

**PUBLIC OVERSIGHT HEARING ON
THE FISCAL YEAR 2005 AND 2006 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 27, 2006, 2:00p.m.
John A. Wilson Building
Council Chambers**



**Testimony of
Sherryl Hobbs Newman
Deputy Chief Financial Officer
Office of Tax and Revenue**

**Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia**

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 2005 and 2006 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 2005 (FY05) demonstrates our commitment to leveraging technology to expand services to taxpayers, while generating and protecting revenue for the District. FY05 saw dramatic increases in taxpayer use of electronic filing and payment options, completion of the real property billing module of the Integrated Tax System (ITS), and improvements in employee productivity and revenue collections.

Of the \$4.8 billion in revenue reported to the General Fund in FY05, OTR total tax collections equaled more than \$4 billion, an 8 percent increase from Fiscal Year 2004 (FY04). The increase was attributed, in part, to increased real property, sales and use, and business tax collections. In FY05, OTR spent considerable resources to prepare for and implement new tax laws, including the creation of several entirely new taxes, such as assessments on nursing care facilities and baseball-related taxes and fees, and other changes impacting tax administration.

In FY06, OTR is focused on continued performance improvements, particularly in the areas of customer service, revenue collections, and information technology.

Among these is the creation of a Standards and Services Unit to perform quality assurance reviews on our critical business processes, to ensure that we are fully utilizing our technological resources and to make recommendations for process improvements. We are also planning an upgrade to the customer service tools in ITS, to improve the monitoring of all customer contacts and ensure that service requests are closed timely and accurately, with a minimum burden on the taxpayer. While undertaking these major initiatives, we must never take our eyes off our mission critical objective to administer fairly the District's tax laws and collect all the revenues due to the District.

Spending and Performance

In FY05 the Office of Tax and Revenue had a budget of \$52.5 million that included authorization for 535 employees. OTR completed the year with a small surplus of \$388,000. Of 52 FTEs funded by the FY05 revenue initiative, more than 44 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 FY06 budget for OTR is \$61.3 million that includes authorization for 566 employees. The majority of this increase is associated with funding for real property enhancements and administration of baseball and other tax law changes.

Given the fiscal constraints and responsibilities facing the District, it is imperative that a tax administration be vigilant in applying its resources to expand and protect the city's revenue stream. While OTR has experienced significant growth over the past 18 months, demands on tax administration have also grown. OTR is heavily dependent on automated systems to manage an increasingly complex tax code. To

keep up with demands, OTR must have full funding to implement and administer effectively all tax law changes, particularly those that impact our automated tax systems.

At OTR, we are also reinvigorating our commitment to our employees and ensuring that they have the skills necessary to manage and use our automated systems, to gain and maintain professional certifications, and to provide the highest quality customer service to the taxpayers. OTR is undertaking a comprehensive strategy for employee learning and development that will give employees in all areas both basic skills refresh and opportunities for advancement. By investing in employees, reaching out to taxpayers, and continuing to use technology to improve the quality and timeliness of service, we help ensure the financial future of the District of Columbia.

Consistent with safeguarding the privacy of taxpayer information, OTR is working to increase collaboration and coordination with other District agencies, to enhance taxpayer compliance and customer service. In addition to several data warehouse projects that are ongoing with agencies across the government, we are working closely with DCRA to identify joint opportunities to improve enforcement. This effort includes our joint initiative to improve the identification and administration of vacant properties, and to implement changes to business licensing and registration, thereby eliminating duplicative processes.

The balance of my testimony this morning will discuss OTR's performance by administration and how we are meeting goals in terms of revenue collection and protection, customer service, technology, and real property services.

Revenue Accounting

OTR's Revenue Accounting Administration contributes to the District's consistently clean CAFR opinion by ensuring that all revenue and deposit transactions are reconciled in an appropriate manner. Through these efforts, OTR recovered almost \$6 million in dishonored checks and \$100,000 in dishonored check fees. RAA also plays a critical role in the transfer of dedicated funds for the Convention Center, Ballpark Fees, and 911 Fees, and will be responsible for new and proposed tax law changes, including natural gas, school revitalization, nursing home care provider taxes and tax increment financing programs.

Compliance

Compliance and enforcement are critical components of effective tax operations. OTR's Compliance Administration is our largest department, and recently completed the process of restructuring to enhance enforcement of tax compliance in the District. This restructuring supports implementation of OTR's comprehensive compliance strategy in a manner that is both aggressive and fair, using market segmentation and other means to focus on specific populations to close the tax gap. The Compliance Administration completed training of new employees hired under our FY05 revenue initiative, and fully expects to meet the associated revenue targets during the current year.

In FY05, the Compliance Administration continued to realize operational achievements and casework results, even as staffing and resources were diverted to train new staff. The various Compliance Administration divisions collected \$82.1 million in FY05.

The Audit Division exceeded its FY05 objective with a year-to-date total assessment of \$42.2 million and 2,208 completed audits. In FY05, there was an emphasis on improving the quality of audits which resulted in a decrease in the number of cases closed as compared with closures in FY04, while at the same time increasing the dollars per auditor to \$819,000, exceeding the prior year average of \$528,000. Increased emphasis on the Division's voluntary compliance program yielded another \$4.8 million.

In FY05, the productivity of our Collections Division, as measured by dollars collected per revenue officer, increased to \$874,000 per person from \$807,000 per person in FY 2004, a 9.2 percent increase. Due to decreased onboard staff in the Collections Division from FY04, the total dollars collected by revenue officers in FY05 was \$79.9 million, 95.5 percent of the total collected in FY 2004.

OTR's Criminal Investigation Division (CI) has had another very productive year.

Despite the loss of two special agents because of a recall of one agent to active military duty and the assignment of another to serve as CI's Acting Chief. CI continues to conduct high profile investigations, including the following:

- A 32-count federal indictment charging a well-known District restaurateur and four of his restaurants with mail fraud, bankruptcy fraud, and failure to pay in excess of \$2 million in District sales taxes.
- A 16-count federal indictment charging a man with masterminding a tax fraud conspiracy whereby he and his co-conspirators (four of whom have already pled guilty) filed false tax returns and defrauded the District of more than \$115,000.

Media coverage of such high profile criminal cases has been an added deterrent to non-compliant taxpayers, serving to increase voluntary compliance through the inherent possibility of criminal prosecution. In FY05, CI also forwarded a total of 42 cases of tax fraud to either the District's Office of the Attorney General or the U.S. Attorney's Office, greatly surpassing previous referrals of 26 cases in FY04 and 18 cases in FY03. In addition, CI initiated two ongoing cases that saved the District in approximately \$2 million in FY05 alone.

In a similar vein, OTR operates and maintains the Clean Hands Program, through which we provide information to District agencies on the tax compliance status of individuals or businesses seeking to obtain licenses or permits from those agencies. This program has been of great assistance to OTR in bringing individual taxpayers and businesses into tax compliance.

OTR also operates and administers both the Certificate of Good Standing Program and the Contract Clearance Program. The Certificate of Good Standing Program provides proof of compliance to individual taxpayers. The Contract Clearance Program provides assurance that individuals or companies entering into contracts with the District of Columbia comply with District tax laws. The Contract Clearance program provides more than 2,500 responses annually to contracting officials in approximately 24 different contracting authorities.

Other major compliance initiatives in FY06 include: ongoing programs to identify non-filing taxpayers; promotion of our voluntary disclosure program; audit emphasis on franchise, excise and trust fund taxes such as sales and withholding; and enhancement of procedures for identifying fraudulent refund claims.

Office of Administrative Hearings

Effective October 1, 2004, the Council required that certain tax appeals be heard by the newly-established Office of Administrative Hearings (OAH). This new appeals process required that OTR's Office of the General Counsel represent the agency in all matters before OAH, involving the participation of our entire team of OTR attorneys, to provide agency-wide leadership in coordinating our audit documentation and witness preparation, preparation of appeals briefs and drafting of motions to be heard by OAH administrative law judges. In FY05, we participated in over 50 cases heard before OAH, and prevailed in a predominant number of these disputes, thereby saving several hundreds of thousands of dollars in District revenues.

Returns Processing

District taxpayers enjoy one of the swiftest and most improved tax return processing systems among U.S. cities. In calendar year 2005, prompt deposits (deposits within 48 hours from paper and e-commerce) reached the \$ 2.1 billion mark, reducing the need for cash-flow borrowings and thus providing savings to the city. This was the eighth consecutive year of significant growth in prompt deposits.

The average individual income tax refund amount increased in 2005 to approximately \$795. For the eighth straight year, the average refund cycle time for clean tax returns was 14 days or less. Taxpayers who filed electronically received their refunds in an average of 6 days.

Alternative filing, which includes the District's award-winning electronic Taxpayer Service Center (eTSC) and federal/state e-filing, saw dramatic growth in calendar

year 2005, particularly in the number of income returns filed electronically. More than 110,000 individual income returns were filed online, up from 92,000 in the last tax year. E-filers represented 37 percent of the District's individual income tax paying population, up from 24 percent in 2003. OTR has made rapid expansion of e-commerce a key strategic goal for the Information Systems Administration. In all, more than 382,000 taxpayers filed and paid income and business taxes electronically in 2005 – a 20% rate of growth over 2004. Business taxes experienced an even more dramatic improvement, as 55% of all businesses file their taxes electronically and account for 42% of all tax revenues.

During 2005, OTR provided a new E-check capability for Real Property taxes, and over 4,300 taxpayers took advantage of this electronic payment option to pay more than \$9 million in tax liabilities. Expansion of the E-check program offers exciting possibilities, as taxpayers can now pay the complete array of business taxes using this option, and we anticipate major FY 06 growth from this revenue stream. As part of OTR's long-term strategy to increase efficiency and reduce burden to the taxpayer, we continue to work toward the goal of having all types of returns available for electronic filing by 2007.

Earned Income Tax Credit (EITC) claims increased slightly in 2005 to 43,384, with approximately \$20 million in refunds delivered to District taxpayers. As part of our outreach efforts this year, OTR sent out approximately 10,000 letters to taxpayers identified as potentially eligible to inform them of the EITC program and the process for filing.

Technology

OTR continues to reap benefits from the implementation of the Integrated Tax System (ITS) in terms of enhanced revenue collections and electronic filing and payment opportunities for taxpayers.

OTR continues to maintain and enhance ITS to ensure its long-term viability and continued productivity and security. In FY06, we will begin 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. During the current year, OTR will also begin an upgrade to the Contact Tracking System (CTS) module of ITS, which will support 100% documentation and tracking of customer contacts, issue resolution, and monitoring of customer service quality.

OTR has partnered with the DC Public Schools System by providing over 300 surplus units of desktop and laptop hardware to the schools, refurbished with the latest software for public and charter schools.

Real Property Tax Administration

The District's real estate market continues to translate into increased tax revenue as a result of rising property values. There continues to be a high demand for property in the District, especially in the condominium segment of the market.

In FY05, the Real Property Tax Administration (RPTA) billed and collected a staggering \$1,440,000,000 in real property taxes, an increase of 34% over FY04. The collection was done through a combination of twice-a-year billings, fair and equitable assessment valuations, and enforcing the tax parity law regarding vacant property and the tax sale. The annual tax sale in July 2005 collected an additional \$4,600,000 in back taxes and penalties from 2,169 delinquent properties, as well as \$32,800,000 in surplus bid revenue over the amount of taxes owed. In addition, there are over 92,000 participants in the popular Homestead benefit and Senior Citizen Tax Relief Programs, totaling over half of the District's property owners.

Within the final two weeks in February, RPTA will mail the first half TY 2006 property tax bills as well as next year's FY 2007 proposed property assessment notices for the District's 176,000 residential and commercial parcels. The FY07 assessment notices reflect the continual rise in District real property values from total value in FY06 of \$121,000,000,000 to \$149,000,000,000 in FY07, a 23% increase.

The Recorder of Deeds (ROD) has continued to incorporate technology into its recordation process to increase efficiency and accuracy. In FY05 the division recorded 182,244 documents which generated \$363,000,000, a slight increase over FY04. As an indicator of its superior performance, the District's Recorder of Deeds continually meets or surpasses the "recording efficiencies" of most of the surrounding jurisdictions (that is, the difference between a filing date and recordation date is smaller in the District than most of the surrounding counties).

The Craig litigation continues to put a significant burden on the resources of the department. Earlier this month, OTR issued a notice to all property owners in the

affected tri-group, notifying them of the status of the litigation and their rights with regard to participation in this class-action lawsuit. We expect that we will see a significant increase in assessment appeals this spring, as a result of publicity surrounding this issue, which will further strain the resources of OTR. The Assessment Division has successfully filled the 7 FTEs granted in the FY05 budget, and has filled 8 of the 16 newly authorized in FY06. However, we continue to experience high turnover in this area due to the demand for real estate appraisers in the metropolitan region.

Customer Service and Public Outreach

Customer service has been defined as the ability of an organization to consistently give customers what they want and need. At OTR, we strive to meet a higher definition of good customer service: the ability to consistently exceed the customer's expectations.

In FY05, the Customer Service Administration (CSA) assisted 53,600 walk-in customers and 251,000 customers via telephone. CSA responded to 115,000 pieces of taxpayer correspondence. Limited resources continued to make this an area of significant challenge, as we look for new ways to service customers quickly and conveniently. The new Interactive Voice Response (IVR) unit, installed in FY04, answered approximately 68,000 callers requesting refund status information, freeing live assistors to work more complex taxpayer issues. The IVR is just one of many self-service options OTR is working to provide citizens and practitioners, to eliminate the burden of waiting in a phone queue or in the walk-in center. In FY06, we have implemented an Estimate Wait Time (EWT) feature to the automated call answering software, which should improve customer

satisfaction by letting callers manage their time better during peak times when waits can be particularly long.

OTR is also continuing its taxpayer outreach efforts throughout the District. OTR hosted its second “Tax Resolution Day” in the fall of 2005, 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. In addition, OTR is ramping up its Language Access Action Plan. OTR is already one of the city’s heaviest users of translation services, and is developing a comprehensive plan to expand the number of brochures and other documents we provide in various languages, as well as looking at ways to compete for limited bilingual resources in our hiring plans.

Summary

Integrity. Responsibility. Accountability. OTR puts a premium on upholding these simple, core principles in our mission and business culture for an important reason: the public’s trust is crucial to our continued progress and to efficient tax operations. As we go forward in 2006 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.

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

Office of Tax and Revenue

Efforts Above our Baseline Operations for FY05

The list below represents new and expanded initiatives undertaken by OTR in FY 2005. Where appropriate and available, metrics are included.

Area	Discussion	Impact
1. Baseball – Sales Tax	The Baseball legislation demanded numerous changes to baseball-related sales taxes.	Additional Revenue of \$8.5 million. This required audit, collections, IT, accounting and returns processing changes
2. Baseball – Ballpark Fee	The Baseball legislation required a new fee to be imposed on all business with greater than \$5 in gross receipts.	Additional Revenue of \$16.2 million. This required a significant IT and processing effort to process the 1,600 tax returns.
3. Baseball – Gross Receipts Taxes	The legislation required a new divided tax rate scheme of the tax rates between commercial and residential customers.	Re-allocation of \$8.9 million Required IT, processing, and accounting changes in OTR.
4. Baseball – TIF & Community Benefits Fund	Large TIF area that operates unlike other DC TIFs.	Requires changes to our accounting and returns processing procedures as well as a manual analysis of the TIF area to develop the base year data.
5. Nursing Home Provider Tax	An entirely new tax imposed on 20 nursing homes in the city.	No Additional Revenue in FY05 FY06 impact is approx. \$4 million .This required IT and business process changes.
6. Clean Hands & Contract Clearances	Expansion of these initiatives has created significant additional burden on our compliance administration and our IT functions	Revenue impact is estimated at \$400,000 since the start of FY06
7. Office of Administrative Hearings (OAH)	Requires significant additional time of audit and general counsel staff to process appeals through OAH.	Has detrimental impact to our revenue estimates
8. Real Estate Market	Very active real estate market has led to many issues in customer service, legislative analysis, outreach, etc.	OTR anticipates a significant increase in assessment appeals. The large number of anticipated appeals will strain existing resources and take time away from <i>next year's</i> valuation process. There will be additional impact on OTR's customer service staff to handle the inquiries as notices are received by the public.
9. TIFs	TIF are manually intensive efforts at OTR that are difficult to administer. As no two TIFs	In FY05, transferred \$9.2 million to 3 TIFs. Two additional TIFs come on line in

	are alike each requires a tailored implementation effort.	FY06.
10. Real Property Tax exemptions	Numerous property specific tax deferral, exemptions, and adjustments	Need for 1 additional FTE in this area to handle increasing numbers of statutory and legislative exemptions.
11. Long-term Care Insurance	New deduction for individual income taxpayers	Required forms, instructions and processing changes
12. Estate Tax	Tax law change in exemption amount	Required forms and processing changes
13. Other Tobacco Tax	A new sales tax rate for a specific category of tobacco products.	Small additional revenues. Cost of manual reconciliation of tax payments to segregate "other tobacco" from parking and to perform funds transfer.
14. BSA – Homestead Deduction Increase	Changed the Homestead benefit from \$38,000 to \$60,000, effectively raising the tax deduction amount from \$338 to \$550 for eligible property owners.	Programming changes to the ITS billing system.
15. BSA - Property Tax Rate Reduction	Lowered the real property tax rate from \$0.96 per \$100 of assessed value to \$0.92 per \$100. In addition, the tax cap has been changed from 12% limit per year change in taxable assessment to 10% change in taxable assessment.	Programming changes to the ITS billing system.
16. BSA - Limited Equity Cooperative Tax Fairness	RPTA's assessment records did not previously identify cooperatives by their equity structure. Mailing sent requesting information on the amount of subsidy provided to the cooperative. This information will be used to value the property as required by the new legislation.	Mailing/questionnaire costs to identify and gather data on LEC's. Programming of CAMA system required to assess and bill these properties under specified formula.
17. BSA – Family Property Recordation and Transfer Tax Exemption	Expands existing deed recordation tax exemptions to include transfers between a grandparent and grandchild.	Forms changes and outreach in process.
18. BSA – Affordable Housing Preservation Tax Assessment	RPTA is still attempting to identify all properties affected by the legislation. This has been particularly complex since we have not previously noted on our assessment records whether or not a	Mailing to identified properties requesting original purchase information. Programming changes needed to perform special assessment and billing calculations on flagged properties.

	property falls under the category of "affordable housing."	
19. BSA -Triennial Group Disparity Correction	This provision recalculates taxable assessments for FY2006 for triennial groups 1 and 2 by a specific formula. Appropriate changes have been made to the ITS billing system for first half 2006 real property bills.	Significant programming costs to perform recalculations and changes to notices.
20. BSA - Tax Deferral for Lower Income and Senior Property Owners (BSA Title I, Subtitle S)	Provides that eligible lower income property owners may defer increases from the prior year's real property taxes due.	Requires administration of application process and verification of income. Will require significant programming changes to Real Property Billing System and monitoring of repayment of deferred amounts.
21. BSA - Reduced Tax Liability for Disabled Property Owners	Creates a new exemption for recordation and transfer taxes for a deed to a residential property to be granted to a trustee for a trust created on behalf of a disabled person (i.e., a special needs trust).	The Recorder of Deeds has added this exemption to their exemption list and is updating their website information.
22. BSA - Equity in Real Property Tax Assessment Act of 2004	Ensure that any valuation reduction decisions by BRPAA on properties receiving the Homestead benefit were considered by the assessors for the next reassessment period.	The Assessment Division has made this provision part of their operating procedures.
23. Assessment Program Improvements	<ul style="list-style-type: none"> • Developed new residential cost model derived directly from recent residential property sales. • Conducted a district-wide "data verification" program and performed 140,000 exterior property inspections. • Implemented multiple regression methodology in the valuation of 32,000 condominium units. • Ensure field inspection of all sales properties (6,000 parcels), mail sales verification questionnaires to each sale properties. 	Performance testing indicates steady improvement in dispersion and price related differential measures.

	<ul style="list-style-type: none">• Ensure that all building permit activity is accounted for (3,000 parcels/year).• Improved training/certification program for assessors.	
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