not periodically perform automated procedures to monitor continued HTC eligibility (as addressed in Finding 7).

DAT headquarters does not perform any documented monitoring of the local assessment offices' procedures for detecting properties that are improperly designated as HTC eligible. As a result, our review of procedures and controls at three local assessment offices disclosed that the offices were not consistently performing detection procedures. For example, at two of the three offices reviewed, documented reviews of the United States Postal Service National Change of Address list were not performed. DAT pays for this service in part to enable local offices to detect home owners who move and thus their properties may become ineligible for the HTC. We were advised by one local office this list is considered a useful tool to detect homeowners who are no longer entitled to an HTC, while two other offices did not consider the list to be a useful tool.

We also noted that one of the local assessment offices reviewed did not adequately assess ownership changes reported by the local government finance office that are uploaded to the Assessment and Administration Valuation System (AAVS). This report includes changes of ownership or address and is the primary mechanism by which the local assessments office can identify properties whose eligibility for the HTC may have changed. Accordingly, the local assessment office needs to evaluate these changes to determine whether the changes result in a property losing eligibility for HTC. However, the local DAT office could not document any review for 8 out of 10 properties which we tested from the report. Of those 8 properties, 6 properties were improperly receiving the HTC. The 6 properties received improper County and State HTCs totaling \$8,903 and \$142, respectively, for fiscal years 2011 through 2013.

During the course of our audit, we were advised by DAT management that a lack of resources would limit the extent of any compliance program. As previously mentioned, DAT maintains an HTC office with 11 employees (8 full-time budgeted positions and 3 temporary positions) that have been almost exclusively devoted to processing and approving HTC applications. DAT management advised us that when the volume of applications diminishes after the December 31, 2012 deadline, the 11 employees in the HTC office will begin performing certain compliance activities. However, the extent to which these employees could be used to address ongoing compliance monitoring has not been analyzed by DAT nor has DAT otherwise analyzed its

overall staffing resources for implementing a compliance program. Consequently, the funding necessary to support a comprehensive compliance program has not been researched. In accordance with law, DAT is reimbursed by the State's 24 subdivisions for the cost to maintain the HTC office for processing and approving applications. Additional tax revenue mostly benefits the counties and municipalities when HTCs granted for ineligible properties are detected and removed. Therefore, it would be reasonable for the local governments to bear a portion of the cost of maintaining a compliance program to detect HTCs that were granted for ineligible properties.

Recommendation 1

We recommend that DAT

- a. develop and document a comprehensive compliance program to help ensure that HTCs are only granted for eligible properties, including specifically defining the roles and responsibilities of headquarters and the local assessment offices when processing HTC applications and ensuring ongoing compliance;**
- b. provide for periodic monitoring by headquarters of the HTC compliance activities performed at the local assessment offices, including ensuring that local offices use available sources of information to identify ineligible properties; and**
- c. perform an analysis of personnel and resource funding requirements for developing a comprehensive compliance program and submit a proposal for consideration by appropriate Executive Department agencies and the General Assembly.**

Finding 2

Procedures over the HTC application processing need improvement.

Certain enhancements are needed to improve procedures and controls over the HTC application processing. Specifically, we noted the following conditions:

- Since it began processing applications for the HTC in 2008, DAT has not routinely compared the property owner names on HTC applications to the property owners' names in the real property records in AAVS. This comparison could identify situations whereby someone other than a property owner (such as a renter) could manually apply for the HTC and an ineligible property could be deemed eligible to receive an HTC based on an application submitted by a non-owner. In addition, other discrepancies could be detected between information in the HTC application system and AAVS which affect HTC eligibility.

We matched the names of property owners listed in DAT's real property records to the names on HTC applications as of June 2012. This comparison disclosed 26,240 instances in which the name on the application did not agree to the name in the real property records. (This comparison was generally made using the property account number and the property owners' last names.) For fiscal year 2013, these properties received HTCs that reduced county and state property tax revenue by approximately \$8.2 million and \$146,000, respectively. We tested 20 of these properties and determined that 15 of the properties should not have been designated as eligible for the HTC at the time of the match.

We also noted that for 10 of the 15 properties the HTCs were based on applications previously submitted by the former owners of the properties. In these cases, it appeared that ownership of the properties had changed and, although the new owners' names were recorded in AAVS, the data fields affecting HTC eligibility were not updated by the applicable local assessment offices. Once a property changed owners, the HTC eligibility should have been removed pending receipt of an application from the new owner. These 15 properties were referred to DAT for further investigation.

- DAT did not establish adequate controls over the subsequent approval of HTC applications initially suspended from processing. Specifically, to ensure the propriety of approved HTC applications, including those approved after being suspended, an output report of approved applications was reviewed by two DAT supervisors. However, these two supervisors also approved the HTC applications. Consequently, there was a lack of assurance that applications approved by these employees were proper as there was no independent review of the approvals.

When the addresses on HTC applications did not agree to owner's income tax filing address, the applications were placed in a pending status. The pending applications were manually researched, such as by checking Motor Vehicle Administration records or by contacting the applicant, and subsequently approved or denied by a DAT employee.

- DAT had a backlog of unprocessed applications. Specifically, we were advised by DAT management that it had an estimated 175,000 unprocessed applications on hand as of January 17, 2013. The backlog resulted from the large number of applications that were received near the December 31, 2012 deadline and the increased level of related activity (phone inquiries) that greatly reduced the level of application processing. In this regard, we noted that DAT only had approximately 1,500 unprocessed applications as of June 18, 2012.

Recommendation 2

We recommend that DAT

- a. compare the names on HTC applications to the listed owners of the properties and review and investigate approved HTC applications for which the applicant's name(s) does not match the listed property owner(s);
- b. investigate the aforementioned properties that were improperly granted an HTC, establish the cause of the inappropriate designation, and establish appropriate guidance and controls;
- c. ensure independent supervisory personnel verify the propriety of the tax credits granted for applications that were initially suspended from processing, at least on a test basis; and
- d. ensure the backlog of HTC applications is processed as soon as possible.

Finding 3

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

Analysis

DAT did not establish adequate controls over the real property records (the AAVS) or the Homestead Application System to prevent or detect unauthorized changes to eligibility determinations. Specifically, we noted that certain system access was not adequately restricted and that edits to critical data fields in both AAVS and the Application System were not subject to independent supervisory review. Although the certain information in AAVS, such as the Homestead Qualification Field, is generally updated weekly in AAVS for new actions recorded in the Application System, the information can also be manually edited in AAVS by certain DAT employees and these edits are not reviewed by independent supervisory personnel. The potential impact of this control weakness is exacerbated by the large number of employees who were assigned critical system capabilities. As of August 2012, 400 employees had access to the AAVS with 371 of these employees being assigned access capabilities that allowed the users to change information such as the Homestead Qualification Field in AAVS.

In addition, our test of 59 employees having access to the Homestead Application System disclosed that 4 employees had unnecessary access to delete an application and the ability to perform other functions on AAVS without supervisory review and approval. DAT does not review these edits for propriety.

We noted eligibility information for HTCs recorded in the Application System and in the AAVS did not always agree. We performed a match between AAVS system data effective July 2012 and the Homestead Application System data effective June 2012. The match identified 1,134 properties in which the AAVS system indicated the application was approved or the property had a grandfathered HTC eligibility but was actually either rejected or pending in the Homestead Application System. Applications rejected or placed in the pending status should render the property ineligible on AAVS. We selected 20 properties from our match and identified 11 properties that, based on the application and other external data sources, were not eligible for the HTC but were classified as eligible for the HTC in AAVS.

Recommendation 3

We recommend that DAT

- a. establish procedures to ensure edits to critical fields affecting HTC eligibility are independently reviewed,**
- b. evaluate the propriety of employee access capabilities for critical data fields in the HTC Application System and AAVS and remove access that employees do not require for their job duties, and**
- c. identify all discrepancies between AAVS and the Homestead Application System regarding eligibility for HTC and research the propriety of the discrepancies and make the necessary changes.**

Finding 4

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

Analysis

DAT should adopt a policy regarding the recovery of all improperly granted HTCs as allowable under law and should consider proposing legislation requiring homeowners to notify it of changes in property status which would affect HTC eligibility.

- DAT did not develop a policy regarding the recovery of all improperly granted HTCs as allowable under law. When DAT detected HTCs granted for ineligible properties, it advised the local taxing authorities and requested them to recover the taxes not paid as a result of HTCs being granted for ineligible properties. State law specifies that the local taxing authorities, not DAT, are responsible for the collection of property taxes. However, our review of procedures at three local assessments offices indicated that DAT did not research and/or inform the local taxing authority of improperly granted HTC's received beyond the prior three

years. We were advised by DAT that the records needed to conduct the research for earlier years were not readily available in its systems.

Prior to July 1, 2012, there was no statutory provision that specifically addressed the recovery of prior HTCs improperly received. However, Title 14 of the Tax-Property Article of the Annotated Code of Maryland contained a statute of limitations provision that allows for the recovery of taxes imposed under the Article owed for the most recent seven years. Legislation enacted during the 2012 legislative session requires a property owner who had been granted an HTC for which they did not qualify to be assessed all state and local taxes (without a time limit) that they would have otherwise paid.

The forgone tax revenue from prior years can be significant. For example, we reviewed 30 properties from lists maintained by two local assessment offices of properties determined to have improperly received HTCs. Although 19 of these properties received HTCs for more than three years, the local assessment offices did not research beyond the most recent three years to determine how long the properties had improperly received the HTC so that improperly received credits could be recovered to the fullest extent possible. Consequently, we estimate that these properties may have had their taxes improperly reduced by an additional \$52,516 and \$6,435 for the County and State, respectively, during fiscal years 2006 through 2012.

- There is no legal requirement that homeowners notify DAT of changes in circumstances affecting a property's eligibility for the HTC. Specifically, although DAT is automatically made aware of certain changes in a property's status (such as via the recordation of a new deed), there is no requirement for a homeowner to notify DAT of certain other changes that would render a property ineligible for the credit (such as the homeowner moving out of state). We were advised by DAT management that a legal provision that would require that such circumstances be reported to DAT would be helpful in their monitoring the ongoing eligibility of properties for the credit.

Recommendation 4

We recommend that DAT

- a. develop a policy regarding recovery of HTCs granted for ineligible properties to the fullest extent allowable under law and develop the related recordkeeping resources,**
- b. ensure that the policy on recovery of improperly granted HTCs for prior years is consistently followed by the local assessment offices, and**

- c. consider proposing legislation to require homeowners to notify it regarding changes in property status that would affect eligibility for the HTC.

Finding 5

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

DAT does not have a plan to evaluate the propriety of HTCs received in prior years on properties removed from eligibility after the December 31, 2012 deadline because an application was not submitted or was not approved. Many such property owners may never send in an application if they have been receiving an HTC to which they were not entitled. As of January 17, 2013, there are 512,823 properties currently deemed eligible for the HTC that may have not submitted an application and will lose HTC eligibility unless an application was submitted before the deadline and it is approved. (As mentioned in Finding 2, DAT had a large unprocessed application backlog.) Additionally, 182,782 of these properties are designated for HTCs that would reduce their fiscal year 2014 County and State property tax bills by approximately \$86.9 million and \$409,000, respectively. Therefore, the amount of improperly granted HTC's received in prior years could be significant.

DAT officials advised us that it does not have the resources to pursue such a large number of cases. However, as previously mentioned (see Finding 1), DAT has not performed an analysis of its staffing needs nor analyzed additional funding necessary to support a comprehensive compliance program regarding HTC.

Recommendation 5

We recommend that DAT

- a. develop a plan to investigate property owners who have previously received HTCs for which applications had not been submitted or approved, and determine if HTCs were granted for ineligible properties in prior years; and
- b. request local taxing authorities to recover taxes for the value of HTCs granted for ineligible properties in prior years to the extent allowed by law.

Finding 6

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

Analysis

DAT's real property records were not formatted in a manner to facilitate computer matches. Specifically, owner names were not consistently recorded in the same data fields and all owners were not always specifically listed in the DAT real property records. There are two owner's name fields in AAVS that allow 34 characters each. In most (but not all) cases, the owner's name is entered with the last name first. A second owner may be entered on either the first field with the first owner or the second field. In other cases, a second or other additional owner may be implied but not specifically entered. For instance, the records may state "and wife" or "et al". There are approximately two million residential real properties in the State; accordingly, adding all owners to current AAVS records and formatting the existing AAVS records consistently would require a significant commitment of resources.

Typically, owner data are entered in AAVS by the local assessments offices for the 23 counties upon notification of a new deed. Owner data for properties in Baltimore City is uploaded to AAVS from the City Government's property system which records new deeds.

While the consistent recordation of property owners' names is not critical to the administration of the assessment process, there is no assurance that matches performed using the owners' name, or portion thereof, will identify all properties that meet the match criteria given such inconsistencies. Furthermore, the lack of a consistent method to format names and the records that lack the names of all property owners makes it impractical for the HTC application system to automatically compare HTC applicant names to property owner names.

Recommendation 6

We recommend that DAT determine the feasibility of

- a. establishing a protocol for recording owner names in its automated real property records and requiring the protocol to be used uniformly by all assessment offices; and**
- b. adding all owners to the current real property records and formatting the existing records consistently, at least on a prospective basis.**

Objective 2

Procedures to Detect Properties Improperly Deemed Eligible for HTCs

Conclusion

DAT should use additional automated procedures to ensure the continued eligibility of properties receiving the HTC.

The only automated screening process currently used at DAT headquarters to prevent improperly approving HTCs is the comparison of the property address to the homeowner's federal tax return address performed when an HTC application is initially received. This procedure does provide some assurance that property owners do not receive an HTC for more than one property. However, this screening process is not repeated in subsequent years, and DAT does not perform other automated processes to ensure the continued eligibility of properties that previously were approved as eligible for the HTC.

Our audit identified several matching processes, as described below, that DAT could employ to help ensure the ongoing eligibility of properties for the HTC. Certain of the matches can be performed on a statewide basis by DAT headquarters and others could be performed at the local assessment offices based on records available from the local jurisdictions.

Finding 7

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

Analysis

Additional automated procedures are available to help ensure properties remain eligible for the HTC on an ongoing basis. As previously mentioned, DAT has not established a comprehensive compliance program to verify the ongoing eligibility of properties for the HTC.

We identified various automated matching processes that, if used, would enhance DAT's ability to identify properties that are no longer eligible for an HTC. Below we describe five matches we performed to identify properties no longer eligible for the HTC and the results of those matches, (as would be expected, match results overlapped in some cases; that is, identified the same questionable properties). Our results demonstrate that these matches can detect properties that are potentially improperly classified as eligible for the HTC. While the results of any matches will need to be verified by DAT

contacting the owner before any action is taken to remove an HTC, the matches provided an effective starting point to identify properties needing further review.³ Also, since not all properties classified as eligible for the HTC will actually receive a credit, DAT's subsequent research of matched properties should focus first on the properties actually receiving credits.

It should also be noted that we performed the matches before the application filing deadline of December 31, 2012 had passed, and thus some properties identified as matches may not be considered eligible for the HTC after applications have been processed.

Motor Vehicle Administration Match

Using individuals' last names and a portion of the properties' addresses, we compared a file from the Motor Vehicle Administration (MVA) of individuals who surrendered their drivers' licenses during fiscal years 2010 through 2012 to homeowners whose properties were classified as eligible for the HTC for fiscal year 2013.⁴ The match disclosed 24,751 properties classified as eligible for the HTC for which at least one owner had surrendered their drivers' license. Furthermore, 10,367 of these properties had their fiscal year 2013 county property taxes reduced by approximately \$7.2 million and 891 of these properties had their state property taxes reduced by approximately \$32,000. Our test of 25 properties designated as eligible for the HTC in which an owner(s) had surrendered their drivers' license, according to the MVA file, disclosed that 21 properties were not eligible for the credit, including 6 properties for which an application had been filed and approved. Of these 21 properties, 20 properties improperly had their county and state taxes reduced by approximately \$178,000 and \$9,000, respectively during fiscal years 2010 through 2013.

Income Tax Records Match

With the assistance of the Comptroller of Maryland, the address individuals used to file their most recent Maryland state income tax returns (generally the 2011 tax year) was compared to the property address used by the same individuals when they applied for the HTC (the Comptroller used the individuals' social security numbers when performing the comparison). We then compared the match results to properties classified as eligible for the

³ There are various reasons why the match results are not conclusive evidence of a property improperly receiving the HTC. For example, in the Motor Vehicle Administration match mentioned below, the match was performed using the last name and the property address. As a result, an adult child that lived at the address and surrendered their driver license would show up as a match result, although eligibility for the HTC would not be affected if the parents continued to live at the same address.

⁴ Per our test, most drivers surrendered their Maryland licenses because they moved to another state. However, certain licenses in the MVA file were surrendered for other reasons such as court orders or medical conditions.

HTC for fiscal year 2013. Our match disclosed 11,231 properties classified as eligible for the HTC for which the applicants filed Maryland tax returns listing an out-of-state address. Of these properties, 4,156 had their fiscal year 2013 county property taxes reduced by approximately \$2.8 million and 652 properties had their state taxes reduced by approximately \$25,000. Our match also disclosed 140,885 additional properties classified as eligible for the HTC whose applicants' state income tax returns listed a different Maryland address than the property for which they received an HTC (that is, the HTC property may no longer be their principal residence). Of these properties, 73,706 had their fiscal year 2013 county property taxes reduced by approximately \$48.2 million and 15,554 properties had their state property taxes reduced by approximately \$493,000. Our test of 30 properties receiving an HTC for which the owner(s) listed an address other than the HTC property address on their Maryland income tax returns disclosed that 11 were not eligible for the credit although applications had been filed and approved for all 11 properties. Based on our research, these 11 properties had their county and State taxes improperly reduced by \$248,133 and \$22,111, respectively, during fiscal years 2007 through 2013.

Multiple Properties Analysis

This match was performed using only DAT's records from the AAVS. We sorted the statewide listing of properties eligible for the HTC for fiscal year 2013 by the addresses the owner provided for tax and assessment notice mailing purposes to identify mailing addresses used for more than one property. This sorting disclosed 9,506 mailing addresses that were used for two or more properties classified as eligible for the HTC, pertaining to 26,058 properties. Of these properties, 10,880 had their fiscal year 2013 county property taxes reduced by approximately \$5.4 million and 4,828 properties had their state property taxes reduced by approximately \$148,000. Our test of 12 pairs of properties receiving the HTC (24 properties) that had the same tax mailing address disclosed that 8 of the 24 properties were not eligible for the credit, including 1 property for which an application had been filed and approved. These 8 properties had their county and state taxes improperly reduced by approximately \$95,500 and \$5,600 respectively, during fiscal years 2007 through 2013. Although the new Application System screening process should generally prevent an owner from receiving an HTC on more than one property due to use of social security numbers, this address sorting analysis would have been useful to detect inappropriate credits during the period when applications were being filed. Additionally, even after the submitted applications have been processed, this analysis could still be useful to detect prior inappropriate credits issued for properties where the owners did not file an HTC application.

Rental Properties Match

Using property addresses, we matched files from five jurisdictions of licensed rental properties to properties classified as eligible for the HTC for fiscal year 2013.⁵ Our match disclosed 9,258 properties classified as eligible for the HTC that were identified as rental properties according to local government records. Of these properties, 4,013 had their fiscal year 2013 county property taxes reduced by approximately \$3.3 million, and 1,427 properties had their state property taxes reduced by approximately \$53,000. Our test of 25 of the 4,013 properties designated as eligible for the HTC for a property that was classified as a rental property by local governments disclosed that 11 properties were not eligible for the credit for certain years, including 5 properties for which an application had been filed and approved. Of these 11 properties, 10 properties had their county and state taxes improperly reduced by approximately \$54,000 and \$2,600, respectively, during fiscal years 2007 through 2013.

Review of Foreclosed Properties

We compared two circuit courts' records of foreclosure cases filed in fiscal year 2012 to properties classified as eligible for the HTC for fiscal year 2013.⁶ We reviewed approximately 330 cases out of approximately 5,900 foreclosure cases to identify 30 properties for which the foreclosure process was completed as of June 30, 2012 and which were identified in DAT's records as eligible for the HTC. Our test of these 30 properties eligible for the HTC for a residence that was foreclosed disclosed that 25 properties were not eligible for the credit, including 10 properties for which an application had been filed and approved. Furthermore, 10 of these properties were not owner occupied prior to the foreclosure proceedings. Of these 25 properties, 16 properties improperly had their county taxes reduced by approximately \$15,300 during fiscal years 2007 through 2013.

According to the Department of Housing and Community Development, there were 15,293 foreclosures in the State during fiscal year 2012. Legislation passed during the 2012 legislative session requires that financial institutions that take possession of properties during foreclosure proceedings are required to notify DAT of such actions. These properties would no longer be eligible for the HTC.

⁵ The five jurisdictions used for our match were Baltimore City, Ocean City and Baltimore, Montgomery, and Howard Counties. These counties and cities and certain other jurisdictions in the state require rental properties to be registered or licensed.

⁶ The two courts covered Baltimore City and Prince George's County where, based on Department of Housing and Community Development records, there was known to be many foreclosures.

We discussed these procedures to detect HTCs granted for ineligible properties with DAT management. They agreed that more procedures, such as the matches we performed, should be used to detect homeowners receiving HTCs to which they are not entitled. While automated procedures to detect properties improperly designated as eligible for the HTC can be performed without a large commitment of resources, investigating potentially ineligible properties can be a time-consuming process. For this reason, DAT management maintained that performing such procedures for every potentially ineligible property would generally not be possible with DAT's existing staff. However, the investigation of match results could be prioritized such as by investigating properties actually receiving an HTC first. Additionally, as previously mentioned (Finding 1), DAT has not analyzed its staffing needs to determine the adequacy of its staff at both its headquarters and local assessment offices.

Recommendation 7

We recommend that DAT develop automated procedures to detect properties that are ineligible for the HTC on an ongoing basis, such as data matches against other state and local agencies' records.

Exhibit A

Maryland Counties and Baltimore City Homestead Credit Cap Over Preceding Year's Taxable Assessment Effective July 1, 2012

SUBDIVISION	PERCENTAGE LIMIT
Allegany	107
Anne Arundel	102
Baltimore City	104
Baltimore	104
Calvert	110
Caroline	105
Carroll	105
Cecil	108
Charles	107
Dorchester	105
Frederick	105
Garrett	105
Harford	105
Howard	105
Kent	105
Montgomery	110
Prince George's	104
Queen Anne's	105
St. Mary's	105
Somerset	110
Talbot	100
Washington	105
Wicomico	105
Worcester	103

Exhibit B

Sample Calculation of the Homestead Property Tax Credit

These tables below show an example of the Homestead Property Tax Credits (HTC) that would be applied to a property depending when the current homeowner first applied for a tax credit that is approved by DAT. (The example assumes no change in property ownership.) The tables also show the interaction of the HTC and the three-year phase-in of the full market value appraisal of the property. The calculations are based on the following conditions:

Property Value:

- \$300,000 previous full market value appraisal with grandfathered HTC
- \$450,000 full market value appraisal at January 1, 2012
- \$400,000 full market value appraisal at January 1, 2015
- A three-year phase-in of the January 1, 2012 appraisal increase

County Property Tax:

- County tax rate of \$1.00 per \$100.00 of county taxable assessment
- County HTC cap on taxable assessment increases of 5 percent per year

State Property Tax:

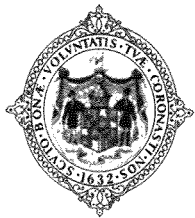
- State tax rate of \$0.112 per \$100.00 of state taxable assessment
- State HTC cap on taxable assessment increases of 10 percent per year

Owner First Applies for HTC by December 31, 2012								
Appraised Full-Value Assessments	Full Value Three-Year Phase-In	Taxable Assessment Due to HTC Cap		Assessment Reduction for Tax Calculation		Tax Reduction Due to HTC		
		County	State	County	State	County	State	
Prior Assessed Full Value	\$300,000							
New Assessed Full Value at 1/1/12	450,000							
For Tax Year Starting 7/1/12		\$350,000	\$315,000	\$330,000	\$35,000	\$20,000	\$350	\$22
For Tax Year Starting 7/1/13		400,000	330,750	363,000	69,250	37,000	693	41
For Tax Year Starting 7/1/14		450,000	347,288	399,300	102,713	50,700	1,027	57
New Assessed Full Value at 1/1/15	400,000							
For Tax Year Starting 7/1/15		400,000	364,652	400,000	35,348	-	353	-
For Tax Year Starting 7/1/16		400,000	382,884	400,000	17,116	-	171	-
For Tax Year Starting 7/1/17		400,000	400,000	400,000	-	-	-	-
Total six-year tax reduction due to HTC:							\$2,594	\$121

Owner First Applies for HTC by June 30, 2014								
Appraised Full-Value Assessments	Full Value Three-Year Phase-In	Taxable Assessment Due to HTC Cap		Assessment Reduction for Tax Calculation		Tax Reduction Due to HTC		
		County	State	County	State	County	State	
Prior Assessed Full Value	\$300,000							
New Assessed Full Value at 1/1/12	450,000							
For Tax Year Starting 7/1/12		\$350,000	\$315,000	\$330,000	\$35,000	\$20,000	\$350	\$22
For Tax Year Starting 7/1/13		400,000	400,000	400,000	-	-	-	-
For Tax Year Starting 7/1/14		450,000	347,288	399,300	102,713	50,700	1,027	57
New Assessed Full Value at 1/1/15	400,000							
For Tax Year Starting 7/1/15		400,000	364,652	400,000	35,348	-	353	-
For Tax Year Starting 7/1/16		400,000	382,884	400,000	17,116	-	171	-
For Tax Year Starting 7/1/17		400,000	400,000	400,000	-	-	-	-
Total six-year tax reduction due to HTC:							\$1,902	\$79

Owner First Applies for HTC after June 30, 2014 or Never Applies								
Appraised Full-Value Assessments	Full Value Three-Year Phase-In	Taxable Assessment Due to HTC Cap		Assessment Reduction for Tax Calculation		Tax Reduction Due to HTC		
		County	State	County	State	County	State	
Prior Assessed Full Value	\$300,000							
New Assessed Full Value at 1/1/12	450,000							
For Tax Year Starting 7/1/12		\$350,000	315,000	330,000	35,000	20,000	350	22
For Tax Year Starting 7/1/13		400,000	400,000	400,000	-	-	-	-
For Tax Year Starting 7/1/14		450,000	450,000	450,000	-	-	-	-
New Assessed Full Value at 1/1/15	400,000							
For Tax Year Starting 7/1/15		400,000	400,000	400,000	-	-	-	-
For Tax Year Starting 7/1/16		400,000	400,000	400,000	-	-	-	-
For Tax Year Starting 7/1/17		400,000	400,000	400,000	-	-	-	-
Total six-year tax reduction due to HTC:							350	22

APPENDIX



State of Maryland

DEPARTMENT OF ASSESSMENTS AND TAXATION

Office of the Director

MARTIN O'MALLEY
Governor

ROBERT E. YOUNG
Director

February 28, 2013

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
301 W. Preston St., Rm. 1202
Baltimore, MD 21201

Dear Mr. Barnickel:

The purpose of this letter is to formally provide you in the attached document the Comments and Response of the Department of Assessments and Taxation to the performance audit report on the Department of Assessments and Taxation – Homestead Property Credits.

Let me take this opportunity to commend the professionalism, thoroughness, and fairness of your audit team performing this review led by Mr. Stephen C. Pease and Ms. Julia M. King.

If you have any questions or if the Department can provide any further information, please let me know.

Sincerely,

A handwritten signature in cursive script that reads "Robert E. Young".

Robert E. Young
Director

Comments and Response of the Department of Assessments and Taxation (DAT) to the Findings and Recommendations of the Legislative Auditors Regarding Homestead Tax Credits

Finding 1 – DAT had not developed a documented comprehensive compliance program to help ensure that HTC's are only granted for eligible properties.

DAT Comments and Response: The Department concurs with the Auditors' finding here and the three specific recommendations (a, b, and c) under this item.

a) Once the Department completes the significant data programming and administrative processing of the 175,000 applications received in the last four months before the December 31, 2012 application deadline, DAT will develop (during the first half of fiscal 2014) a comprehensive written manual describing the specific procedures to validate applications. That manual will combine existing procedures historically utilized by the local Assessment Offices to validate eligibility and the newer procedures developed by the central application processing unit in 2007 as well as incorporating certain automated procedures proposed in this Audit.

b) The manual will provide a specific list of audits to be performed by local Assessment Offices and a mandatory monthly schedule for performing those duties.

c) The Department will prepare for the submission of the Fiscal 2015 Budget Request a detailed proposal for additional positions and funding for implementing the comprehensive compliance program proposed by this Audit to be considered by the Executive Department of Budget and Management and the General Assembly. For the record, this fiscal request will be substantial because of the demonstrated need in the Audit for an increased number of employees. The Legislative Auditors had a team of two managers and six field employees at the Department for six months to find and validate limited numbers of improper Homestead Tax Credits. In this regard, it must be emphasized that the Department's employees in the local Assessment Offices who perform Homestead audits do so on a part-time basis because they have other regular assessment related duties to perform each day. Finally, legislation will have to be introduced accompanying the budget request that will amend the existing Homestead application law to provide for local governments to reimburse the Department for

the cost of the additional employees and other administrative costs for implementing these new ongoing audits. Given that legislation is likely to be enacted in the 2013 session that will extend the Homestead application deadline until December 31, 2013, there is sufficient time for the Executive Budget Department and the General Assembly to approve the funding for additional Homestead employees for the Department.

Finding 2 – Procedures over the HTC application processing need improvement.

DAT Comments and Response: The Department concurs with the Auditors' finding here and the four specific recommendations (a, b, c, and d) under this item.

a) and b) Initially, the Department had compared the names of all HTC applicants with the name in its legal ownership file in the AAVS Real Property System. However, that practice was discontinued for electronically filed applications after a careful review of exceptions showed that the program was producing a large number of “false positive” exceptions based upon revision to a maiden name by the former spouse or et al (“and others”) ownership of the property. The Department has continued to check the applicant name and the ownership name for all paper applications that are manually entered into the data system as well as for the substantial number of applications “imaged” into the system via the “KOFAX” system.

The Department will implement (by December 31, 2013) an additional computer program that will retroactively compare applicant name with ownership name for all electronically filed applications in each calendar year. That program will produce a better “exceptions” report that can be individually investigated by the Department. The report also will contain a section for dealing with ownership discrepancies where the original applicant owner has died and the AAVS system’s “stop” credit feature for transferred properties did not apply because the property was transferred via inheritance and not transferred for a financial “consideration” to a new, unrelated owner.

c) Given the limited number of “full-time” Homestead Tax Credit employees (8 permanent employees) to process and audit the 1.1 million applications, the Department is going to have to assign (by July 1, 2013) a managerial level employee from a totally unrelated agency program to perform a spot review on a test basis of the propriety of tax credit eligibility for initially suspended applications.

d) The Department has already developed an orderly plan to process by March 31, 2013 (in just three months after the December 31, 2012 deadline), the 175,000 applications received in the past four months. The Department could not process this group of applications as they were received because its limited number of employees were occupied answering the 87,000 telephone calls and 13,000 e-mails received in this same four month period.

Finding 3 – DAT did not establish adequate controls over its automated records to prevent or detect unauthorized changes to HTC eligibility determinations.

DAT Comments and Response: DAT concurs with the finding and the three recommendations (a, b, and c) under this item.

a) The Department will establish a procedure (by December 31, 2013) to have an independent supervisory review on a test basis of changes to critical fields such as deleting a Homestead application.

b) The Department has already begun restricting system access to AAVS as it relates to the Homestead Qualification Field. The only reason that 371 of 400 employees had access that included the ability to change such information as the Homestead Qualification Field was because AAVS is a new system itself where Assessment Office employees were testing its applications and functionality. The Department's IT managers will continue to monitor and eliminate data permission for employees who do not have an ongoing need for such access to perform their specific job duties.

c) The Department's IT Unit will develop (by December 31, 2013) a report identifying any discrepancies between AAVS and the Homestead Application System on Homestead eligibility. The Department submits that most of the differences are due to timing issues based upon the updating of the systems by the agency's IT Unit.

Finding 4 – Certain policies and requirements could be established to improve DAT oversight of the HTC Program.

DAT Comments and Response:

a) The Department can agree with the finding of the Auditors that there needs to be a fixed policy on the number of years for recapturing Homestead Tax Credits improperly received by the homeowner. However, the Department does

not agree with their determination that a “general” statute of limitations provision for recovery of taxes for seven years (found in Section 14-1101 of the Tax-Property Article) applies to the recovery of Homestead Tax Audits improperly received.

The Department’s legal counsel has advised that the authority to collect any past taxes has been unclear until the passage of Chapter 701, Laws of Maryland 2012 adding subsection (n) to §9-105. Before that enactment creating a 25% penalty for willful misrepresentation beginning for the July 1, 2012 tax year, the legal argument against the collection of taxes for prior years is that “once an assessment becomes final then there was no specific statutory authority for adjusting the assessment upwards after that ‘finality’ to recapture the taxes offset by an erroneous Homestead Tax Credit”.

The Department notes that the three prior years recapture of tax credits observed by the Auditors in the three different County Assessment Offices has been the consistent determination of that policy by the agency. DAT decided on the three prior year recapture policy for several reasons: (1) the time period is consistent with the limited three year period by which a homeowner can claim a refund of taxes erroneously paid found at Section 14-915, Tax-Property Article; (2) the three prior year period is consistent with the number of years of federal tax return information that the Department is able to retain for data storage purposes in order to audit Homestead eligibility in the first place; and (3) the majority of the local governments (whom the Auditors note have the legal responsibility to collect taxes and who would receive the bulk of the tax dollars recaptured) have requested that time period be used by the Department.

The Department has advised the Auditors that there is a separate property tax appeal from a homeowner in Baltimore City that has just commenced which challenges the legal right to collect even three prior years of improperly granted Homestead Credits. Pending the outcome of that appeal, the Department will continue to follow a policy statewide of advising local governments of the recaptured tax credits for up to three prior years. When in the course of the investigation of a Homestead account that the Department employee finds more years of improper receipt of a credit beyond the three, then the employee will advise the county government employee receiving the information of the additional years. Because of the labor intensive nature of the effort required to investigate more than a three year period and because of the limitation on the number of years of automated records, the Department does not have sufficient staff to investigate

every Homestead recovery for a seven year period even if the longer period is determined to be permissible under the law.

b) As the Auditors have suggested, DAT will introduce departmental legislation at the 2014 session that will require homeowners to notify the Department of changes in the property's status that would affect eligibility for the HTC. That legislation also will include a proposal creating a specific provision for recapture of Homestead Tax Credits and the number of years to be recaptured.

Finding 5 – DAT does not have a plan to investigate the proprietary of HTCs received in prior years on properties removed from eligibility after the application filing period.

DAT Comments and Response: The Department agrees with the finding and can comply with the two recommendations if the Executive Budget Department and the General Assembly approves funding for a significant number of additional employees in the Homestead Program.

There will be a six figure amount of homeowners who did not apply by the December 31, 2012 deadline for a variety of reasons. Although a large number of these homeowners did not apply because they know they no longer mathematically qualify for an actual credit due to reduced assessments, there will still be a six figure amount of homeowners receiving a credit who did not apply.

The Department will run a report of the nonfilers in descending order by the amount of Homestead Credit granted on the property. Given the current likelihood that legislation will be enacted in the 2013 session to extend the Homestead application filing deadline for another year until December 31, 2013, there will be another year and sufficient time for funds to be appropriated to provide additional employees to perform this particular and other audits suggested in this Audit Report. Those employees also will be needed to perform the tasks to recapture any improperly granted credits for multiple prior years. There is no overstatement in emphasizing how manually labor intensive and time consuming it becomes to investigate individual property owners where the Department must meet a legally sustainable standard of proving nonresidency for any year the tax credit is removed.

Finding 6 – SDAT's real property records were not formatted in a manner to facilitate computer matches.

DAT Comments and Response: The Department agrees with the finding and will comply with the recommendation requesting the agency to explore the feasibility of changing its Real Property format for all property records to better facilitate computer matches on property owner name for the Homestead Program.

The Department has made appropriate inquiries and it is not economically feasible to obtain a vendor to add all owners to the current AAVS records and reformat the existing AAVS records for 2.1 million properties. This process would require the vendor to examine every deed for every property to make these changes. However, the Department will review its existing instructions regarding the entry of ownership changes and issue a revised instruction to ensure consistency in the inclusion of additional names.

Finding 7 – Additional automated procedures are available to help ensure properties remain eligible for the HTC on an ongoing basis.

DAT Comments and Response: The Department agrees with the Auditors' finding and will adopt the one principal recommendation made here for the agency to use additional automated procedures to ensure the continued eligibility of properties receiving the HTC.

The Department believes that the automated procedure that will produce the most fruitful results is the Motor Vehicle Administration (MVA) match. It needs to be noted for the record that prior to the date when the Department began the administration of the Homestead application law in 2007, the agency had requested the MVA to agree to provide certain MVA records in an automated format. Instead, the MVA agreed to provide the Department with the capability to look up the driving records of persons on a manual, individual basis because of the significant number of demands the MVA receives for its information. For this Audit, the Auditors were able to request the MVA to provide them with a specialized spreadsheet showing all drivers in Maryland who had surrendered their driver's license or identification card to another State. As a result, a member of the General Assembly has introduced, after discussions with the Department, legislation (SB645) that would require the MVA and the counties to provide electronic records information to assist the Department in determining eligibility for the Homestead Property Tax Credit. The MVA match report will be produced by July 30, 2013 based on conversations already taking place between the two agencies.

The second automated procedure is the Income Tax Records match. Because the Comptroller's Office ran and edited the report instead of providing the underlying data, the results here will require significant individual testing and investigation of the exceptions. That investigation also will require the Department to obtain a particular commercial vendor's information service that the Legislative Auditors routinely have in their offices. There are many valid reasons for having a different tax return address such as a return filed by a separated spouse, an elderly parent filing a return at the address of an adult son or daughter, an adult child moving from the home, or the Comptroller's Office using a different tax year's address for the return. Since the Department matched the Homestead property address income tax return in our federal income tax database, the Department believes that this particular automated procedure will produce less positive results. Depending on the number of applications the Department receives based on the filing deadline extension legislation, the Department expects to produce this report on July 1, 2014.

The third automated procedure recommended by the Auditors is the Multiple Properties Analysis which the Department will begin performing on an automated report basis on December 31, 2013. The Auditors note that this audit is useful for properties not yet submitting a Homestead application. Otherwise, the Homestead application screening process prevents an owner from receiving a HTC on more than one property due to the comparison of Social Security numbers. In addition, there is a longstanding manual letter issuance and credit removal process in the local Assessment Offices where the employees send out an inquiry whenever a property owner uses a different "mail to address" for receipt of Assessment Notices or tax bills. This new automated procedure will be included in the comprehensive compliance manual the Department is developing pursuant to Recommendation 1 of this Report.

The fourth automated procedure is the Rental Properties Match which is an audit that the local Assessment Offices (in counties where rental licensing exists) have been performing for years. The Auditors have acknowledged to the Department that several of the properties in their test of 25 properties had already been earmarked for recapture by the local Assessment Office. The Auditors had requested their own independent rental property lists from the local governments without reference to earlier lists and the time periods for those lists. As was noted in the larger Audit Report, it is essential for the Department to contact individual property owners to receive an explanation of the property's use. Recently, the Department had found several instances where the City Government had incorrectly indicated that a property was a currently licensed rental property when

in fact the property had been purchased two years earlier by the former tenant. The local Assessment Office employees will continue reviewing these reports as they are received from local governments.

The fifth and final automated procedure discussed by the Auditors is the Review of Foreclosed Properties. The Department would assign the lowest priority to this audit because the Department successfully had departmental legislation enacted in the 2012 session that requires a mortgage lender to report the foreclosure order on the property to the Department within 60 days of “ratification” of the Order by the court. Equally important, the legislation contains a self policing mechanism that places a lien on the property until the Homestead Tax Credit amount for that tax year is paid. The local Assessment Offices that administer the new mortgage foreclosure reporting law are already sending lists of these properties to the Homestead Section to remove Homestead Credits for those properties still receiving them. At our own initiative, the Department will seek (by December 31, 2013) an electronic listing from the Department of Labor, Licensing, and Regulation (DLLR) of its new (effective October 1, 2012) registry of foreclosed properties to compare to a listing of properties receiving a Homestead Tax Credit in the Department’s AAVS.

The Legislative Auditors conclude this section of the Audit Report noting that “while automated procedures can be performed without a large commitment of resources, investigating potentially ineligible properties can be a time-consuming process”. All of these procedures will have to be prioritized if the Department does not receive a significant commitment of new employees.

It is important to note again, as was mentioned previously in the comments and response to finding 1, that the Department is still in the midst of the data programming and administrative processing of those application the Homestead office received in the four months before the December 31, 2012 application deadline. Also, pending legislation introduced in the current session of the General Assembly appears likely to extend the application deadline through December 31, 2013. If this occurs, a significant number of the 8 permanent employees the Department intends to commit to performing some of the reviews on the results from new automated procedures will be needed to continue the processing of applications that are received throughout the extended application period. Therefore, all of the suggested timelines in this response for beginning the reviews of automated procedures are subject to revision based on the number of applications received in the extended filing period, the number of telephone calls received by the Homestead Section in the extended filing period, and the number

of new employees, if any, the Department receives in the fiscal 2015 budget request.

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