



City of New York

OFFICE OF THE COMPTROLLER

Scott M. Stringer
COMPTROLLER



FINANCIAL AUDIT

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Deputy Comptroller for Audit

Audit Report on the New York City
Department of Finance's Collection of
Real Property Transfer Tax and New
Real Estate Taxes

FM18-093A

September 20, 2019

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

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To the Residents of the City of New York:

My office has audited the New York City Department of Finance (DOF) to determine whether it properly collected the Real Property Transfer Tax (RPTT); calculated and remitted the portion allocable to the Metropolitan Transportation Authority (MTA) from the RPTT collected; and billed and collected the Real Estate Tax (RET) subsequent to a revocation of not-for-profit exemption. We audit City agencies such as DOF as a means of increasing accountability and ensuring that City resources are used effectively, efficiently and in the best interest of the public.

This audit found that DOF's examination process for RPTT returns is limited and as a result, it cannot be reasonably assured that the returns are facially complete or sufficient, that taxpayers are providing all required documentation with their RPTT returns, and that the City is collecting the full amount of RPTT due and owed. Further, this audit found that DOF's policies and procedures related to the submission and review of RPTT returns were inconsistent and incomplete. At the same time, this audit also found that, based on the RPTT reported as due and paid, DOF properly calculated the portion allocable to the MTA. With regard to the RET, this audit found weaknesses in DOF's billing and collection of that tax in situations where a change in property use or ownership should have resulted in the revocation of an exemption, such as a property transferred from a tax exempt to a non-exempt party. As a result, these weaknesses increase the risk of inadequate collection and potential loss of City revenue and funds due to the MTA.

The audit made seven recommendations, including that DOF should revise its written procedures for Examiners to follow; provide adequate RPTT training to Examiners and Supervisors; consider expanding its Automated City Register Information System's functionality to automatically identify and require the submissions of all the related documents with the RPTT returns; consider upgrading its computer system to automatically impose RET from the date of the transfer that removes the exemption or otherwise effectively implement the requirement that taxpayers pay the full RET starting from the date a property changes from exempt to non-exempt; conduct unannounced site visits to ensure that properties are used for exempt purposes only; and retroactively bill and collect from the owners the \$2,096,701 under billed RET.

The results of the audit have been discussed with DOF officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report. If you have any questions concerning this report, please e-mail my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,

A handwritten signature in blue ink that reads "Scott M. Stringer".

Scott M. Stringer

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT

Audit Report on the New York City Department of Finance's Collection of Real Property Transfer Tax and New Real Estate Taxes

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EXECUTIVE SUMMARY

The New York City (the City) Department of Finance (DOF) is responsible for administering the City's tax and revenue laws. For Fiscal Year 2018, it reported collecting approximately \$39 billion in revenue and valued more than one million properties worth a total market value of more than \$1 trillion. Among its taxing responsibilities, DOF is charged with collecting Real Property Transfer Tax (RPTT), billing and collecting Real Estate Tax (RET), administering property tax exemption and abatement programs, and maintaining public property records related to real property ownership.

For Fiscal Years 2016 and 2017, the City reported \$1,788,182,063 and \$1,418,683,372 in RPTT revenue, respectively, related to the approximately 159,000 recorded transfers for 173,000 properties and 42,000 non-recorded transfers for 51,000 properties in all five boroughs. Of the total RPTT collected in connection with commercial transactions greater than \$500,000, 38.095 percent of the RPTT collected goes to a special fund for the Metropolitan Transportation Authority (MTA).¹

In general, RET is imposed on real property in all five boroughs based on a property's assessed value and the current tax rate, taking any real estate tax exemptions that the property might be entitled to into account.² When a property is transferred from a tax exempt entity (such as a governmental entity or a not-for-profit organization) to a *non*-tax exempt entity, DOF is responsible not only for collecting any RPTT due as a result of the transfer, but also for removing all real estate tax exemptions based on the grantor's eligibility at the time of transfer and placing the property back onto the tax roll. Similarly, when an exempt owner leases or uses a property for non-exempt

¹ Commercial transactions are the transfers related to properties other than the residential properties (one-, two- or three-family homes, individual residential condominium units or individual cooperative apartments).

² A property's assessed value is a percentage of its market value as determined by DOF and is based on its tax class. Property in New York City is divided into four tax classes. Tax Class 1 includes one- to three-unit residential properties; Tax Class 2 includes residential property with more than three units including cooperatives and condominiums; Tax Class 3 includes utility company equipment and special franchise property; and Tax Class 4 includes all other real property, including office buildings, factories, stores, hotels and lofts.

purposes, all tax exemptions that are not applicable to the new owner or as a result of a non-eligible use should also be removed and the RET should be restored.

Audit Findings and Conclusion

Overall, we found that DOF's examination process for RPTT returns is limited and as a result, it cannot be reasonably assured that the returns are facially complete or sufficient, that taxpayers are providing all required documentation with their RPTT returns, and that the City is collecting the full amount of RPTT due and owed. Further, we found that DOF's policies and procedures related to the submission and review of RPTT returns were inconsistent, incomplete, and contained instructions for DOF employees that were contradicted by various DOF officials. These weaknesses increase the risk that the work of DOF's Examiners charged with conducting a facial review of the returns will be ineffective and that the full amount of RPTT due will not be collected.

The scope and purpose of DOF's review of RPTT returns was described in various ways in different written DOF procedures and in explanations provided by DOF officials to the auditors. However, at an exit conference at which our preliminary findings were reviewed, a senior DOF official who has signed off on many of the written procedures stated that DOF Examiners are responsible solely for checking for the presence of four items when they receive RPTT returns: (1) that the grantor and grantee information is provided; (2) that the returns are signed; (3) that the signatures are notarized; and (4) that a tax was paid. DOF officials maintained that DOF has not instituted a process whereby the Examiners review the submission of related documents to ensure that all additional necessary documentation is submitted with the returns or that the correct amount of taxes are paid.

Because DOF does not require that steps be taken as part of its examination processes to ensure that the RPTT returns are facially correct or sufficient, and that the documentation taxpayers are required to file with their RPTT returns is in fact filed, DOF has not established adequate written policies and procedures for managing its receipt and review of RPTT returns and did not provide adequate training to and oversight of its examination staff. In addition, we found that a defect in ACRIS resulted in incorrect RPTT assessments being made. As a result of DOF's limited review and control weaknesses, in our sample of 179 RPTT returns, we identified approximately \$620,000 in potentially uncollected RPTT. Thus, we do not have reasonable assurance that DOF properly reviews RPTT returns and collects the full amount of RPTT due.

We also found that, based on the RPTT reported as due and paid, DOF did properly calculate the portion allocable to the MTA. Accordingly, based on the amount of RPTT collected, the full amount due to the MTA was remitted by DOF to the New York City Transit (NYCT) and New York City Department of Transportation (DOT).

With regard to the RET, we found weaknesses in DOF's billing and collection of that tax in situations where a change in property use or ownership should result in the revocation of an exemption, such as a property transferred from an exempt to a non-exempt party.³ We determined that for 26 of the transfers included in our audit sample, the RET was not appropriately applied, resulting in over \$2 million in uncollected taxes.

³ A transfer from an exempt to a non-exempt party can be a sale or lease of the property.

DOF's failure to institute sufficient controls over its RPTT and RET operations significantly increases the risk of inadequate collection and potential loss of City revenue and of funds due to the MTA.

Audit Recommendations

To address the issues raised by this audit, we make seven recommendations as follows:

- DOF should revise its written procedures for Examiners to follow and should provide instructions for conducting RPTT reviews that are consistent with the instructions provided to RPTT filers with the returns and with the City's rules and regulations. Such revised written procedures should include detailed steps the Examiners should take when reviewing the returns and the related documents that should accompany the returns in every situation and be consistently applied for all five boroughs.
- DOF should provide adequate RPTT training for Examiners and Supervisors to ensure that RPTT related documentation is reviewed properly and consistently.
- DOF should review ACRIS' functionality to ensure that manual overrides can be made by tax filers only in permissible circumstances.
- DOF should consider expanding ACRIS' functionality to automatically identify and require the submissions of all the related documents DOF's RPTT return instructions direct taxpayers to submit with their RPTT returns and to further automatically identify the "suspected documents" to preempt incomplete submissions.
- DOF should consider upgrading its computer system to automatically impose RET from the date of the transfer that removes the exemption or otherwise effectively implement the requirement that taxpayers pay the full RET starting from the date a property changes from exempt to non-exempt, including by, as needed, revising policies and procedures to detail the requirements related to the billings for the unexpired portion of the billing cycle.
- DOF should conduct unannounced site visits to ensure that properties are used for exempt purposes only.
- DOF should retroactively bill and collect from the owners the \$2,096,701 under billed RET.

Agency Response

In its response, DOF agreed with three of the audit's seven recommendations. For the remaining four recommendations, DOF partially agreed with three and disagreed with one. Among other things, DOF specifically agreed that the Examiners should ensure that supporting documents, if required, are attached in order for RPTT returns to be filed; that DOF should provide adequate training to ensure that all Examiners and supervisors are properly and consistently reviewing and accepting the related documentation in accordance with the RPTT instructions; and that ACRIS should have functionality that enables it to automatically identify and require submission of most of the related documents, and claims that the system already has such functionality. At the same time, DOF maintains that "supporting documentation is used only for auditing the returns. The Examiners are not auditors, and if the returns meet the criteria for acceptance at the time of recording, they cannot reject the return and thereby delay the recording of the document, the filing of the return, and the posting of the taxes."

AUDIT REPORT

Background

DOF is responsible for administering the City's tax and revenue laws. For Fiscal Year 2018, it reported collecting approximately \$39 billion in revenue and valued more than one million properties worth a total market value of more than \$1 trillion. Among its taxing responsibilities, DOF is charged with collecting RPTT, billing and collecting RET, administering property tax exemption and abatement programs, and maintaining public property records related to real property ownership.

DOF's administration of the RPTT is governed by Chapter 23 Real Property Transfer Tax of the Rules of the City of New York (RCNY) and Chapter 21 Real Property Transfer Tax of the New York City Administrative Code. Further, DOF has issued several Standard Operating Procedures (SOPs) that make specific reference to aspects of RPTT return filing, review and payments which detail DOF's internal procedures for processing the returns. The RPTT applies to sales, grants, assignments, transfers or surrenders of real property in New York City, whenever the consideration exceeds \$25,000.⁴ It also applies to a sale or transfer of at least 50 percent of ownership in a corporation, partnership, trust, or other entity that owns/leases property, and to transfers of cooperative housing stock shares (herein collectively referred to as transfers).

RPTT rates vary depending on the property type and the consideration reported on the RPTT return.

- For residential properties (one-, two- or three-family homes, individual residential condominium units or individual cooperative apartments), if the consideration is \$500,000 or less, the RPTT is calculated using a 1 percent rate and a 1.425 percent rate if the consideration exceeds \$500,000.
- For all other properties (commercial transactions), if the consideration is \$500,000 or less, the RPTT is calculated using a 1.425 percent rate and a 2.625 percent rate if the consideration exceeds \$500,000.

Of the total RPTT collected in connection with commercial transactions greater than \$500,000, 38.095 percent of the RPTT collected goes to a special fund for the MTA—NYCT, the City Paratransit system and MTA Bus Company. Accordingly, on a monthly basis DOF electronically remits 96 percent of those receipts to NYCT, consisting of 90 percent earmarked for NYCT General Operations and 6 percent for the reimbursement of City Paratransit costs. DOF remits the remaining 4 percent to DOT as a subsidy for the MTA Bus Company.

In general, a notarized joint RPTT return must be filed by both the grantor (transferor) and the grantee (transferee) for all real property transfers whether or not the transfer documents (*e.g.*, deeds, leases, or development agreements) are to be recorded. Exceptions exist for a grant of a leasehold interest in a one-, two- or three-family house or in an individual dwelling unit, unless tax is owed or the lease is to be recorded. The taxpayer instructions for completing and filing RPTT returns list the supplemental schedules and related documentation required to be filed in conjunction with the return, which vary depending on the nature of the transferors and transferees

⁴ Consideration is the price actually paid or required to be paid for the real property or economic interest therein by money, property or any other thing of value.

(e.g., whether they are limited liability companies [LLCs], partnerships or individuals) and the specific conditions of the transfer (e.g., transfers pursuant to a marital settlement agreement or a divorce decree, and transfers by or to a tax exempt organization). These supplemental schedules and related documentation are necessary to enable DOF to verify information provided in the RPTT return about essential elements of the transaction for tax purposes.

RPTT returns filed for Manhattan, the Bronx, Brooklyn, or Queens properties must be created through DOF's Automated City Register Information System (ACRIS). The RPTT returns and the related documents can be submitted electronically through ACRIS, by mail, or in person. Based solely on the information provided by the taxpayer in the RPTT return, ACRIS automatically calculates the amount of the RPTT due. Approximately 10,000 RPTT returns are filed every month in ACRIS.

RPTT returns filed in connection with transfers of Staten Island properties are not filed in ACRIS, but rather the returns and associated documents are filed on paper hard copies with the Office of the Richmond County Clerk by mail or in person. On average, roughly 750 RPTT returns are filed with the Richmond County Clerk each month. Based on the information contained in these paper RPTT returns, the Richmond County Clerk staff manually calculates the amount of RPTT due. On a weekly basis, DOF collects the RPTT returns and related documents from the Office of the Richmond County Clerk, and manually inputs the RPTT return information into ACRIS and also scans any documents accompanying those returns into ACRIS as well.

In all five boroughs, RPTT returns are required to be filed and any tax due is required to be paid within 30 days of the transfer date. For Staten Island transfers, any tax due, if not prepaid to DOF, is required to be paid at the Office of the Richmond County Clerk.

DOF's Office of the City Register, which is part of DOF's Department of Land Records (Land Records), is responsible for examining the RPTT returns and associated documents in ACRIS for every borough except for Staten Island, and for recording and maintaining all property-related documents, including deeds, mortgages and leases.⁵ Review responsibilities for returns and property-related documents filed in Staten Island are handled by the Office of the Richmond County Clerk, Division of the County Register and that office has issued a separate SOP governing the Staten Island examination staff's paper reviews of RPTT returns. However, the purpose of the reviews is the same for all five boroughs, whether conducted through ACRIS or on paper.

According to Chapter 21, Section 11-2105(f) of the New York City Administrative Code, "The payment of, and the filing of returns relating to, the taxes imposed hereunder, shall be required as a condition precedent to the recording or filing of a deed, lease, assignment or surrender of lease or other instrument effecting a conveyance or transfer subject to such taxes." Section 11-2105(d) of the New York City Administrative Code also requires that "if a return when filed is incorrect or insufficient on its face the commissioner of finance shall take the necessary steps to enforce the filing of . . . a corrected return." In addition, as stipulated in Chapter 23, Section 23-09(c) of the Rules of the City of New York, the "[City] Register is also authorized to reject a return that states that there was no consideration for the deed unless there is attached to such return a statement setting forth the grounds upon which it is claimed that there was no consideration."

In 2018, Land Records was staffed by 85 employees including 24 Examiners and 3 Supervisors totaling 27 employees tasked with reviewing RPTT submissions, along with the deeds,

⁵ DOF is also responsible for examining the RPTT returns and the related documents in connection with non-recorded transfers in all five boroughs.

mortgages, leases and multiple other property-related submissions to DOF. Their responsibilities are, according to DOF's SOP #10 to ensure "completeness." SOP #3 specifies that Examiners' responsibilities include "perform[ing] the normal examination process and escalat[ing] suspected documents to [a] Supervisor for their review and possible referral to the Quality Review unit." Following this instruction, SOP #3 lists specific situations where escalation by Examiners should take place, including "NYC Real Property Tax Returns submitted with a missing or invalid Tax Payer Identification Number and not accompanied by an affidavit explaining the reason for the missing or invalid identification number" [Section 3.1(a)] and the submission of "[d]ocuments where the consideration is less than the property's assessed value." [Section 3.1(e)] DOF officials additionally stated that suspected documents include documents where the consideration is greater than zero and less than the property's assessed value.

According to Land Records officials, the City Register receives close to 3,000 submissions a day of all types (not just RPTT returns) and files and/or records roughly 1,500 to 2,500 documents a day, all of which are reviewed by this group of Examiners.

The Examiners are not given any specific training related to their reviews of RPTT returns. However, as a guide for Examiners, Land Records has established specific procedures for their reviews of RPTT returns and published them in SOP #3 *Quality Review*, and in SOP #10 *NYC Real Property Transfer Tax-Filing, Abatements, and Cancellations*. In addition, after receiving the preliminary draft report, DOF provided auditors with SOP #2 *Examination*, which provides detailed guidance to Examiners on their reviews of documents submitted for *recording* such as deeds and mortgages, but does not address their reviews of RPTT returns submitted for *filing*.⁶

To further help guide the Examiners in the performance of their functions, Land Records created an Examiner's Refresher Training Guide, a 47-page document that contains instructions for the Examiner's reviews of property-related documents submitted for recording, with limited RPTT related instructions. Additionally, Land Records provides an examination checklist, which identifies documents required to be submitted with filing both City and State transfer tax returns, and which primarily focuses on examinations of documents submitted for *recording*, such as deeds and other conveyances, rather than on records *filed* with the RPTT returns.

In addition to the review process conducted by the staff of Land Records, DOF has a separate Tax Audit unit that reviews RPTT returns. The returns audited by the Tax Audit unit are selected from all five boroughs based on a modeling system established by DOF's Audit Case Analysis and Recording (ACAR) unit. In connection with these audits, the Tax Audit unit verifies the RPTT amounts calculated by DOF for the sampled transfers. The Tax Audit unit operated with 9 auditors in Fiscal Year 2017 and 12 auditors in Fiscal Year 2018 and completed a total of 1,113 RPTT audits during our two-year scope period, Fiscal Years 2016 and 2017 (July 1, 2015 through June 30, 2017). The Tax Audit unit conducts its reviews based on an RPTT audit manual derived from applicable rules and regulations that govern the RPTT and related Statements of Audit Procedure. The unit's audits during our scope period required multiple levels of internal reviews, including by a supervisory group and the Quality Analysis Group, and were documented in both electronic and hardcopy formats.

For Fiscal Years 2016 and 2017, the City reported \$1,788,182,063 and \$1,418,683,372 in RPTT revenue, respectively, related to the approximately 159,000 recorded transfers for 173,000

⁶ The versions provided by Land Records officials for SOP #2 Examination, SOP #3 Quality Review, and SOP #10 NYC Real Property Transfer Tax-Filing, Abatements, and Cancellations were updated on September 28, 2018, February 9, 2018, and January 25, 2018, respectively. According to a Land Records senior official, whenever SOPs are updated, the old versions are not maintained and so that official represented that they did not have access to the versions in effect during the audit scope period.

properties identified by borough, block, and lot and 42,000 non-recorded transfers for 51,000 properties in all five boroughs.⁷ Of the RPTT revenue reported for Fiscal Years 2016 and 2017, \$12,048,008 and \$2,461,184 were recovered as the result of tax audits conducted for each of those respective years.⁸

The grantor of the property is typically responsible for paying the RPTT. However, if a governmental entity is transferring the property to a non-governmental entity, then the non-governmental entity is responsible for payment of the RPTT. In the case of a sale from a tax exempt entity (such as a governmental entity or a not-for-profit organization) to a *non-tax* exempt entity, all real estate tax exemptions based on the grantor's eligibility should be removed at the time of transfer.

Similarly, with regard to the RET, when a property is transferred from an exempt to a non-exempt owner, or when an exempt owner leases or uses a property for non-exempt purposes, all tax exemptions that are not applicable to the new owner or as a result of a non-eligible use, should also be removed and the RET should be restored. The RET is generally imposed on real property in all five boroughs, based on a property's assessed value and the current tax rate. When a tax exemption or abatement is granted, the taxable assessed value or the tax amount due on the property can be reduced. However, when an exemption is wholly or partially removed, the property owner should be billed for the RET, effective from a date as specified by the applicable provisions of the Real Property Tax Law.

Objectives

To determine whether DOF properly:

1. collected the RPTT;
2. calculated and remitted the portion allocable to the MTA from the RPTT collected; and
3. billed and collected the RET subsequent to a revocation of not-for-profit exemption.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The audit scope was Fiscal Years 2016 and 2017 (July 1, 2015 through June 30, 2017). Please refer to the Detailed Scope and Methodology at the end of this report for specific procedures and tests that were conducted.

⁷ One transfer can include one or more properties. Also, a property can be involved in multiple separate transfers. For example, a property can have a deed transfer and a development rights transfer.

⁸ For Fiscal Year 2018, \$36,710,688 in RPTT revenue was resulted from tax audits.

Discussion of Audit Results with DOF

The matters covered in this report were discussed with DOF officials during and at the conclusion of this audit. A preliminary draft report was sent to DOF and discussed at an exit conference held on June 5, 2019. On August 8, 2019, we submitted a draft report to DOF with a request for comments. We received a written response from DOF on August 23, 2019. In its response, DOF agreed with three of the audit's seven recommendations. For the remaining four recommendations, DOF partially agreed with three and disagreed with one.

Among other things, DOF specifically agreed that the Examiners should ensure that supporting documents, if required, are attached in order for RPTT returns to be filed; that DOF should provide adequate training to ensure that all Examiners and supervisors are properly and consistently reviewing and accepting the related documentation in accordance with the RPTT instructions; and that ACRIS should have functionality that enables it to automatically identify and require submission of most of the related documents, and claims that the system already has such functionality. At the same time, DOF maintains that "supporting documentation is used only for auditing the returns. The examiners are not auditors, and if the returns meet the criteria for acceptance at the time of recording, they cannot reject the return and thereby delay the recording of the document, the filing of the return, and the posting of the taxes." Accordingly, limitations on the Examiners' role notwithstanding, DOF acknowledges that regardless of whether the supporting documentation will ultimately be used for auditing purposes, certain related documents are required as part of the RPTT filing. Our recommendations, once implemented, would streamline DOF's RPTT and other documentation review processes.

The full text of DOF's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

Overall, we found that DOF's examination process for RPTT returns is limited and as a result, it cannot be reasonably assured that the returns are facially complete or sufficient, that taxpayers are providing all required documentation with their RPTT returns, and that the City is collecting the full amount of RPTT due and owed. Further, we found that DOF's policies and procedures related to the submission and review of RPTT returns were inconsistent, incomplete, and contained instructions for DOF employees that were contradicted by various DOF officials. These weaknesses increase the risk that the work of its Examiners charged with conducting a facial review of the returns will be ineffective and that the full amount of RPTT due will not be collected.

The scope and purpose of DOF's review of RPTT returns was described in various ways in different written DOF procedures and in explanations provided by DOF officials to the auditors. However, at an exit conference at which our preliminary findings were reviewed, a senior DOF official who has signed off on many of the written procedures repeatedly stated that DOF Examiners are responsible solely for checking for the presence of four items when they receive RPTT returns: (1) that the grantor and grantee information is provided; (2) that the returns are signed; (3) that the signatures are notarized; and (4) that a tax was paid. DOF officials maintained that DOF has not instituted a process whereby the Examiners review the submission of related documents to ensure that all additional necessary documentation is submitted with the returns or that the correct amount of taxes are paid.

Because DOF does not require that steps be taken as part of its examination processes to ensure that RPTT returns are facially correct or sufficient, and that the documentation taxpayers are required to file with their RPTT returns is in fact filed, DOF has not established adequate written policies and procedures for managing its receipt and review of RPTT returns and did not provide adequate training to and oversight of its examination staff. In addition, we found that a defect in ACRIS resulted in incorrect RPTT assessments being made. As a result of DOF's limited review and control weaknesses, in our sample of 179 RPTT returns, we identified approximately \$620,000 in potentially uncollected RPTT. Thus, we do not have reasonable assurance that DOF properly reviews RPTT returns and collects the full amount of RPTT due.

We also found that, based on the RPTT reported as due and paid, DOF did properly calculate the portion allocable to the MTA. Accordingly, based on the amount of RPTT collected, the full amount due to the MTA was remitted by DOF to NYCT and DOT.

With regard to the RET, we found weaknesses in DOF's billing and collection of that tax in situations where a change in property use or ownership should result in the revocation of an exemption, such as a property transferred from an exempt to a non-exempt party. We determined that for 26 of the transfers included in our audit sample, the RET was not appropriately applied, resulting in over \$2 million in uncollected taxes.

DOF's failure to institute sufficient controls over its RPTT and RET operations significantly increases the risk of inadequate collection and potential loss of City revenue and of funds due to the MTA.

DOF Response: "The report indicates that because of the limited review of the returns, 'it cannot be reasonably assured that the returns are facially complete or sufficient.' A definition of the meaning of 'facially complete or sufficient' in the context of an RPTT return is not provided. Facially complete and sufficient could be interpreted to mean that all

required schedules are complete and the return is signed and notarized. A deeper review, as described in the report, would seem to go beyond 'on its face' validation; such a review would be an audit function, and as noted, the examiners in the Office of the City Register are not auditors.

The report implies that the findings from the non-random sample of 179 RPTT returns support the conclusion that the current process 'significantly increases the risk of inadequate collection and potential loss of City revenue,' without acknowledging that the sample is a very small percentage of the overall number of returns submitted. It is possible for a reasonable person to conclude that the issues are relatively insignificant in relation to the overall number of returns processed and revenue collected."

Auditor Comment: For an RPTT return filed to be facially complete or sufficient, it should contain all of the required related documents discussed in this report. DOF in its audit response expressly states that it "agrees that the examiners should ensure that certain supporting documents are attached" to the RPTT returns filed with DOF. The report recommends that the Examiners be required to ensure that the RPTT returns they review contain all of the required related documents, not that they conduct a deeper review of the returns, as DOF erroneously suggests in its audit response.

With regard to the results of our review of 179 RPTT returns for which we identified approximately \$620,000 in potentially uncollected tax revenue, we neither state nor suggest that those results are projectable to the entire population of RPTT returns filed. Rather, in accordance with our auditing protocols, our reviews of a limited sample of RPTT returns are discussed to the extent they illustrate the potential significant effects of weaknesses we identified in DOF's internal controls over its RPTT review process. Principal among these weaknesses is our finding that the Examiners' did not ensure that the required related documents are filed with the RPTT returns, such as the documents necessary to substantiate the condition of transfer selected or the consideration reported, as required by the City's rules and regulations. In view of the limited audit reviews performed each year by DOF's Tax Audit unit, our findings discussed in the report can significantly increase the risk of inadequate collection and potential loss of City revenue.

The details of our findings are discussed in the following sections of this report.

Insufficient Controls over the Review of RPTT Returns

DOF has a limited examination process for RPTT returns and consequently, has not established sufficient internal controls to ensure that RPTT returns are properly reviewed. As a result, the City may not have collected the full amount of RPTT due. In our sample of 148 RPTT returns, we found that as much as \$505,518 in RPTT that may have been due was not collected.⁹

In particular, we found that DOF has not established procedures and processes that would enable it to effectively follow the rules and regulations governing its receipt of RPTT returns and RPTT payments. In addition, we found that it does not provide dedicated RPTT training for the Examiners and that the SOPs governing the Examiners' work in ACRIS do not sufficiently detail all the steps they are required to follow upon receipt of an RPTT return.¹⁰ These reviews are the

⁹ Thirty-one additional transfers (179-148) in our sample are discussed later in the report, in the section entitled *Defect in ACRIS Resulted in Incorrect RPTT Assessments Being Made*.

¹⁰ The particular related documentation that the filers are required to submit with their RPTT returns is specified in the filing instructions the filers receive with the returns.

first (and often the only) opportunity DOF has to detect incomplete, incorrect and/or possibly fraudulent returns.

According to Comptroller's Directive #1, *Principles of Internal Control*, internal controls are required to help ensure that management's directives are properly carried out. Such controls are a fundamental part of an agency's policies and procedures, and function as a means of enforcing management's directions.

DOF Did Not Adhere to the Rules and Regulations Governing Its Review of RPTT-Related Documents

According to Chapter 21, Section 11-2105(f) of the New York City Administrative Code,

The payment of, and the filing of returns relating to, the taxes imposed hereunder, shall be required as a condition precedent to the recording or filing of a deed, lease, assignment or surrender of lease or other instrument effecting a conveyance or transfer subject to such taxes.

Section 11-2105(d) of the New York City Administrative Code further requires that

if a return when filed is incorrect or insufficient on its face the commissioner of finance shall take the necessary steps to enforce the filing of . . . a corrected return.

In addition, as stipulated in Chapter 23, Section 23-09(c) of the Rules of the City of New York,

[The City] Register is also authorized to reject a return that states that there was no consideration for the deed unless there is attached to such return a statement setting forth the grounds upon which it is claimed that there was no consideration.

In our review of a sample of 148 RPTT returns from all five boroughs, we found that 59 (40 percent) of the returns were missing one or more of the related documents required by DOF to be filed with RPTT returns or were misfiled, for a total of 67 instances. Without these RPTT-related documents and the returns properly filed with the transfer documents, DOF may not be able to verify whether the appropriate RPTT was applied to the transfers. Specifically, we found:

- 55 instances where business partners and/or LLC members were not listed (including the names and social security numbers/employer identification numbers for each) on the returns as required by DOF's RPTT return instructions for transfers related to partnerships or multiple member LLCs. Of the transfers related to these 55 instances, 17 of them reported no consideration for the deed. DOF officials confirmed in a meeting and in an email that examination staff are supposed to look for the list of LLC members where transfers involve multiple LLCs. In addition, with regard to these 17 returns in our sample that reported zero consideration, RCNY Section 23-09(c) specifies that "[t]he Register is also authorized to reject a return that states that there was no consideration for the deed unless there is attached to such return a statement setting forth the grounds upon which it is claimed that there was no consideration." A membership list is essential to enable DOF to determine whether the correct RPTT was applied, based on factors such as the percentage change in ownership of a partnership/LLC, and the relationship between the grantor and grantee.
- Six instances of sales with consideration of or over \$400,000 where a contract of sale or closing statement was not included with the return as required by DOF's RPTT return instructions for such transfers. RCNY Section 23-09(a) also specifically mandates that "Where the consideration is \$400,000 or more, a copy of the contract of sale or closing

statement, if any, must be attached.” Similarly, Land Records’ examination checklist for the RPTT section states that a “Contract of Sale is required for purchase of [\$]400,000 or more.” A contract of sale or closing statement is required to verify that the consideration reflected on the RPTT return is correct.

- One instance where the reported “condition of transfer” the filer selected was “pursuant to a will or trust agreement.” However, neither a will nor a trust agreement was provided as is required by DOF’s RPTT return instructions. Land Records’ examination checklist for the RPTT section states that a “Trust Agreement or Will is required” where applicable. Without a copy of the will or trust agreement, DOF cannot determine whether the transfer is tax exempt or not.
- Two additional instances where the supporting documentation required in the RPTT instructions based on the condition of transfer selected by the filer in ACRIS were not submitted with the RPTT return: (1) a balance sheet related to a liquidation transfer; and (2) the official letters related to approval of claimed exemptions. DOF confirmed at a meeting held on July 20, 2018 and in an August 9, 2018 email that the transfer with missing official letters related to exemption approval as required by the RPTT return instructions “should have been rejected by the Examiner.” It was also confirmed at the same meeting that the Examiners should check whether the RPTT related documents submitted match the condition of transfer selected. However, in an email confirmation received on August 9, 2018, DOF officials stated that “[the Examiners] are not checking the document against the condition of transfer. They are just making sure that the condition of transfer is selected.” Accordingly, the understanding of DOF officials of the RPTT return review requirements appear to be inconsistent. Moreover, we note that without those supporting documents, however, DOF cannot ensure that the correct tax was in fact assessed.
- Three instances where RPTT returns were not correctly filed with the transfer documents. In two of these instances, the RPTT return was filed incorrectly with a lease instead of the deed. In one other instance, the RPTT return for our sampled property was filed with a document reciting consideration paid for a different property that was being transferred at the same time. DOF cannot be assured that the correct taxes were paid if the RPTT returns are not filed with the correct transfer documents.

At the exit conference, the DOF senior official stated that Land Records’ review of RPTT returns for “completeness” is limited to: (1) ensuring grantors and grantees information is provided; (2) that the RPTT return is signed; (3) that the signatures were notarized; and (4) that a tax is paid. This senior official further stated that it is not Land Records’ responsibility to ensure the completeness of the submission or to review any RPTT related documentation.

However, by not reviewing and ensuring that the RPTT returns were submitted with the appropriate related documents, DOF cannot be assured that the RPTT returns are correct and sufficient on their face or that taxpayers are paying and DOF is collecting the full amount of RPTT owed, as required by the New York City Administrative Code. DOF is charged with collecting RPTT. The Administrative Code of the City of New York puts the onus on DOF to ensure that “payment of, and the filing of returns relating to” the transfer of properties is correct and sufficient before an “instrument effecting a conveyance or transfer subject to . . . taxes” is filed. Administrative Code Section 11-2105(f). By not instituting sufficient controls to ensure the completeness of the RPTT filings, which includes all related documents, DOF increases the risk that it will not fulfill its mandate with respect to the filing of RPTT returns and the payment of any applicable taxes.

Of the 59 returns on file with DOF that were missing one or more required related documents or misfiled with an incorrect transfer document, we reviewed the full filings. We found that, based on the information contained in the RPTT returns and associated documents filed with them, it appeared that DOF had correctly assessed the RPTT due for 54 returns—which totaled \$6,186,126. However, we also found that five returns may have been incorrectly assessed by ACRIS as zero tax amount due and so the correct amount of tax may not have been paid.

We referred these five RPTT returns to DOF's Tax Audit unit for its review. In response to the referral, Tax Audit officials stated that four of these five transfers could possibly have been taxable, meaning that DOF's assessment in ACRIS of zero tax due may not have been correct as we noted. For the fifth RPTT return, Tax Audit officials stated that they needed to do further review to make any determination. However, they also stated that it is possible that all five of the assessments we questioned were simply change of identity transfers, which would have meant that they were not taxable.

Notably, as DOF's Tax Audit unit's inability to provide a definitive answer based on the information on file with DOF indirectly confirms, without the required RPTT related documents to substantiate the consideration reported on the five RPTT returns, DOF cannot determine whether the transfers were taxed appropriately. Thus, the agency's failure to ensure that required documents were filed along with the five questioned RPTT returns increased the risk that the RPTT for each of the five transfers was not properly assessed and collected. Using DOF's market value for the five properties and the applicable tax rates, we estimate that \$505,518 in RPTT may not have been collected.

DOF Response: “The report misstates the purpose of the 2015 request to begin including a member list. This list was not requested prior to 2015 because there was no need and the examiners have no grounds to reject a filing if the list is omitted or incomplete.”

Auditor Comment: According to the RPTT return instructions and the confirmation obtained at a meeting with a DOF official and examination staff, a member list is a required RPTT related documentation as part of the examination process. The report did not misstate the purpose of this request, rather, we explain the importance of the member list to verify the condition of transfer selected in the RPTT return.

DOF Provides Inadequate Guidance to Examiners Regarding the RPTT Review Process

As noted, in accordance with the DOF's RPTT instructions, different types of RPTT-related documentation must accompany RPTT returns filed with DOF, depending on the condition of transfer reported. With regard to RPTT returns related filings made in ACRIS, DOF's examination checklist and SOPs #3 and #10 do not provide explicit instructions to guide the Examiners' activities, but rather address aspects of the review process in general terms. Without a detailed checklist and specific instructions in the SOPs, Examiners do not have sufficient guidance to ensure that the RPTT returns they review contain all of the required related documents, as described in the previous section of this report.

Further, the Examiners do not receive clear and consistent instruction as to what exactly they are supposed to do when examining RPTT returns. For example, as noted, the SOPs applicable to returns filed in ACRIS require Examiners to review RPTT returns to ensure “completeness,” which includes “perform[ing] the normal examination process and escalat[ing] suspected documents to [a] Supervisor for their review and possible referral to the Quality Review unit.” However, DOF's

Land Records officials stated that the Examiners “are not checking the document[s submitted with the RPTT returns] against the condition of transfer. They are just making sure that the condition of transfer is selected.”

Moreover, the limited standard of review articulated by various DOF officials are inconsistent with the SOP’s requirement that “suspected documents” should be escalated by an Examiner to a Supervisor. As noted above, SOP #3 requires escalation of “suspected documents” to a Supervisor where, among other things:

- NYC Real Property Tax Returns [are] submitted with a missing or invalid Tax Payer Identification Number and not accompanied by an affidavit explaining the reason for the missing or invalid identification number, [Section 3.1(a)], and where
- Documents [are submitted] where the consideration is less than the property’s assessed value. [Section 3.1(e)]

DOF officials additionally stated that suspected documents include documents where the consideration is greater than zero and less than the property’s assessed value. Such an escalation cannot occur without the documents being reviewed.

Further, we note that the limited review mandate articulated by DOF officials is also inconsistent with the Richmond County Clerk’s SOP governing its reviews of RPTT returns, which states that the RPTT “form must contain . . . additional documentation as required for ‘Condition of Transfer’ checked” and that “returns which do not contain all of this information are not ‘complete’ and must be rejected.” In addition, information published on DOF’s web page dedicated to providing guidance to the taxpayers on how to create and properly fill out an RPTT return in ACRIS is also inconsistent with the limited review standard articulated by DOF officials. Specifically, DOF’s web page details the steps to be taken by taxpayers when they file RPTT returns, including the related documents that should accompany the returns.

We also note that Section 11-2105(d) of the New York City Administrative Code requires that “if a return when filed is incorrect or insufficient on its face the commissioner of finance shall take the necessary steps to enforce the filing of . . . a corrected return.” In addition, RCNY Section 23-09(c), states that the “[City] Register is also authorized to reject a return that states that there was no consideration for the deed unless there is attached to such return a statement setting forth the grounds upon which it is claimed that there was no consideration.” Under DOF’s existing procedures, the City Register is first and likely its only office that would have an opportunity to enforce the filing of a “corrected” return, reject a return that reports no consideration for the deed without setting forth the grounds upon which it is claimed that there was no consideration, and escalate suspect documents as required.

The Tax Audit unit provides the only other review outside of the Land Records, where the Examiners are charged with flagging documents for additional review. Given that Tax Audit completed only 1,113 audits (0.6 percent of 201,313 recorded or non-recorded transfers in all five boroughs) during our audit scope period, the Examiner’s initial review of submitted documents is an essential means of ensuring complete RPTT related submissions. Accordingly, the absence of comprehensive and consistent written procedures that provide clear guidance to the Examiners consistent with the Administrative Code and the Rules of the City of New York increases the risk that they will fail to properly review the RPTT returns and consequently, that errors, omissions and fraud will go undetected and result in the City’s failing to collect the correct amount of taxes due.

DOF Response: “The Land Records Office has several SOPs that mention review of RPTT in the context of the specific jobs that are being performed. The examiners ensure that when required, an RPTT is attached to the document being recorded. These documents are mainly deeds, but there are other documents that might require the filing of the RPTT. The examiners are required to ensure that the RPTT is completed, signed, and notarized, and that the required tax noted on the return was paid.

DOF agrees that the examiners should ensure that certain supporting documents are attached. However, as noted in the RPTT instructions and in this report, the supporting documentation is used only for auditing the returns. The examiners are not auditors, and if the returns meet the criteria for acceptance at the time of recording, they cannot reject the return and thereby delay the recording of the document, the filing of the return, and the posting of the taxes.”

Auditor Comment: DOF does not directly address the audit finding that it failed to provide clear and consistent instructions and training to Examiners on their responsibility to ensure that all required documents are filed with RPTT returns. Instead, while the agency expressly acknowledges “that the examiners should ensure that certain supporting documents are attached” to the RPTT returns, DOF erroneously suggests that checking for the existence of required supporting documents would require Examiners to act as auditors. Such is not the case. Rather, ensuring that all the required RPTT related documents are filed with an RPTT return is not an audit function. However, it is fundamental to ensuring that the return, when filed, is correct and sufficient on its face, as required by Chapter 21, Section 11-2105(d) of the New York City Administrative Code.

Defect in ACRIS Resulted in Incorrect RPTT Assessments Being Made

To determine whether the RPTT was properly assessed through ACRIS, we identified and reviewed 31 transfers that had zero RPTT assessed and an arm’s length condition of transfer.¹¹ The results of our analysis of these RPTT filings indicate that DOF does not have sufficient controls in place in ACRIS to ensure that the proper RPTT rate is applied to all individual transfers. Based on the sample we reviewed, we found that at least \$110,884 in RPTT was not properly assessed through ACRIS. In addition, we found inappropriate tax rates applied to filings where the RPTT filers were able to manually override the automatic assessment of the tax rate made by ACRIS.

Zero Tax Rates Improperly Applied

As noted above, the RPTT rate applied to transfers varies based on the property type, condition and the consideration of a transfer, including multiple circumstances that could appropriately result in the applicable RPTT rate being assessed as zero. For example, where a property is reported as having been transferred as a gift with zero consideration, the RPTT rate would be zero and that amount would automatically be applied by ACRIS for such return filed electronically. In addition, when an arm’s length transfer is made between two tax exempt organizations or where

¹¹ In coming up with the 31 transfers for review, we included all recorded transfers with zero RPTT for our scope period, but excluded any transfers that had a value for a lien, credit, or exemption. Further, we excluded any that had an exempt grantor or grantee, such as a nonprofit or religious organizations. These 31 sampled transfers were reviewed in addition to the 148 sampled transfers discussed above. Please see the detailed Scope and Methodology section of this report for a more complete description of our sampling and tests.

either is the transferor or transferee, the RPTT rate would also automatically be determined to be zero by ACRIS based on the exemption status of the grantor or grantee.

Based on our review of 31 transfers that reported zero tax due on their RPTT returns, we found 13 transfers that appear to have had a RPTT rate inappropriately applied. Many of these errors resulted from that fact that the RPTT rate is automatically applied in ACRIS based on the information entered by the taxpayer when the return is prepared and submitted electronically. Although the system is capable of resetting the tax rate based on the revised information input in the system, we found that in 10 of our sampled cases, the system did not function as intended.¹² Rather, the tax rate was automatically applied by ACRIS when the RPTT returns were initially entered into the system, and it was not reset after the taxpayers electronically edited information in the returns that warranted a change in the tax rate that had been applied.

For example, in one transfer, the taxpayer reported a change in beneficial ownership of more than 50 percent and consideration of \$2,250,000 on an RPTT return. This transfer was subsequently determined through ACRIS to have a zero tax rate, apparently as a result of the taxpayer having initially entered information into ACRIS that would warrant a determination that no RPTT was due, but then making material changes in the information that was eventually submitted to DOF which indicated that, in fact, some RPTT was due. We found similar material revisions to the information supplied by the taxpayers for nine other RPTT returns in our sample, where revised information provided in the RPTT returns filed through ACRIS indicated taxable transactions, but where zero tax rates were applied. In these 10 instances, had the apparently correct RPTT rate been applied, we determined that \$95,635 in RPTT should have been imposed for these transactions.

Subsequent to the exit conference, ACRIS Finance Information Technology (FIT) provided evidence to substantiate the correction of this defect, for which a fix was deployed on April 16, 2019. However, without subsequent testing, we cannot confirm that the defect has been remediated.

DOF Response: “DOF acknowledges that there was a defect in ACRIS which caused the tax rate to be 0% in the circumstances described in the report. This defect has been corrected, and because ACRIS is public-facing, the auditors in the Office of the New York City Comptroller could, if they chose, validate that the defect no longer occurs. The non-random audit sample identified all 10 instances of the defect in the roughly 201,000 returns in the review period. The defect did impact returns outside the audit period, but the occurrence rate was similarly low, with roughly 10 additional instances for a total of approximately 20 in the 15-year history of ACRIS. Given the length of time ACRIS has been used for creating RPTT tax forms, such defects are very uncommon and as such should not be taken as an indication of the overall capability of ACRIS to correctly compute RPTT taxes.”

Auditor Comment: We appreciate DOF’s responsiveness to address the audit finding and that it corrected the defect noted within and beyond our audit scope.

¹² When a Staten Island taxpayer creates an RPTT return via ACRIS, the tax rate will be determined by ACRIS, unless the taxpayer chooses to override it. However, Staten Island taxpayers are required to print out and submit the hardcopy to the Office of the Richmond County Clerk. Staten Island taxpayers can also prepare a return manually. Then the calculation will be based on the tax rate applied by the taxpayer. Notwithstanding, the Office of the Richmond County Clerk independently recalculates the RPTT, using the reported taxable consideration and the applicable tax rate.

Improper ACRIS Tax Rate Assessments

Two of the 13 erroneous applications we found in our sample of a zero tax rate resulted from improper taxpayer overrides of the tax rates assessed in ACRIS. These improper overrides occurred as a result of the fact that taxpayers are allowed, in certain situations only, to override the tax rate in the system. Those situations are supposed to only be: (1) where a specific condition of the transfer requires an alternate tax rate (e.g., a related party transfer); or (2) when the transfer is related to court order or bankruptcy. However, in two transfers identified in our sample we found manual overrides, although the transfers otherwise appear to be subject to the RPTT and neither RPTT return specified either of the permissible reasons for overriding the applied tax rate. Had the apparently correct tax rates been applied to these two sampled transfers, \$6,699 would have been due from the taxpayers.

In one additional instance where we identified a transfer that appeared to have improperly been assessed to have a zero tax rate, we found that the taxpayer reported a transfer of a two-family dwelling with consideration of \$600,000 between unrelated parties, but reported that there was no change in beneficial ownership and consequently the RPTT was calculated to be zero. In this instance, because the percentage of transfer was over 50 percent, RPTT was, in fact due on this transfer. Had an RPTT rate been applied, \$8,550 would have been due from the taxpayer.

ACRIS is not equipped with the functionality to flag RPTT returns with overridden tax rate or zero percentage change in beneficiary ownership when a consideration is being reported. Had it been, these errors may not have gone undetected by the Examiners.

DOF's Response to Our Sampled Findings

We brought the 10 cases where ACRIS appears to have incorrectly applied a zero tax rate to otherwise taxable transfers to the attention of officials from DOF's FIT unit, which is responsible for ACRIS application development and accordingly has knowledge of the system functions. According to these officials, the application of a zero tax rate in the cases we presented could have been the "result of a defect that occurs in the rare circumstance where the return preparer originally claimed a specific set of exemptions that properly would result in a 0% rate and then reversed the choice. ACRIS incorrectly did not reset the rate back to its proper non-zero value."

We also brought all 13 of the transfers we identified from our sample of 31 that appear to have improperly been assessed with a zero RPTT rate to the attention of DOF's Tax Audit unit: the 10 transfers identified as having an improper zero tax rate automatically applied by ACRIS; the 2 transfers we identified where the taxpayers appear to have made improper system overrides that lowered the RPTT rate assessed to zero; and the one instance where apparent inconsistent information entered into the system resulted in an erroneous assessment of a zero tax rate. Officials from that unit reviewed each of the transfers based on the filed returns and the related documents filed with them. According to the Tax Audit unit officials, two of the transfers may have been the result of an ACRIS issue, that is, ACRIS appeared to have incorrectly applied a zero tax rate where the information in the system indicated that it did not apply. Further, the Tax Audit officials stated that the other 11 also "seem taxable" based on the information in ACRIS, but cautioned that some or all of those 11 transfers may be non-taxable for reasons not disclosed in the returns that were filed.

Our findings reflect that ACRIS has critical control weaknesses that can result in inaccurately low tax rates being applied to RPTT filings. However, DOF does not have a mechanism in place to ensure that the correct RPTT was assessed aside from the limited number of audits performed

by the Tax Audit unit. None of the 13 sampled transfers we found problems with were selected by Tax Audit for review.

Recommendations

DOF should:

1. Revise its written procedures for Examiners to follow and should provide instructions for conducting RPTT reviews that are consistent with the instructions provided to RPTT filers with the returns and with the City's rules and regulations. Such revised written procedures should include detailed steps the Examiners should take when reviewing the returns and the related documents that should accompany the returns in every situation and be consistently applied for all five boroughs;

DOF Response: "The Department of Finance partially agrees with this recommendation. DOF will review its SOP[s] to ensure that the requirements for acceptance of an RPTT are consistent in each SOP and that they match the instructions provided to RPTT [filers]. However, examiners are not required to perform a detailed review of the supporting documentation that might be required to accompany the RPTT."

Auditor Comment: DOF erroneously suggests that we recommend that the Examiners perform a detailed review of the supporting documentation. We do not. Rather, our recommendation is that there should be consistent written procedures that include detailed steps for the Examiners to take to ensure that the RPTT returns they review contain all of the required related documents as discussed in the report.

2. Provide adequate RPTT training for Examiners and Supervisors to ensure that RPTT related documentation is reviewed properly and consistently;

DOF Response: "DOF agrees with this recommendation. We will continue to train staff to ensure that all examiners and supervisors are properly and consistently reviewing and accepting the related documentation as per the RPTT instructions."

Auditor Comment: We appreciate DOF's representation that it agrees with this recommendation, and urge the agency to not simply "continue to train staff" as they have previously, since as we note above, the Examiners have not been given any specific training related to their reviews of RPTT returns. But rather urge DOF to provide direct training to the Examiners related to their reviews of RPTT returns and required documents submitted for filing.

3. Review ACRIS' functionality to ensure that manual overrides can be made by tax filers only in permissible circumstances; and

DOF Response: "DOF agrees. This functionality already exists. A tax return preparer can only perform a manual override of the tax rate if either 'circumstances of this transfer require an alternative tax rate' or 'transfer is related to court order or bankruptcy.' Both are permissible circumstances for a manual override. When a return preparer indicates that either circumstance applies, the choice is flagged in the ACRIS

database and is subsequently passed to the Department of Finance's Audit Division for incorporation into audit models.

Please note that the override was used to set the tax rate to 0% for those transfers with consideration over \$25,000 that would normally have triggered tax in 247 out of 183,000 returns submitted through ACRIS and 20 of roughly 18,000 submitted through the Office of the Richmond County Clerk. This shows that the use frequency of this functionality in ACRIS is roughly one-tenth of 1% (0.13%), which matches the roughly one-tenth of 1% frequency (0.11%) rate seen at the Richmond County Clerk's Office.”

4. Consider expanding ACRIS' functionality to automatically identify and require the submissions of all the related documents DOF's RPTT return instructions direct taxpayers to submit with their RPTT returns and to further automatically identify the “suspected documents” to preempt incomplete submissions.

DOF Response: “DOF partially agrees. ACRIS already has functionality to automatically identify and require submission of related documents, but this functionality is only enabled for most of the related documents in DOF's RPTT return instructions.

DOF agrees that this is not enabled for all related documents. These requirements are then presented to the return submitter during a later required step of the submission process, and then to the examiners. As for ‘suspected documents,’ the audit report does not define this term, but it is a generally accepted term for the Office of the City Register and concerns deed, mortgage, and other possible fraudulent recordings. It is not directly related to RPTT return filing.”

Auditor Comment: In its response, DOF did not clearly explain how the requirements for those related documents that are not enacted can then be “presented to the return submitter during a later required step of the submission process, and then to the examiners.” We continue to recommend that DOF should consider to expand its ACRIS functionality to require the submission of all the RPTT related documents. Regarding the “suspected documents,” the report cited two examples from the “suspected documents” listed in DOF's SOP that are both directly related to RPTT return filing. Our recommendation to expand ACRIS' functionality can deter, in each case, filers' completion of the RPTT return without providing the necessary information or selecting the appropriate condition of transfer to justify the reported consideration.

DOF Failed to Ensure RET Is Properly Billed Following Property Transfers That Cause Changes to Tax Exempt Status

DOF did not apply the RET in a timely manner subsequent to full or partial revocation of not-for-profit exemptions, which resulted in \$2,096,701 of under billed RET in the 90 returns we sampled.¹³ To be eligible for an exemption under the not-for-profit law, a property must meet two

¹³ For the purpose of this audit, we sampled only transfers related to the revocation of not-for-profit exemptions and did not sample any other types of tax exemptions.

criteria: (1) the owner of the property must be a not-for-profit organization as recognized by being tax exempt by the Internal Revenue Service; and (2) the use of the property must be for an exempt purpose. According to Real Property Tax Law Section 520(1), when an exempt property is acquired and the new owner is not entitled to an exemption, the property is *immediately* subject to taxation and will be taxed pro rata for the unexpired portion of any fiscal year during which the transfer of title occurred and be liable in full for taxes in any fiscal year commencing subsequent to the date of transfer. In addition, Real Property Tax Law Section 420-a stipulates that if any portion of the exempt property is leased or used for non-exempt purposes, such portion shall be subject to taxation.

During our audit scope period, when a property transfer was filed with DOF, the information, including, particularly changes in ownership, was recorded in ACRIS, then extracted and uploaded to DOF's FairTax System and used as part of its determination of the RET to be assessed. Additionally, in determining the appropriate RET, DOF relied on information provided by the property owners in required annual exemption renewal forms. Among other things, in those forms, exempt owners are required to self-report any changes in ownership and use of the property, including specifically whether the owner is renting part of the property. In those cases where the property is being rented, the owner is required to attach the lease agreement for review. DOF may conduct property inspection by its assessors to verify the use of space.¹⁴

During our audit scope, DOF ran a weekly report of all ownership changes. If, based on information in that report of property ownership changes, a not-for-profit property exemption should be wholly or partially removed, an exempt property restored (EPR) bill was automatically issued by FairTax for the next billing cycle.¹⁵ DOF's Commercial Exemption unit is responsible for manually creating and issuing the EPR bills, and pursuant to Real Property Law Section 520(1), that bill should reflect the unexpired portion of the billing cycle during which the exemption is removed. However, as a result of computer system limitation, DOF does not automatically bill the taxpayer from the date a RET exemption is removed. Rather, we found that DOF did not start billing taxpayers for RET until the start of the next billing cycle where the change from tax exempt to taxable occurs in the middle of a billing cycle. As a result, we found that the City is forgoing a substantial amount of tax revenue.

Of the 90 sampled transfers reviewed, we found that 48 transfers resulted in removal of exempt status. Specifically, we found that properties associated with 24 (50 percent) of those 48 transfers were not billed at the new EPR for the period between the date of transfer or leasing and the date the next billing cycle began.¹⁶ As a result, in these sampled instances, DOF failed to collect the RET due for un-billed periods between 1 to 361 days, resulting in \$1,602,385 of under billed RET. For example, in one instance, a property was transferred from an exempt entity to a non-exempt entity on October 7, 2016. Although the non-exempt owner was billed starting the next billing cycle which commenced on January 1, 2017, no bill was issued for the period October 7, 2016 through December 31, 2016, the unexpired portion of the billing cycle during which the exemption was removed. This omission resulted in a failure to bill \$181,159 in tax due to the taxpayer. Similarly, DOF did not bill a non-exempt owner a total of \$227,035 for the period December 6, 2016 through December 31, 2016, the unexpired portion of the billing cycle that remained after the transfer of ownership to a non-exempt owner. DOF officials acknowledged that both taxpayers were not billed the EPR for the unexpired portion of the billing cycle.

¹⁴ According to DOF officials, properties that are exempt for religious purposes will not be inspected to verify for the property use.

¹⁵ The next EPR billing cycle begins on the first day of the quarter immediately following an exemption revocation.

¹⁶ We sampled a total of 90 transfers from a population of approximately 155,000 transfers representing the recorded transfers for properties in Tax Class 1, 2 and 4 in all five boroughs during our audit scope. Please refer to our detailed scope and methodology.

For the properties associated with the remaining 24 transfers that lost their tax exempt status prior to the beginning of the next tax billing cycle, we found that 22 of those were billed the EPR for the unexpired portion of the billing cycle. In those cases, the EPR was manually calculated by DOF.

Finally, for the remaining two of the 24 transfers, we found that DOF did not bill the RET from the time of transfer or leasing through the present, resulting in \$494,316 of unbilled RET, as of May 20, 2019. In one instance, the exempt owner did not indicate that the property had been leased to a non-exempt entity in its annual exemption renewal forms submitted for tax years 2017/2018 through 2019/2020. However, our review of ACRIS records found that this property has been leased to a non-exempt entity on March 1, 2017 for an initial term of 30 years. DOF did not bill the RET from March 1, 2017 through May 20, 2019, resulting in at least \$258,818 in unbilled RET. We brought this case to the attention of the Commercial Exemption unit. In response, the DOF officials confirmed our findings and stated that they are “revoking for 19/20 [exemption] and imposing charges back to lease date.”

In one other transfer in the sample of 90 we reviewed, we identified a property that had been sold by an exempt entity to a non-exempt LLC on December 3, 2015. The exempt entity is the single member of the LLC. An affidavit notarized on December 14, 2015, indicated that the exempt entity will continue to use the property for exempt purposes under a 25-year lease. According to DOF, this property should remain tax exempt, because the exempt entity is the single member of the non-exempt LLC. However, our review noted that the ruling referenced by DOF to support its view requires that the LLC “must also show that it is effectively a non-for-profit entity, organized or conducted for Section 420-a purposes” and must meet other requirements. The LLC’s Operating Agreement and Articles of Organization do not indicate that the non-exempt entity was organized for Section 420-a purposes. Accordingly, we question DOF’s failure to bill the RET in the amount of \$235,498 for the period from December 3, 2015 through May 20, 2019.

Recommendations

DOF should:

5. Consider upgrading its computer system to automatically impose RET from the date of the transfer that removes the exemption or otherwise effectively implement the requirement that taxpayers pay the full RET starting from the date a property changes from exempt to non-exempt, including by, as needed, revising policies and procedures to detail the requirements related to the billings for the unexpired portion of the billing cycle;

DOF Response: “DOF agrees. The agency has recently implemented a new computer system that will automatically restore a sold not-for-profit property directly to the tax roll as of the date of sale. The prior system would only restore the property as of the next billing cycle and the prorated portions of the current billing cycle required manual calculation and input.”

Auditor Comment: Although DOF’s new computer system will automatically restore a sold not-for-profit property directly to the tax roll as of the date of sale, the system should also restore to the tax roll exempt properties that are used for non-exempt purposes as of the exemption removal date. In addition, we continue to recommend that DOF revise their policies and procedures as needed.

6. Conduct unannounced site visits to ensure that properties are used for exempt purposes only; and

DOF Response: “DOF disagrees. The Department of Finance conducts annual exemption renewals of almost all not-for-profit properties and has done so since 2012-13 tax year. During this renewal process, DOF may inspect a property and request additional information regarding its use to determine if the exemption is correctly granted. DOF needs the property owner’s permission to enter the premises, just as the police do, and cannot conduct surprise inspections. However, a property owner who refuses access to a DOF assessor may have his or her property tax exemption reduced or revoked for the upcoming year.”

Auditor Comment: Unannounced site visits are effective to identify and deter any unreported ownership transfers or non-exempt property uses. As with DOF’s existing property inspection functions, when a property owner refuses access to an unannounced visit, DOF may have his or her property tax exemption reduced or revoked. Therefore, we continue to recommend that DOF conduct unannounced site visits.

7. Retroactively bill and collect from the owners the \$2,096,701 under billed RET.

DOF Response: “DOF partially agrees. The agency is in the process of charging the prorated periods prior to the system implementation of the exempt property restore charges. Some of this work was delayed while the new system was being implemented and the functionality of partial-year restorations of real estate taxes was on hold. That functionality is available now, and DOF will have all prorated periods restored to the tax rolls by the end of the calendar year.

DOF disagrees with the Comptroller’s Office recommendation to bill \$2[3]5,498 for two properties from December 3, 2015, through May 20, 2018. Neither of the two properties was transferred to for-profit or unrelated entities, but rather to limited liability corporations that were single-member entities of the grantor not-for-profit. The use of LLCs is common among not-for-profit entities to protect the assets of the organization and limit its liability for any tort claim on the property. ‘One City hospital has well over 100 properties that are owned in such a situation,’ all of which continue to qualify for an exemption.

Lastly, while the transfer of the Manhattan property referenced in the report (block 1245, lot 1001) did not result and should not have resulted in the imposition of real estate taxes due to the transfer, the Department of Finance removed the property’s exemption for tax year 2019-20 after review of the property indicated that it was not qualified for an exemption. DOF sent a change-by-notice letter to this organization on May 1, 2019, informing it of our decision.”

Auditor Comment: With respect to the transfer (block 448, lot 4) from an exempt entity to a non-exempt LLC on December 3, 2015, DOF’s own ruling, which was provided prior and subsequent to the exit conference, requires that the LLC “must also show that it is effectively a non-for-profit entity, organized or conducted for Section 420-a purposes” and must meet

other requirements. Accordingly, DOF should reassess this and other transfers to the same effect, and should bill and collect any under billed RET.

With respect to the property (block 1245, lot 1001) leased by an exempt entity to a non-exempt LLC, DOF does not explain in its response why the property “did not result and should not have resulted in the imposition of real estate taxes due to the transfer” although its review confirmed that the property was not qualified for an exemption. DOF’s response also contradicted its determination, confirmed to the auditors in an email sent on January 25, 2019, that would result in “revoking for 19/20 [exemption] and imposing charges back to lease date.” We continue to recommend that DOF should retroactively bill and collect \$258,818 in unbilled RET.

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The audit scope was July 1, 2015 through June 30, 2017. To obtain an understanding of the laws, policies and procedures that govern RPTT and RET, we reviewed and, where applicable, used as criteria the following documents:

- NYC Administrative Code, Chapter 21: Real Property Transfer Tax;
- The Rules of the City of New York, Chapter 23: Real Property Transfer Tax;
- NYC Real Property Transfer Tax Form and Instructions;
- Real Property Transfer Tax Manual for Tax Audit;
- Statement of Audit Procedures – Fair Market Value of Real Property PP-2008-23;
- Land Records’ Standard Operating Procedures #2 – Examination;
- Land Records’ Standard Operating Procedures #3 – Quality Review;
- Land Records’ Standard Operating Procedures #10 – NYC Real Property Transfer Tax-Filing, Abatements, and Cancellations;
- Land Records’ City Register Examination Checklist;
- Land Records’ Examiner’s Refresher Training Guide;
- Office of the Richmond County Clerk, Standard Operating Procedures for the Examination of Real Property Instruments;
- Real Property Tax Law Sections 520, 494 and 420-a;
- DOF’s Standard Operating Procedure – Not-For-Profit; and
- Comptroller’s Directive #1 – Principles of Internal Control.

To obtain an understanding of DOF’s policies, procedures and internal controls over the collection of the RPTT, we conducted walkthrough meetings with DOF’s Land Records and met with the staff to observe and understand their roles in reviewing and recording RPTT documentation. We also conducted a walkthrough meeting with officials at the Office of the Richmond County Clerk to obtain an understanding of how they process RPTT. We conducted a walkthrough with DOF’s Tax Audit unit, to obtain an understanding of its function and the computer system used to manage RPTT tax audits. Of the 1,113 audit cases completed during the fiscal years 2016 and 2017, we judgmentally selected and reviewed 10 cases based on the highest amount of “Payment Received” and type of “Primary Issue” and determined how they were assessed. To obtain an understanding of the modeling process for audit case selection, we met with DOF’s ACAR team.

To clarify issues related to ACRIS’ functionality, we conducted a walkthrough meeting with ACRIS FIT officials. To obtain an understanding of how the MTA allocable portion is calculated and

transferred, we met with DOF's Revenue and Budget Analysis and ACRIS FIT. To obtain an understanding of how the property owners are billed for RET, we met with officials of DOF's FIT and Property Division. The results of the meetings were documented in memoranda, flowcharted, and our understanding of the operations were confirmed in writing with DOF officials.

In April 2018, we received from ACRIS FIT a listing of 173,225 properties related to recorded transfers and 51,299 properties related to non-recorded transfers for our audit scope. To determine the reliability of the ACRIS data, we compared the sampled online (echeck and credit card) deposits and I-payments from sampled Wells Fargo bank accounts posted on July 25, 2016 to the ACRIS data. We also traced the sampled transfers for Staten Island from the Transmittal Advice to Richmond County's Real Property Official Record and to the ACRIS data. Finally, we traced sampled echeck payments recorded in ACRIS to the respective Wells Fargo bank account.

To determine whether DOF properly collected the RPTT, we conducted the following tests:

- We randomly selected 68 transfers, from the population of 153,611 properties for recorded transfers in Manhattan, the Bronx, Brooklyn, and Queens, and determined whether the RPTT was properly assessed. Additionally, we reviewed the sampled transfers to determine whether a contract of sale or closing statement was filed.
- From the ACRIS data, we judgmentally selected 80 transfers: 30 arm's-length transfers from Tax Class 1, 2, 4 properties in Manhattan, the Bronx, Brooklyn and Queens that had no consideration; 30 arm's length transfers from Tax Class 1, 2, 4 properties in Manhattan, the Bronx, Brooklyn and Queens that had a consideration amount of \$400,000 or more, 10 transfers from Staten Island that had no consideration and 10 transfers from Staten Island with a consideration of \$400,000 or more. We then selected from each group the 10 largest variances between consideration and DOF's property market value. For these sampled transfers, we determined whether the RPTT was properly assessed.
- To determine whether the required RPTT documentation for the 148 sampled transfers (68 + 80) were properly submitted and reviewed by Land Records, we reviewed the RPTT returns and related documents for each of these transfers.
- To determine whether RPTT was properly assessed, we reviewed all 31 transfers that had zero RPTT from the 151,819 properties based on the arm's length condition of transfer, from Tax Class 1, 2, 4 properties in Manhattan, the Bronx, Brooklyn and Queens. Specifically, we excluded any transfers that had a value for lien, credit, or exemption. Further, we excluded any properties that had a grantor or grantee that was RPTT exempt, such as nonprofits, religious organizations, schools/universities, etc.
- To determine whether transfers with a consideration greater than zero and less than DOF's assessed value were properly reviewed and assessed, we judgmentally selected 10 transfers from Tax Class 1 properties, because it contained the largest number of transfers of the four tax classes. We filtered the total population of 81,379 properties by arm's length condition of transfer and by "Fee type interest" (e.g., when a sale of property occurs). We subtracted DOF's assessed value from the consideration per the RPTT return, filtered by transfers that provided consideration per the RPTT return for any amount above \$10, and selected the first 10 transfers that had the largest negative difference. We excluded any transfers that had any value for lien, credit, and exemption.

To determine whether DOF properly calculated and remitted the portion allocable to the MTA from the RPTT collected during our audit scope, we judgmentally selected June 2017, the last month of the audit scope period, for our review. We recalculated the portion allocable to the MTA for the

month of June 2017 using ACRIS data and compared it with DOF's Monthly City Register Activity and Revenue Report, ACRIS MTA Split Report, ACRIS MTA Split Detail RPTT Report, RPTT Monthly MTA report for Interest and Penalty, Payment Voucher, Tax Audit's RPTT Cash Report and Incremental MTA Revenue.

To determine whether DOF adequately billed and collected the RET subsequent to a transfer or a revocation of a not-for-profit exemption, we judgmentally selected 90 transfers for our review. Initially, we filtered the 157,224 transfers for Tax Class 1, 2, and 4 properties in five boroughs with tax exempt grantors (nonprofits, religious organizations, schools/universities) and non-exempt grantees (entities that should be paying taxes) and obtained a population of 107 transfers. Of those 107, we randomly selected 42 transfers. Further, we requested exemption data from DOF for the recorded and non-recorded transfers for our audit scope. We filtered the 153,312 recorded and non-recorded transfers in all five boroughs, by using six legal references: 420-a (houses of worship, religious organizations), 420-b (library, historical, etc.), 406(1) (city government organizations), 412a (NYC industrial development, IDA – PILOT), 404(1) (state government organizations) and 486 (non-profit medical and dental indemnity and HIP center). We then filtered by grantees that were LLCs and then by grantors that were not LLCs or for profit organizations and obtained a population of 164 transfers. Of these, we randomly selected 48 transfers for the audit testing. For the total of 90 sampled transfers, we reviewed the account history, exemptions and assessed values retrieved from DOF's NYCProperty website, property history retrieved from DOF's Digital Tax Map website, FairTax screen shots, annual exemption renewal submissions and related letter ruling obtained from DOF.

The results of the above tests, while not projectable to their respective populations, provided a reasonable basis for us to evaluate and support our findings and conclusions regarding whether or not DOF properly collected the RPTT, calculated and remitted the portion allocable to the MTA from the RPTT collected, and billed and collected the RET due upon a revocation of not-for-profit exemption.



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Annette M. Hill
Assistant Commissioner & City Register

August 23, 2019

Ms. Marjorie Landa
Deputy Comptroller for Audit
Office of the City Comptroller
1 Centre Street, Room 1100 North
New York, NY 10007

Re: Audit Report on the New York City Department of Finance's Collection of the Real Property Transfer Tax and New Real Estate Taxes (FM18-093A)

Dear Deputy Comptroller Landa:

I am pleased to share the Department of Finance's formal response to the New York City Office of the Comptroller's draft report entitled "Audit Report on the New York City Department of Finance's Collection of Real Property Transfer Tax and New Real Estate Taxes (FM18-093A)," dated August 8, 2019.

Introduction:

Currently, the New York City Administrative Code requires that all real property transfer tax (RPTT) returns for transfers in the five boroughs be created in the E-tax section of the Automated City Register Information System (ACRIS). The returns for the boroughs of Manhattan, the Bronx, Brooklyn, and Queens are submitted for filing to the Office of the City Register at the time of document recording. Returns for Staten Island associated with recordable documents are submitted to the Office of the Richmond County Clerk.

The E-tax section of ACRIS forces the return preparer to complete all required primary schedules and any required sub-schedules. As such, ACRIS only allows the return preparer to print a final return when the return is essentially complete on its face. Once printed, the only required items missing from the return are the notarized signatures of the grantors and grantees.

All real property transfer tax returns for transfers in Manhattan, the Bronx, Brooklyn, and Queens must be submitted with cover pages created in ACRIS. The Cover Page section of ACRIS validates that the RPTT return has been completed in the E-tax section of ACRIS and printed. Further, the Cover Page section of ACRIS conditionally requires submission of most supporting

documentation requested in the RPTT instructions via a supporting document check list. The remaining supporting documents requested in the instructions, but for which ACRIS is not currently configured to explicitly require in the checklist, are nonetheless listed on the checklist as optional supporting documents. The supporting documentation to be included with the RPTT return is listed on the cover page and is visible as an additional reminder to the submitter and to City Register staff.

Examiners in the Office of the City Register review documents submitted for recording along with the filing of the RPTT returns. The examiners are charged with ensuring that the documents submitted to the Office of the City Register meet the statutory requirements for recording; that the RPTT returns are completed, signed, and notarized; that the required tax noted on the return is paid; and, if required, that supporting documents are attached. The examiners are not auditors, and if the returns meet the criteria for acceptance at the time of recording, the examiners cannot reject and thereby delay the recording of the document, the filing of the return, and the posting of the taxes.

All return details for transfers are submitted to the Department of Finance's Treasury & Payment Services Division for recording in the agency's business tax system (BTS). These details include flags indicating whether the tax rate was overridden, information about transfers and schedules that may have reduced the tax paid, and all details sufficient to determine whether the return instructions requested additional supporting documentation. The Audit Case Analysis & Reporting group runs models of filed RPTT returns from the BTS database and selects transfer returns deemed audit-worthy. These candidates for audit are then assigned to the Audit Division for review. The auditors have the ability and expertise to conduct a thorough review of the filed returns.

As ACRIS enforces completeness of the fields on the RPTT return, the examiners in the Office of the City Register review and confirm that the returns are signed and notarized, with the following certification:

I swear or affirm that this return, including any accompanying schedules, affidavits and attachments, have been examined by me and is, to the best of my knowledge, a true and complete return made in good faith, pursuant to Title 11, Chapter 21 of the Administrative Code and the regulations issued thereunder.

Analysis of Audit Findings and Conclusions:

Insufficient Controls over the Review of RPTT Returns

The report indicates that because of the limited review of the returns, "it cannot be reasonably assured that the returns are facially complete or sufficient." A definition of the meaning of "facially complete or sufficient" in the context of an RPTT return is not provided. Facially complete and sufficient could be interpreted to mean that all required schedules are complete and the return is signed and notarized. A deeper review, as described in the report, would seem to go beyond "on its face" validation; such a review would be an audit function, and as noted, the examiners in the Office of the City Register are not auditors.

The report implies that the findings from the non-random sample of 179 RPTT returns support the conclusion that the current process “significantly increases the risk of inadequate collection and potential loss of City revenue,” without acknowledging that the sample is a very small percentage of the overall number of returns submitted. It is possible for a reasonable person to conclude that the issues are relatively insignificant in relation to the overall number of returns processed and revenue collected.

The report misstates the purpose of the 2015 request to begin including a member list. This list was not requested prior to 2015 because there was no need and the examiners have no grounds to reject a filing if the list is omitted or incomplete.

DOF Provides Inadequate Guidance to Examiners Regarding the RPTT Review Process

The Land Records Office has several SOPs that mention review of RPTT in the context of the specific jobs that are being performed. The examiners ensure that when required, an RPTT is attached to the document being recorded. These documents are mainly deeds, but there are other documents that might require the filing of the RPTT. The examiners are required to ensure that the RPTT is completed, signed, and notarized, and that the required tax noted on the return was paid.

DOF agrees that the examiners should ensure that certain supporting documents are attached. However, as noted in the RPTT instructions and in this report, the supporting documentation is used only for auditing the returns. The examiners are not auditors, and if the returns meet the criteria for acceptance at the time of recording, they cannot reject the return and thereby delay the recording of the document, the filing of the return, and the posting of the taxes.

Defect in ACRIS Resulted in Incorrect RPTT Assessments Being Made

DOF acknowledges that there was a defect in ACRIS which caused the tax rate to be 0% in the circumstances described in the report. This defect has been corrected, and because ACRIS is public-facing, the auditors in the Office of the New York City Comptroller could, if they chose, validate that the defect no longer occurs. The non-random audit sample identified all 10 instances of the defect in the roughly 201,000 returns in the review period. The defect did impact returns outside the audit period, but the occurrence rate was similarly low, with roughly 10 additional instances for a total of approximately 20 in the 15-year history of ACRIS. Given the length of time ACRIS has been used for creating RPTT tax forms, such defects are very uncommon and as such should not be taken as an indication of the overall capability of ACRIS to correctly compute RPTT taxes.

Our responses to the report’s recommendations follow:

1. DOF should revise its written procedures for Examiners to follow and should provide instructions for conducting RPTT reviews that are consistent with instructions provided to RPTT filers with the returns and with the City’s rules and regulations. Such revised written procedures should include detail steps the Examiners should take when reviewing the returns and the related documents that should accompany the returns in every situation and be

consistently applied for all five boroughs.

The Department of Finance partially agrees with this recommendation. DOF will review its SOPS to ensure that the requirements for acceptance of an RPTT are consistent in each SOP and that they match the instructions provided to RPTT filers. However, examiners are not required to perform a detailed review of the supporting documentation that might be required to accompany the RPTT.

2. DOF should provide adequate RPTT training for Examiners and Supervisors to ensure that RPTT related documentation is reviewed properly and consistently.

DOF agrees with this recommendation. We will continue to train staff to ensure that all examiners and supervisors are properly and consistently reviewing and accepting the related documentation as per the RPTT instructions.

3. DOF should review ACRIS functionality to ensure that manual overrides can be made by tax filers only in permissible circumstances.

DOF agrees. This functionality already exists. A tax return preparer can only perform a manual override of the tax rate if either “circumstances of this transfer require an alternate tax rate” or “transfer is related to court order or bankruptcy.” Both are permissible circumstances for a manual override. When a return preparer indicates that either circumstance applies, the choice is flagged in the ACRIS database and is subsequently passed to the Department of Finance’s Audit Division for incorporation into audit models.

Please note that the override was used to set the tax rate to 0% for those transfers with consideration over \$25,000 that would normally have triggered tax in 247 out of 183,000 returns submitted through ACRIS and 20 of roughly 18,000 submitted through the Office of the Richmond County Clerk. This shows that the use frequency of this functionality in ACRIS is roughly one-tenth of 1% (0.13%), which matches the roughly one-tenth of 1% frequency (0.11%) rate seen at the Richmond County Clerk’s Office.

4. DOF should consider expanding ACRIS functionality to automatically identify and require the submission of all the related documents DOF’s RPTT return instructions direct taxpayers to submit with their RPTT returns and to further automatically identify the ‘suspected documents’ to preempt incomplete submissions.

DOF partially agrees. ACRIS already has functionality to automatically identify and require submission of related documents, but this functionality is only enabled for most of the related documents in DOF’s RPTT return instructions.

DOF agrees that this is not enabled for all related documents. These requirements are then presented to the return submitter during a later required step of the submission process, and then to the examiners. As for “suspected documents,” the audit report does not define this term, but it is a generally accepted term for the Office of the City Register and concerns deed, mortgage, and other possible fraudulent recordings. It is not directly related to RPTT return filing.

5. DOF should consider upgrading its computer system to automatically impose RET from the date of the transfer that removes the exemption or otherwise effectively implement the requirement that taxpayers pay the full RET starting from the date a property changes from exempt to non-exempt, including by, and needed, revising policies and procedures to detail the requirements related to the billings for the unexpired portion of the billing cycle.

DOF agrees. The agency has recently implemented a new computer system that will automatically restore a sold not-for-profit property directly to the tax roll as of the date of sale. The prior system would only restore the property as of the next billing cycle and the prorated portions of the current billing cycle required manual calculation and input.

6. DOF should conduct unannounced site visits to ensure that properties are used for exempt purposes only.

DOF disagrees. The Department of Finance conducts annual exemption renewals of almost all not-for-profit properties and has done so since the 2012-13 tax year. During this renewal process, DOF may inspect a property and request additional information regarding its use to determine if the exemption is correctly granted. DOF needs the property owner's permission to enter the premises, just as the police do, and cannot conduct surprise inspections. However, a property owner who refuses access to a DOF assessor may have his or her property tax exemption reduced or revoked for the upcoming year.

7. DOF should retroactively bill and collect from the owners the \$2,096,701 under billed RET.

DOF partially agrees. The agency is in the process of charging the prorated periods prior to the system implementation of the exempt property restore charges. Some of this work was delayed while the new system was being implemented and the functionality of partial-year restorations of real estate taxes was on hold. That functionality is available now, and DOF will have all prorated periods restored to the tax rolls by the end of the calendar year.

DOF disagrees with the Comptroller's Office recommendation to bill \$245,498 for two properties from December 3, 2015, through May 20, 2018. Neither of the two properties was transferred to for-profit or unrelated entities, but rather to limited liability corporations that were single-member entities of the grantor not-for-profit. The use of LLCs is common among not-for-profit entities to protect the assets of the organization and limit its liability for any tort claim on the property. "One City hospital has well over 100 properties that are owned in such a situation," all of which continue to qualify for an exemption.

Lastly, while the transfer of the Manhattan property referenced in the report (block 1245, lot 1001) did not result and should not have resulted in the imposition of real estate taxes due to the transfer, the Department of Finance removed the property's exemption for tax year 2019-20 after review of the property indicated that it was not qualified for an exemption. DOF sent a change-by-notice letter to this organization on May 1, 2019, informing it of our decision.

Thank you for the opportunity to respond to the draft audit report, and please do not hesitate to contact the Department of Finance if you have further questions.

Sincerely,



Annette M. Hill
Assistant Commissioner & City Register

cc: Jeffrey Shear, Deputy Commissioner, Treasury & Payment Services
Pierre Dejean, Assistant Commissioner, Property Exemptions Administration
Robertsanti Curro, Senior Director, Excises Taxes & Non-Field Units
Celia Carino, Director of Internal Audit
Robert Hartman, Internal Auditor
George Davis III, Deputy Director, Audit Services, Mayor's Office of Operations