AUDIT REPORT

CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF FINANCIAL AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on the Tax Classification of Real Property in the Borough of Bronx by the Department of Finance

FP05-120A

June 30, 2005

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, §93 of the New York City Charter, my office has examined whether the Department of Finance (Finance) has adequate procedures to ensure that real properties in the borough of Bronx that are listed as Tax Class 1 on the assessment rolls are correctly classified. The results of our audit, which are presented in this report, have been discussed with Finance officials, and their comments have been considered in preparing this report.

Audits such as this provide a means of ensuring that property owners are being correctly billed for real estate taxes in accordance with the New York City Real Property Tax Law.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at audit@Comptroller.nyc.gov or telephone my office at 212-669-3747.

Very truly yours,

William C. Thompson, Jr.

WCT/gr

Report: **FP05-120A**
Filed: **June 30, 2005**

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AUDIT REPORT IN BRIEF

This audit determined whether the Department of Finance has adequate procedures in place to ensure that mixed-use properties in the borough of Bronx that are listed as Class 1 on the assessment rolls are correctly classified. The scope of this audit covered tax assessments for Fiscal Year 2005.

Audit Findings and Conclusions

The audit found that Finance does not have adequate procedures in place to ensure that mixed-use properties in the borough of Bronx that are listed as Class 1 on the assessment rolls are correctly classified. Although Finance routinely inspects Class 2, 3, and 4 properties to ensure that they are correctly classified on the assessment rolls, it does not conduct such inspections of Class 1 properties. Instead, Finance inspects Class 1 properties only when it is informed by the Department of Buildings that the properties are being altered or renovated.

We identified 59 properties listed as Class 1 on the assessment rolls that appeared to be misclassified. Using Finance guidelines, we determined that these properties should have been classified as Class 4. Had these properties been correctly classified, we calculate that Finance would have billed the owners an additional $431,171 property taxes for Fiscal Year 2005 and subsequent years.

Audit Recommendations

We recommend that Finance should:

- Inspect the properties identified in this report and confirm whether they are misclassified.
- Make the necessary adjustments to the assessment rolls for the properties that are misclassified.

- Conduct annual inspections of all Class 1 mixed-use properties and a sample of all other Class 1 properties to ensure that they are properly classified on the assessment rolls.

INTRODUCTION

Background

The Department of Finance (Finance) administers and enforces the tax laws; collects taxes, judgments and other charges; educates the public about their rights and responsibilities with regard to taxes and tax benefit programs in order to achieve the highest level of voluntary compliance; provides service to the public by assisting in resolving customer problems; and protects the confidentiality of tax returns. Finance processes parking summonses and provides an adjudicative forum for motorists who wish to contest them. It also provides collection enforcement services for court-ordered private and public sector debt.

In accordance with the New York City Real Property Tax Law (RPTL), Finance classifies every parcel of property in New York City for real-estate tax purposes. The tax classifications are:

- *Class 1*: Residential properties (with three units or less) and "Mixed Commercial/Residential Use" (mixed-use) properties (with three or less units) provided 50 percent or more of these spaces are used for residential purposes. This includes the following types of primarily residential property: one-, two-, and three-family homes, condominiums of three stories or less that were originally built as condominiums; condominiums of three dwelling units or less that were previously one-, two-, or three-family homes; single-family homes on cooperatively owned land (also known as bungalows); and certain vacant land zoned for residential use or, if not in Manhattan south of 110th Street, vacant land adjoining improved Class 1 property.

- *Class 2*: All other primarily residential properties, including any residential condominiums not in Class 1. This includes co-ops but does not include hotels, motels, or similar property.

- *Class 3*: Real estate of utility corporations and special franchise properties, excluding land and certain buildings.

- *Class 4*: All other properties, such as stores, warehouses, hotels, and any vacant land not classified as Class 1.

Properties are assessed at certain percentages of their full market value based on their classification. In general, Class 1 properties are assessed at six percent of market value and Class 2, 3, and 4 properties are assessed at 45 percent of market value.

The Property Division is responsible for producing a fair, accurate, and legal assessment roll each year. Finance assessors are responsible for valuing properties in their assigned areas. In that regard, assessors assure that properties are assigned to the correct building class and tax class; that physical characteristics of the building, including the square footage, are recorded accurately; and that properties are valued in accordance with assessment roll guidelines and general appraisal rules.

During Fiscal Year 2004, Finance collected $11.4 billion in property taxes. According to Finance records, there were 947,533 taxable properties, consisting of 688,205 Class 1 properties, 179,607 Class 2 properties, 406 Class 3 properties, and 79,315 Class 4 properties.

This is the third of a series of audits currently being conducted on Finance tax classification procedures. The first audit covered the borough of Brooklyn[1] and the second audit covered the borough of Queens[2]. Audits of Manhattan and Staten Island properties will be covered in separate reports.

Objective

The objective of this audit was to determine whether Finance has adequate procedures in place to ensure that mixed-use properties in the borough of Bronx that are listed as Class 1 on the assessment rolls are correctly classified.

Scope and Methodology

This audit covered tax assessments for Fiscal Year 2005 (July 1, 2004 to June 30, 2005).

In order to fulfill our objective, we reviewed applicable provisions of the RPTL. We met with Finance officials to obtain an understanding of the regulations governing the classification of real property and Finance procedures for ensuring that properties are correctly classified.

Finance provided us with a list of 1,247 Class 1 mixed-use properties in the Bronx. We selected all 1,247 properties in the borough of Bronx for review. In February 2005, we visited each of the properties to determine whether they were correctly classified. Our determination was based on the percentage of commercial space at each of the properties, since properties with more than 50 percent of the space used for commercial purposes cannot be classified as Tax Class 1—§ 1802 of the RPTL states that "all one, two and three family residential real property, including such dwellings used in part for nonresidential purposes but which are used **primarily** [Emphasis Added] for residential purposes," are to be classified as Class 1 properties. Properties that are more than 50 percent commercial cannot be considered "primarily for residential purposes." For the properties we noted that were misclassified, we applied formulas provided by

[1] Audit Report on the Tax Classification of Real Property in the Borough of Brooklyn by the Department of Finance (FP04-059A), issued August 2, 2004.

[2] Audit Report on the Tax Classification of Real Property in the Borough of Queens by the Department of Finance (FP04-149A), issued June 2, 2005.

Finance to calculate the amount of additional tax due based on the appropriate tax classification for each property.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

Discussion of Audit Results

The matters covered in this report were discussed with officials from Finance during and at the conclusion of this audit. A preliminary draft report was sent to Finance officials and was discussed at an exit conference held on June 7, 2005. On June 8, 2005, we submitted a draft report to Finance officials with a request for comments. We received a written response from Finance officials on June 24, 2005.

In its response, Finance stated that it "continues to implement significant initiatives and safeguards to ensure adequate procedures are in place to accurately assess all properties in the City of New York." Finance also indicated that it has implemented two of the report's three recommendations, but it did not agree with the recommendation that annual inspections of all Class 1 mixed-use properties and a sample of all other Class 1 properties be conducted to ensure that they are properly classified on the assessment rolls. Finance stated that the law requires only that Class 1 properties be inspected every three years. In any case, Finance indicated that it will be using new technology to complete virtual inspections of 100 percent of properties every year, which is line with the intent of our recommendation.

The full text of the comments received is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

Finance does not have adequate procedures in place to ensure that mixed-use properties in the borough of Bronx that are listed as Class 1 on the assessment rolls are correctly classified. Although Finance routinely inspects Class 2, 3, and 4 properties to ensure that they are correctly classified on the assessment rolls, it does not conduct such inspections of Class 1 properties. Instead, Finance inspects Class 1 properties only when it is informed by the Department of Buildings that the properties are being altered or renovated. Consequently, 59 mixed-use properties were listed as Class 1 on the assessment rolls that appeared to be misclassified.

> ***Finance Response:*** In its response, Finance took exception with the amount of additional Fiscal Year 2005 property taxes that the report stated would have been billed to owners had the properties been properly classified. Specifically Finance stated:
>
> "The methodology used . . . to determine additional tax due for Fiscal Year 2005 appears to contravene the governing statute (RPTL § 1805) which requires that all assessment

changes, even after a reclassification, be phased in over five years except assessment changes due to improvements or alterations are not subject to the phase in.

"Accordingly, the Report overstates that an additional $431,171 in property taxes for Fiscal Year 2005 and subsequent years would have been collected on 59 properties apparently misclassified as Class 1 rather than Class 4. (based on a sample of 1,247 properties). The actual amount is significantly less because, as indicated, state law (RPTL §1805) requires that assessment increases be phased in over five years. Furthermore, since only 34 buildings actually require reclassification, the amount of additional taxes collected for the properties identified in this audit is $51,106."

Auditor Comment: Although Finance contends that only 34 buildings are to be reclassified and that the amount of additional taxes due for Fiscal Year 2005 is $51,106, it did not provide information on which properties it agreed to change to class 4 or when these properties should have been changed. Moreover, Finance did not provide information about any improvements or alterations to the properties, which would have eliminated the requirement for a phase-in period. As Finance pointed out in its response, "the phase in requirement applies in cases of reclassification in the absence of additions or improvement to the property." Clearly, photographs of some of the properties we cited in the audit indicate that these properties underwent major improvements and alterations. Therefore, the phase-in requirement would not be applicable in these cases.

Finance's failure to provide us with the information mentioned above prevented us from determining the validity of the Department's claim that the additional taxes would be $51,106. In any case, the salient point is not the amount of money due, rather it is that the properties should be properly classified in accordance with the RPTL.

Improper Classification of Mixed-Use Properties

Our inspection of the 1,247 mixed-use properties revealed that 59 were misclassified. These properties should have been listed as Class 4 because more than 50 percent of the properties' space was used for commercial purposes. Had those 59 properties been correctly classified, we calculate that Finance would have billed the owners an additional $431,171 in property taxes for Fiscal Year 2005 and subsequent years (based on each year's tax rate and the assessed value of the properties).[3]

Examples of misclassified properties are as follows:

- 2250 Westchester Avenue was listed on the assessment rolls as a "Primarily Two-Family with One Store or Office" (Tax Class 1, Building Code S2). Our inspection of the property disclosed that the building had a realty office on the first floor and an office on the second floor. (See Appendix I for a photograph of the property.) Accordingly,

[3] We recognize that according to Real Property Tax Law §1805, Finance will have to phase-in the additional taxes over a five-year period. The $431,171 that was calculated assumed that the properties were always correctly classified as class 4 properties, therefore, no phase-in would have been required.

Finance should have classified this property as a "Store Building; 2-Story or Store/Office" (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property $2,605 rather than the $11,417 due based on the appropriate Class 4 tax classification.

- 626 City Island Avenue was listed on the assessment rolls as a "Primarily Two-Family with One Store or Office" (Tax Class 1, Building Code S2). Our inspection of the property disclosed that the entire building was used as a realty office. (See Appendix II for a photograph of the property.) Accordingly, Finance should have classified this property as a "Store Building; One Story" (Tax Class 4, Building Code K1). For Fiscal Year 2005, Finance billed the owner of this property $2,584 rather than the $9,349 due based on the appropriate Class 4 tax classification.

- 1128 Morris Park Avenue was listed on the assessment rolls as a "Primarily One-Family with One Store or Office" (Tax Class 1, Building Code S1). Our inspection of the property disclosed that the entire building was used as a professional building. (See Appendix III for a photograph of the property.) Accordingly, Finance should have classified this property as a "Professional Building" (Tax Class 4, Building Code O7). For Fiscal Year 2005, Finance billed the owner of this property $3,799 rather than the $15,578 due based on the appropriate Class 4 tax classification.

- 3935 White Plains Road was listed on the assessment rolls as a "Primarily Two-Family with One Store or Office" (Tax Class 1, Building Code S2). Our inspection of the property disclosed that the building had a store on the first floor and a law office on the second floor. (See Appendix IV for a photograph of the property.) Accordingly, Finance should have classified this property as a "Store Building; 2-Story or Store/Office" (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property $2,291 rather than the $11,975 due based on the appropriate Class 4 tax classification.

- 5602 Broadway was listed on the assessment rolls as a "Primarily Two-Family with One Store or Office" (Tax Class 1, Building Code S2). Our inspection of the property disclosed that the building had a bar on the first floor and a law office on the second floor. (See Appendix V for a photograph of the property.) Accordingly, Finance should have classified this property as a "Store Building; 2-Story or Store/Office" (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property $3,213 rather than the $16,544 due based on the appropriate Class 4 tax classification.

Recommendations

Finance should:

1. Inspect the properties identified in this report and confirm whether they are misclassified.

Finance Response: "We agree. Finance has inspected all the identified properties and has reclassified properties that Finance agreed were misclassified."

2. Make the necessary adjustments to the assessment rolls for the properties that are misclassified.

   Finance Response: "We agree. Finance has made the necessary adjustments to the '06/'07 tentative assessment roll for the properties Finance agreed were misclassified."

3. Conduct annual inspections of all Class 1 mixed-use properties and a sample of all other Class 1 properties to ensure that they are properly classified on the assessment rolls.

   Finance Response: "We disagree. By law, Finance is only required to inspect Class 1 properties every three years. Through the use of state-of-the art technology, Finance will in effect be collecting property specific information on an annual basis. The agency is currently working with the Department of Information, Technology and Telecommunication (DoITT) to utilize digital photography data collected from several flyovers of the City that were completed over the last five years. Finance will also utilize new technology to obtain digital front face photos of all properties in the City of New York. Together with the flyover photos and data, these front face photos will change the way we do business. As result, Finance will be completing virtual inspection of all New York City properties every year."

   Auditor Comment: Our purpose in recommending these inspections is to ensure that properties are properly classified and that the City does not forgo additional property taxes. Therefore, we acknowledge that Finance's using new technologies to complete virtual inspections of 100 percent of properties every year is consistent with the intent of the recommendation.

APPENDIX I

<u>2250 Westchester Avenue</u>: Finance records inaccurately listed this property as a "Primarily Two-Family with One Store or Office (Tax Class 1, Building Code S2)

APPENDIX II

626 City Island Avenue: Finance records inaccurately listed this property as a "Primarily Two-Family with One Store or Office (Tax Class 1, Building Code S2)

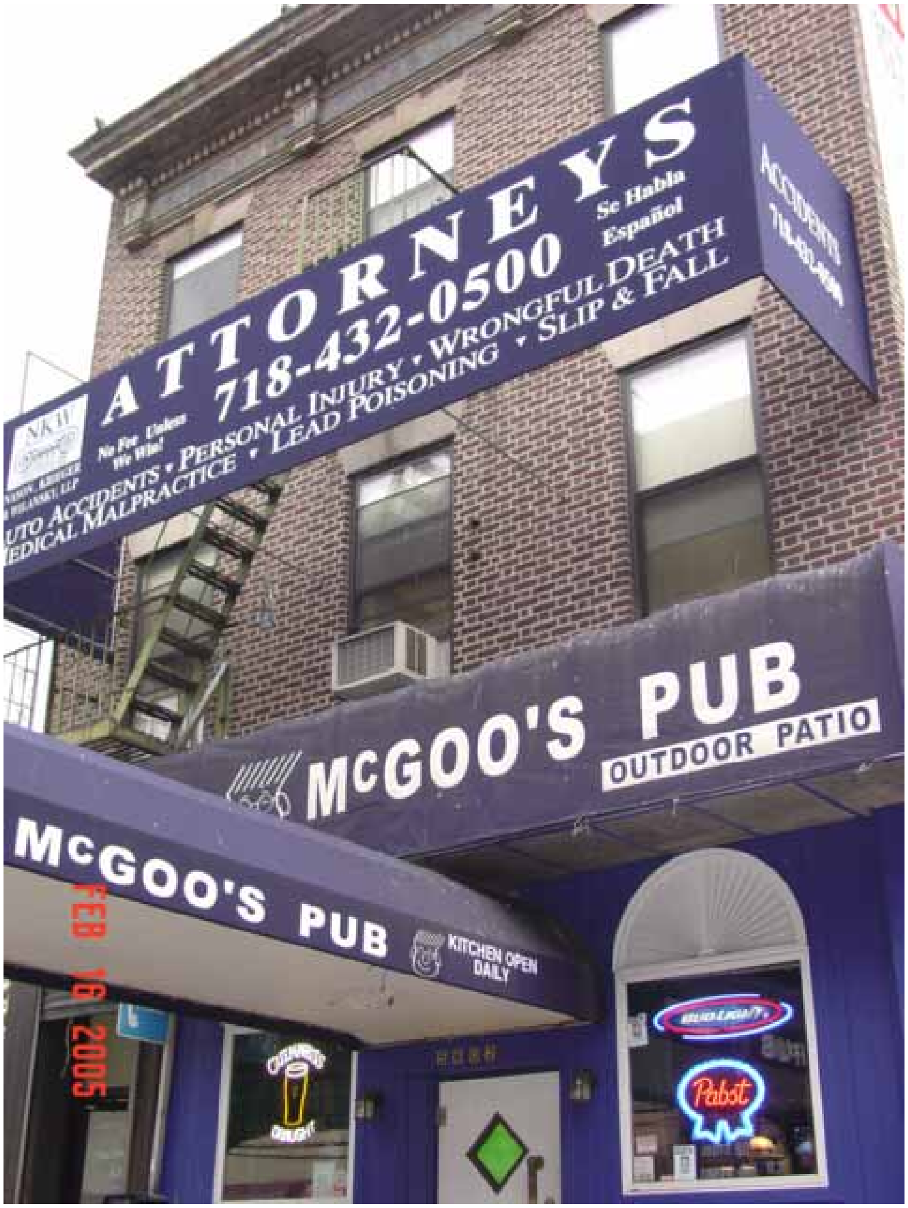
APPENDIX III

<u>1128 Morris Park Avenue</u>: Finance records inaccurately listed this property as a "Primarily Two-Family with One Store or Office (Tax Class 1, Building Code S2)

APPENDIX IV

<u>3935 White Plains Road</u> : Finance records inaccurately listed this property as a "Primarily One -Family with One Store or Office (Tax Class 1, Building Code S1)

APPENDIX V



5602 Broadway: Finance records inaccurately listed this property as a "Primarily Two-Family with One Store or Office (Tax Class 1, Building Code S2)

FINANCE
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THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

BY FAX AND HAND DELIVERY

June 24, 2005

Mr. Greg Brooks
Deputy Comptroller
Office of the Comptroller
1 Centre Street
New York, NY 10007-2341

Re: Audit Report on the Tax Classification of Real Property in the Borough of Bronx by the Department of Finance FP05-120A

Dear Mr. Brooks:

Thank you for the opportunity to respond to the City of New York Office of the Comptroller ("Comptroller") Draft Audit Report on the Tax Classification of Real Property in the Borough of Bronx by the New York City Department of Finance ("Finance").

The Department of Finance continues to implement significant initiatives and safeguards to ensure adequate procedures are in place to accurately assess all properties in the City of New York. The agency appreciates the efforts of your audit staff and acknowledgment of the progress made through the use of new technologies.

Before responding to the specific findings and recommendations of this audit it is necessary to refer back, however, and to reiterate Finance's response to Audit FP04-149A on the Tax Classification of Real Property in Queens, which included an overview of the governing statute's (RPTL § 1805) requirements for phase in of tax increases on properties for a change in class in the absence of improvements or alterations. Once again, the methodology used by the audit staff to determine additional tax due for Fiscal Year 2005 appears to contravene the governing statute (RPTL § 1805) which requires that all assessment changes, even after a reclassification, be phased in over five years except assessment changes due to improvements or alterations are not subject to the phase in. This was also referenced at the agency exit conference on June 7th. There is case law and opinions by the New York State Office of Real Property Services that support Finance's adherence to the requirements of RPTL § 1805 as indicated in our response to the audits of the Boroughs of Queens (and also Brooklyn). Although the audit does indicate on page 5, footnote 3, that it recognizes the five-year phase-in requirement, it bases its dollar estimate of taxes lost on the assumption that no phase-in would have been required if the properties were always correctly classified as Class 4. As there is no basis for such an assumption, especially in light of the fact that many of the properties are still correctly classified as Class 1, the practical effect is as if the Comptroller audit staff set aside the reality of RPTL § 1805 and its five-year phase-in requirement for this particular audit.

Accordingly, the Report overstates that an additional $431,171 in property taxes for Fiscal Year 2005 and subsequent years would have been collected on 59 properties apparently misclassified as Class 1 rather than Class 4.(based on a sample of 1,247 properties). The actual amount is significantly less because, as indicated, state law (RPTL § 1805) requires that assessment increases be phased in over five years. Furthermore, since only 34 buildings actually require reclassification, the amount of additional taxes to be collected for the properties identified in this audit is $51, 106.

Of the five sample properties specifically cited as being misclassified as Class 1 rather than Class 4, further inspection as recommended by the audit revealed that two require no change at all and were correctly classified, one required change but not as indicated by the audit staff, and two required change as indicated. Of the 59 properties, Finance has subsequently inspected, 25 required no change in classification, while 34 did, however, of these, not all the changes reflected the audit staff's conclusions and would generate lesser dollar amount tax projections even before the five-year phase in difference is factored.

The report suggests that Finance implement three recommendations. Below are the recommendations and Finance's comments:

Recommendation 1:

Inspect the properties identified in this report and confirm whether they are misclassified.

Finance's Response:
We agree. Finance has inspected all the identified properties and has reclassified properties that Finance agreed were misclassified.

Recommendation 2:

Make the necessary adjustments to the assessment rolls for the properties that are misclassified.

Finance's Response:

We agree. Finance has made the necessary adjustments to the '06/'07 tentative assessment roll for the properties Finance agreed were misclassified.

Recommendation 3:

Conduct annual inspections of all Class 1 mixed-use properties and a sample of all other Class 1 properties to ensure that they are properly classified on the assessment rolls.

Finance's Response:
We disagree. By law, Finance is only required to inspect Class 1 properties every three years. Through the use of state-of-the art technology, Finance will in effect be collecting property specific information on an annual basis. The agency is currently working with the Department of Information, Technology and Telecommunication (DoITT) to utilize digital photography data collected from several flyovers of the City that were completed over the last five years. Finance will also utilize new technology to obtain digital front face photos of all properties in the City of New York. Together with the flyover photos and data, these front face photos will change the way we do business. As a result, Finance will be completing virtual inspection of all New York City properties every year.

If you have any questions concerning this response, please feel free to call me at (212) 669-4878.

Sincerely,

Michael Koslow

Michael Koslow
Audit Coordinator

Cc: Martha E. Stark, Commissioner, Department of Finance
Rochelle Patricof, First Deputy Commissioner, Department of Finance
Dara Ottley-Brown, Assistant Commissioner, Property, Department of Finance