

**PUBLIC OVERSIGHT HEARING ON
THE FISCAL YEAR 2006 AND 2007 SPENDING AND
PERFORMANCE BY THE OFFICE OF THE CHIEF
FINANCIAL OFFICER (OCFO)**

**Before the
Committee on Finance and Revenue
Council of the District of Columbia**

The Honorable Jack Evans, Chairman

**February 28, 2007
Council Chambers, John A. Wilson Building**



**Testimony of
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Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Sherryl Hobbs Newman, Deputy Chief Financial Officer for the Office of Tax and Revenue (OTR). I am pleased to present testimony today on OTR's performance during Fiscal Years 2006 and 2007 to date. At the conclusion of my statement, I will be available should you have specific questions you would like addressed.

Overview

OTR's performance in Fiscal Year 2006 (FY06) demonstrates our commitment to leveraging technology to expand services to taxpayers, while generating and protecting revenue for the District. Of the \$5.1 billion in revenue reported to the General Fund in FY06, OTR total tax collections equaled nearly \$4.5 billion, a 5 percent increase from Fiscal Year 2005 (FY05). The task of funding various economic development and other legislative initiatives continues to fall heavily on OTR, as we implemented and distributed funds for three new TIF's (Embassy Suites, H & M and Capitol Hill Towers), one new Business Improvement District (BID), the Nursing Home Provider tax, and continued to transfer funds for the Convention Center, the Ballpark fund, and the Highway Trust Fund, among others.

In FY06, the Office of Tax and Revenue had a budget of \$59.5 million (\$54.9 million local) that included authorization for 566 employees. OTR completed the year with a small surplus of just \$1,800 in local funds. Of the 27 FTEs newly authorized in FY06 primarily for Real Property and specific tax law changes including baseball, 23 have been filled to date. OTR continues to recruit

aggressively to fill remaining vacancies and keep up with attrition, particularly in revenue-producing and highly competitive fields like real property.

The FY07 budget for OTR is \$91.9 million and 628 FTEs, of which \$69.4 million is in local funding, a \$14.5 million increase from FY06. While this increase is quite large, it is primarily for the revenue initiatives authorized as part of the FY07 budget, and the majority of the increase is made up of one-time costs. I will discuss the implementation of the revenue initiatives later in my testimony.

The Council has invested significant resources in OTR over the past 3 years, to raise revenue and administer an increasingly complex tax code. You will see, both in our current revenue initiatives, and in our successful baseline compliance activity, OTR provides a strong return on investment.

Accomplishment of Strategic Objectives

OTR began FY06 with an aggressive schedule of process improvements. Significant progress has been made on many fronts. Along with specific customer service and taxpayer compliance initiatives that will be discussed in greater detail later in my testimony, OTR has undertaken a comprehensive review of policies and procedures, redefined performance management objectives and measurements, and allocated resources to critical training needs throughout the organization.

Over the last three years, the Council has approved an additional 136 FTEs for OTR to improve taxpayer compliance, implement new legislation and make other needed operational improvements. Of these newly appropriated FTEs, OTR has filled 105 or 77% of them. This increase in staff, attrition due to retirement of

some of our most experienced employees, and the maturity of the Integrated Tax System (ITS), have made the need for training and documentation of procedures absolutely essential to the future of the organization. OTR established a Training Institute in FY06, and it has already implemented the first phase of management training and development, along with refresher training on ITS. As the Institute goes forward, it will roll out additional technical, customer service, and tax training programs that will be managed as part of an overall employee development strategy. We are also ensuring that each department has fully documented procedures for all critical processes, which will provide a needed reference tool for all employees, and a starting point for a rigorous quality assurance program, to be implemented during FY07.

During the last 6 months of FY06, OTR began a complete review of employee position descriptions and annual performance plans, to ensure that employees are being held accountable to relevant and measurable performance goals. Concurrently, we reviewed and revised our internal metrics as part of an improved performance management strategy that will improve efficiency and give managers better tools to make program and resource allocation decisions.

We expect all of these initiatives to pay significant dividends in FY 2007 and 2008. In September, OTR is also looking forward to welcoming the annual meeting of the Northeastern States Tax Officials Association (NESTOA). In my role as President of NESTOA 2007, I am proud of this opportunity to showcase the District of Columbia to more than 350 of my colleagues.

Revenue Initiatives and Compliance Activity

In FY07, OTR is working diligently to collect an additional \$49 million in revenue as part of the revenue initiatives approved by Council. While many of these initiatives are still in the developmental stage as necessary technology and employee recruiting and training occurs, OTR has collected \$17.5 million through the end of December, or 36% of the total goal.

Early results in raising additional revenue are coming from increasing the case yield from collection efforts and through Clean Hands activity. Improved legislative authority in this area has allowed OTR to do improved detection of non-filers among those seeking to do business with and within the District of Columbia. Our Compliance Administration has already begun several audit projects in specific areas of tax fraud, and work is underway to scan and index W-2's and Business Registration documents to improve data matching and identify fraudulent filers.

In FY06, the various Compliance Administration divisions collected \$93 million, a 16% increase over FY 2005, and stopped fraudulent refunds in excess of \$26 million dollars through their programs, compared to \$5.5 million in FY 2005. Compliance is well on its way to achieving the FY07 baseline goal of \$95 million in collections, in addition to the revenue enhancements discussed earlier.

The Audit Division exceeded its FY06 objectives of \$50 million, completing more than 3,000 audits and assessing taxes due of \$53.2 million. While the total number of audits has decreased from prior years, emphasis on quality audits over quantity is resulting in a significant increase in revenue from each case. The Revenue Protection Unit continues to protect the District from fraudulent claims filed by

unscrupulous taxpayers and tax preparers. During the 2006 filing season we investigated and closed down 2 unscrupulous preparers who preyed on the Latino population. Their main scam was to file returns with fraudulent itemized deductions and false dependents. During this filing season we have targeted a number of preparers – one of whom we may close shortly – including one location of a nationwide tax service. These preparers are using a variety of schemes, including false Schedule C/Earned Income Credit and Head of Household claims.

The Collection Division also saw increased collections of 13% over FY05, while simultaneously providing more non-revenue producing services. Contract clearances were provided on more than 1,500 requests from various procurement offices for vendors providing goods and services to the District. The Collection Division has also expanded the Alcohol Beverage Control (ABC) program to ensure compliance by all businesses requesting an ABC license. As in the Audit Division, Collections are focusing on high yield and more productive cases, yielding an average of \$6,000 more per case closed in FY07 than during the same period in FY06. In Collection, the dollars per FTE in FY06 increased to \$1.07M as compared to the \$874,000 per FTE in FY05.

One key to maintaining a high level of voluntary compliance in the District is the inherent threat of criminal prosecution for violations of District tax laws. Our Criminal Investigation Division forwarded 54 cases for prosecution to either the Office of the Attorney General or the U.S Attorney's Office during FY06, up from 42 in FY05. Several cases received significant media coverage and resulted in several taxpayers receiving sentences that included various periods of incarceration and significant restitution orders.

Our Voluntary Disclosure program continues to be successful, with 533 total agreements filed since FY 1999 for \$36.9 million. In FY 2006, 122 agreements were entered for \$4.7 million. In FY 2007, there are already 22 agreements for just under \$1 million.

Real Property

The District's real estate market continues to translate into increased tax revenue as a result of rising property values, although we are seeing a slow down in the rate of increase.

In FY06, the Real Property Tax Administration (RPTA) billed and collected \$1.27 billion in real property taxes, an increase of 11% over FY05. The annual tax sale in July 2006 collected \$29 million from 2,317 delinquent properties, including back taxes, penalties and surplus bid revenue over the amount of taxes owed.

Beginning today, taxpayers will receive their first half TY 2007 property tax bills as well as next year's FY 2008 proposed property assessment notices for the District's 176,000 residential and commercial parcels. The FY08 assessment notices reflect the continual rise in District real property values from total value in FY07 of \$150.4 billion to \$172.3 billion in FY08, a 14.59% increase. In an effort to be more customer friendly, and in response to several entities that made this request, notices have been revised to clearly indicate both total and taxable assessment amounts. We continue to see improved accuracy in our valuation processes. The general level of assessments based upon 2008 proposed values compared to calendar year 2006 sales prices is 97% of market value. The

Coefficient of Dispersion is 10.2% (standard is less than 15%) and the Price related Differential is 1.00 (standard is between 97 and 1.03%).

Improvement of the billing process remains a high priority for OTR. In FY06, we implemented over 70 software modifications in support of this most critical function, and also developed a comprehensive set of test scenarios to improve bill accuracy.

The Recorder of Deeds (ROD) has continued to incorporate technology into its recordation process to increase efficiency and accuracy. In FY06, the division recorded 205,704 documents which generated \$343 million, a slight decrease from FY05. The District continues to be a leader in electronic recordation. Despite these technological improvements, OTR remains gravely concerned about the condition of the building at 515 D Street. We are working with the Office of Property Management to identify space for an immediate relocation of employees and records, with the expectation that the capital project for the building will begin in earnest in FY08.

The Real Property Administration is also in the midst of completing phase one of our Homestead revenue initiative, using various criteria to identify potential fraud cases and requiring additional data from recipients to support the exemption. In FY06, nearly 8,000 individuals claiming a Homestead exemption were sent letters in order to confirm eligibility. As of January 28, 2007, approximately 2250 of those were determined to be ineligible for the benefit, with a revenue impact of \$5.87 million. The second phase of the Homestead reconfirmation process will begin in late Spring, 2007.

Another revenue initiative planned for FY07 in the area of vacant property will begin to move forward soon, based on an implementation plan developed jointly with DCRA. In FY07, OTR will provide the funding associated with this initiative to DCRA (through an intradistrict agreement) to hire the necessary inspectors to improve the process of identifying vacant property and ensure follow up as necessary to properly bill these properties as Class 3.

Customer Service

OTR also continues to focus on improving customer service, by improving automated or self-service options, and by improving the quality of the services provided. We have increasingly seen taxpayers take advantage of services like the Interactive Voice Response (IVR) system and the Electronic Taxpayer Service Center (eTSC) to get information on refund status, review account status, and to address questions about changing tax policies.

In FY06, OTR added a bi-lingual call routing feature to the automated call system to allow Spanish speaking citizens to take advantage of some of these same self-service opportunities, as well as an Estimated Wait Time feature, which informs taxpayers of the likely wait time to reach a live assistor and allows them to leave a message during periods of particularly heavy call volume.

OTR answers approximately 300,000 calls a year, and serves nearly 50,000 taxpayers through our walk-in service centers. Through the first four months of FY07, we have experienced an abandoned call rate of just 1.2%, well below industry standard. Several factors are contributing to this success: increased utilization of self-service options; a modest increase in staffing; and usage of

monitoring and workforce allocation software that allows us to respond dynamically to service level demands. The average combined wait and handled time in the call and walk-in centers have remained under the goal of 25 minutes through the beginning of FY07. During FY07, we plan to implement quality monitoring software, to ensure that taxpayer concerns are handled both quickly and correctly. This is one critical element of our focus on quality.

We have also expanded the role of the Problem Resolution Office (PRO) to address and analyze particularly complex and long-standing taxpayer issues. The PRO coordinates and resolves individual income, business, real property tax concerns, and related tax issues for a variety of taxpayers. We have also established a Council liaison program they assist those constituents that are referred to OTR from a Councilmember.

OTR remains proactive in its efforts to educate taxpayers on tax law changes and agency initiatives. In addition to the information available on our web site, a valuable source of information on tax policy and filing requirements that is continually enhanced for taxpayer satisfaction, OTR makes full use of public service announcements and the media to ensure that critical information is disseminated to the public. Agency employees participate in more than 60 outreach events with local churches, ANC, members of the tax practitioner community, accounting firms and associations, and legal entities and associations annually. OTR hosted its third "Tax Resolution Day" in the fall of 2006, in conjunction with the Mayor's Customer Service Week. We again participated in Congresswoman Eleanor Holmes Norton's annual tax fair, and we continue to work with nonprofit community organizations to spread the word about the Earned Income Tax Credit program and other tax benefits that may assist the District's

neediest taxpayers. Earned Income Tax Credit (EITC) claims increased by about 2,000 in 2006 to 45,482, with approximately \$30.2 million in refunds delivered to District taxpayers.

Finally, to further increase ease of filing for taxpayers, in FY06 we continued to expand options for electronic filing and payment. In FY06, almost 450,000 returns were filed electronically, a 20% increase from the prior year. To better service these taxpayers, we implemented valuable enhancements to the electronic Taxpayer Service Center (eTSC) web site, including the eCheck payment option for business accounts, so that all registered business taxpayers are now able to pay their taxes online without pre-validation of their bank account. We also completed a comprehensive hardware and software upgrade to ensure high availability, improved performance, scalability and redundancy of the web site. To date we are seeing a 10% increase in electronic filings over last year.

Forms/Tax Policy

In FY06, OTR began a comprehensive process of redesigning tax forms and notices to ensure that they are clear and understandable. Already we have successfully redesigned the D40 Income Tax form with the goal of simplifying and improving the flexibility of the form to meet changing legislative requirements. During FY06, our Information Systems Administration had to modify over 26 tax forms and implement several major enhancements related to the Budget Support Acts of 2005 and 2006, including Nursing Home Provider Tax, O-Type Fees Assessment and Collection, and Other Tobacco Product Tax Collection. The time

and cost involved in making such modifications continues to be one of our most difficult challenges.

OTR is also reviewing the inventory of notices, with the goal of eliminating unnecessary documents and clarifying the presentation of information on those that remain. As stated earlier, significant improvements have been made to the assessment notice, and real property owners should notice the difference on the notices they are receiving this week.

Legal Decisions

In FY06, OTR received several critical rulings upholding our ability to fairly administer the tax code.

In the Bender case, the lower court held that the OTR could not collect unincorporated franchise tax, a net income tax, on a real estate partnership doing business in the District to the extent of the nonresident partner's allocable share of that tax. The Appeals Court remanded the case to trial court with instructions to enter an order granting summary judgment for the District, rejecting the taxpayer's argument that such a tax violated the prohibition in the Home Rule Charter on imposing a personal tax on commuters. The Supreme Court has declined to hear the case, so the Appeals Court decision stands.

In a case against the Washington Post, the Post filed a claim for partial refund of the use taxes previously paid on the purchase of System Software from an out-of-state vendor. OTR denied the claim and subsequently the Post filed a petition in the District of Columbia Superior Court Tax Division. Subsequently, the Washington Post dismissed its petition.

In the case of Peter S. Craig v. District of Columbia and Polly H. Ernst v. District of Columbia, the trial court issued its judgment and order voiding the tax year 2002 assessments in January, 2006. The fiscal impact to the District of an unfavorable decision in this case is estimated at approximately \$15 million for TY 2002 and \$55 million if such a decision were applied to TY 2003 (the case for that year is currently stayed). Under certain circumstances there could be an additional impact in later years. The case was appealed to the District of Columbia Court of Appeals. On January 12, 2007, oral arguments were held before the District of Columbia Court of Appeals. The decision is not expected before May.

Technology

Technology remains the key to OTR's many successes, and a critical issue for our future.

Over the past 5 years, District taxpayers have enjoyed one of the swiftest and most improved tax return processing systems among U.S. cities. While technology continues to rapidly change and be enhanced, we look for effective ways to keep our processes viable. In calendar year 2006, prompt deposits (deposits within 48 hours from paper and e-commerce) reached \$ 2.2 billion. The average refund cycle time for clean paper returns was 15 days or less, but taxpayers who filed electronically received their refunds in an average of 5 days.

OTR continues to maintain and enhance ITS to ensure its continued productivity and security, in line with industry best practices, by incorporating elements of the System Development Life Cycle (SDLC) methodology. These tools impose

structure and discipline on the software development and maintenance processes to ensure improvement in ISA reliability, systems quality and customer satisfaction.

In FY06, we began a total technological refresh of the aging front-end imaging equipment and software, which will allow us to do more complete scanning and data capture of tax returns and attachments. This will show immediate benefits in compliance and customer service, as more data will be available to review taxpayer accounts and, over the long run, will assist the agency in implementing a much improved document retention strategy. This is the first of the major replacement projects necessary to ensure that we maintain our ability to process tax returns and collect revenues effectively.

We are also increasing our focus on data management issues, loading tax return line item data to the report writing database for 2002 through 2006, which will allow OTR and Office of Revenue and Analysis to produce their own critical tax-related reports and analysis without waiting for ITS programming resources for report development. The availability of all of this data makes security an even more critical issue for us. To ensure that we are doing everything we can to secure taxpayer data and the integrity of our systems, we have recently hired a security specialist to review and upgrade our data security measures.

Summary

OTR's goal is to become the premier tax administration in the country, by providing high quality services that inspire public trust and are recognized as fair, convenient and efficient. As we go forward in 2007 and beyond, we remain committed to working with the city's leadership to ensure that we provide the best

possible tax administration to our citizens, while protecting the revenue engine of the District.

Thank you, Mr. Chairman, and members of the committee, for this opportunity to testify. I am happy to answer your questions at this time.