



Office of the City Auditor

INFORMATION CALENDAR
June 2, 2009

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Business License Tax Program Audit Report Fiscal Year 2008

SUMMARY

The attached Business License Tax (BLT) Program Audit Report conveys the results of the Auditor's Office BLT program audits during fiscal year 2008 (FY08). The Business License Tax audits initiated during FY08 were of Berkeley residential rental properties and automotive repair shops. All cases selected for audit appeared to be unlicensed or underreporting tax due the City.

CURRENT SITUATION AND ITS EFFECTS

Total payments collected during fiscal year 2008 from Business License Tax audits totaled \$105,976.

The Business License Tax Program Audit had 77 open cases, which included 16 cases carried forward from the prior year. Twenty residential rental properties, and 13 auto repair shops were billed a total of \$95,660 for unpaid taxes, penalties, and interest. There were 15 dropped/closed cases, and 2 provisionally billed cases totaling \$8,869 at fiscal year-end. Provisionally billed auditees were tentatively billed using Rent Board information, pending receipt of requested documentation to verify gross receipts reported to the City. If City staffs' efforts to obtain rental gross receipts information for the 2 cases are not successful, the provisional billings become final.

As of June 30, 2008, 17 Business License Tax auditees owed the City \$149,173. Seven of these audit cases, with billed amounts totaling \$43,003, were forwarded to the Finance Department to have the unpaid audit assessments charged to the owners' property tax bills.

Since inception of the audit program in 1982, auditors have billed tax, penalties, and interest totaling nearly \$5 million. Revenue identified is not a one-time windfall but becomes part of the future revenue stream, assuming auditees pay the correct tax in subsequent years. For each \$100,000 identified by audit, about \$18,667 in recurring tax can be expected for each future year, as long as the audited businesses continue to generate consistent gross receipts.

In addition, BLT audit work acts as a deterrent to those who might consider underreporting or neglect to obtain a license.

POSSIBLE FUTURE ACTION AND FISCAL IMPACTS

The Auditor's Office billed approximately \$157,000 in Business License tax, penalties, and interest during FY09 (a 64% billing increase from FY08) and expects to collect \$169,000 in BLT payments.

In FY10, the Auditor's Office and Finance are planning a joint effort aimed at increasing Business License tax revenues by identifying unlicensed businesses and billing them for unpaid Business License tax, penalties, and interest.

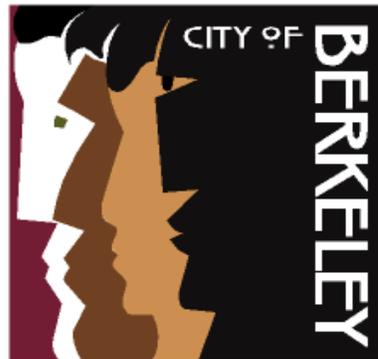
CONTACT PERSON

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Attachment

1: Business License Tax Program Audit Report Fiscal Year 2008

City of Berkeley



Business License Tax Program Audit Report

For Fiscal Year Ending June 30, 2008

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Presented to Council June 2, 2009

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BUSINESS LICENSE TAX AUDIT PROGRAM REPORT

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I. PURPOSE AND OBJECTIVE

The purpose of this report is to present the results of the City Auditor's Business License Tax (BLT) Audit Program for fiscal year 2008 (FY08).

The objective of the BLT Audit Program is to recover Business License revenues that the City might not otherwise receive because businesses or persons doing business in Berkeley did not procure a Business License, were delinquent in payment of tax, or under-paid the tax due.

II. SCOPE AND METHODOLOGY

The City Auditor's Office assesses compliance with the BLT ordinance by auditing entities and individuals engaged in business within Berkeley. The review period is based on compliance for the three most recent BLT calendar years at time of audit selection¹. A fourth BLT year may be incorporated into the review if the audit case has not been completed by March 1 (due date for business licenses), and we have identified the case as being unlicensed or underreported gross receipts.

Seventy-seven cases were audited during FY08. Sixty-one of these cases were initiated in FY08: 21 residential rental properties and 40 automotive repair business. The other 16 cases were carried over from FY07.

The residential rental property cases were identified by comparing Rent Board data² to the City's Occupational License (OL) data using Audit Command Language (ACL) data extraction and analysis software. Properties were selected for audit if Rent Board data indicated a property owner could charge significantly higher total rents than the gross receipts reported by taxpayers.

Automotive repair shops selected for audit were identified by comparing OL data to Franchise Tax Board, telephone directory, and City search website information. The automotive repair shops selected appeared to be unlicensed or reported much lower gross receipts than similar businesses in the same industry.

¹ The audit cases selected during July 1 through February 28 consisted of Business License years 2005, 2006, and 2007. Audit cases selected during March 1 through June 30 consisted of Business License years 2006, 2007, and 2008.

² Passage of Ballot Measure P: In November 2004 Berkeley voters passed Ballot Measure P, authorizing the amendment of the "Rent Stabilization and Eviction for Good Cause Ordinance". The Measure P amendment permits the City to use Rent Board information to help enforce other City ordinances, such as the Berkeley BLT ordinance. The Auditor's Office used this information to identify rental property owners who appeared not to have licensed their property or who appeared to have underreported the gross receipts used to calculate the BLT due.

The audited business owners were requested to provide supporting documentation for their reported gross receipts. The audits initiated in FY08 focused on gross receipts reported for BLT years 2005 through 2007. Audit cases carried over from FY07 focused primarily on business license tax years 2004 to 2007. Based on the information provided and/or compiled, the auditors billed business owners for unpaid BLT, plus penalties and interest, in accordance with Berkeley Municipal Code (BMC) Section 9.04.

BLT audit work was performed in accordance with Generally Accepted Government Auditing Standards for a performance audit. Audit work was limited to those areas specified in the scope and methodology section of this report.

III. BACKGROUND

A. General Information

The BLT ordinance was enacted in 1977 and is codified under Berkeley Municipal Code (BMC) Chapter 9.04. It was established solely for revenue purposes and is not meant to be a regulatory function. The Finance Department is responsible for the administration and collection of BLT revenue. The City received revenue from BLT totaling \$13,979,763 during FY08.

B. Annual Licensing Procedure

The BMC requires all individuals and entities engaged in business within Berkeley to obtain a Berkeley business license and to pay an annual license fee. Each December the Finance Department sends a BLT renewal form (Tax Declaration) to all applicable licensed businesses listed in the City's OL database. Taxpayers are instructed to identify their gross receipts, calculate the tax due, and return the form to the Finance Department with payment. Newly established businesses are required to obtain a business license within 15 days of commencing business.

BLT is generally assessed on a business' prior year gross receipts generated within Berkeley. However, in some instances the tax is assessed based on gross payroll, value added (gross receipts less value of raw materials), or a flat fee. The applicable BLT rates for the FY08 audit sample were 1) Rental properties, taxed at a flat fee of \$77, or at the rate of \$10.81 for each \$1,000 of gross receipts, whichever is higher; and 2) Automotive repair shops (classified under business, personnel and repair services), taxed at a flat fee of \$51, or at the rate of \$1.80 for each \$1,000 of gross receipts, whichever is higher.

All licenses are effective January 1 and expire December 31st. A business license is delinquent if not paid within thirty days after commencing business. A business license renewal is delinquent if payment is not received annually on or before February 28th. Delinquent businesses are assessed penalties.

These businesses are also assessed interest at the rate of one percent each month on unpaid taxes and penalties. Interest continues to accrue until paid.

Penalty for Non-payment or Underpayment

Type of Business	Number of Days Delinquent or Delinquent Date	Penalty on Unpaid Tax
New	After 30 days	10%
New	After 60 days	50%
Renewal	After February 28	10%
Renewal	After April 1	50%

IV. SUMMARY OF FY08 PROGRAM RESULTS

A. Audits Initiated

The City Auditor's Office initiated 61 new audit cases consisting of 21 residential rental property cases and 40 auto repair cases. The majority of the cases selected were licensed business owners who appeared to have paid taxes based on underreported gross receipts (basis for tax). Three cases appeared to be unlicensed. In addition to the 61 cases, 16 cases were carried over from the previous year.

B. Audit Activities and Assessments

The Auditor's Office assessed a total of \$99,200 in unpaid taxes, penalties, and interest. However, \$3,540 in taxes, penalties, and interest assessments was waived by Council, due to a code-misclassification within the City's OL system that affected two auto repair shop cases. Thirteen auto repair shops were assessed a net amount of \$42,871 in unpaid taxes, penalties, and interest, and 20 residential rental property owners were assessed a total of \$52,789 in unpaid taxes, penalties, and interest.

Summary of FY08 Audit Activity

Audit Activity for Residential Rental Properties and Auto Body Repair Shops	Audit Cases Carried Over From FY07 (I)	FY08 Initiated Audit Cases (II)	FY08 Total Audit Cases (I)+(II)
Total Audit Activity	16	61	77
Less: Billed Audits	(8)	(25)	(33)
Closed/Dropped Audits	(6)	(9)	(15)
Audit Cases Carried Over to FY09	2	27	29*

* Two of the audit cases have been provisionally billed. One case is from FY07, the other is from FY08.

FY08 Audit Assessment Composition

Audit Assessment Composition	Assessments for Cases Carried Over From FY07 Residential Rental Properties (I)	Assessments for Cases Initiated in FY08 Residential Rental Properties (II)	Assessments for Cases Initiated in FY08 Auto Repair Shops (III)	FY08 Total Assessment (I)+(II)+(III)
Unpaid BLT	\$ 14,064	\$ 15,056	\$ 26,645	\$ 55,765
Penalty Assessments	\$ 7,032	\$ 6,978	\$ 12,663	\$ 26,673
Interest Charges	\$ 5,364	\$ 4,295	\$ 7,103	\$ 16,762
Adjustment			(\$ 3,540)**	(\$ 3,540)
TOTAL	\$ 26,460	\$ 26,329	\$ 42,871	\$95,660
%	28%	27%	45%	100%

** Waived by Council. Refer to Section B of this report for more information.

C. Provisional Audit Assessments

Provisional audit assessments are interim billings based on Rent Stabilization Board data. If a residential rental property owner declines several requests to provide gross receipts documentation that support BLT taxes due, they are provisionally billed. When a provisional bill is issued, the auditee is asked to pay the assessment and/or file an appeal, or provide the requested documentation. If the auditee continues to be non-responsive, the provisional bill becomes final. Because

provisional assessments are subject to change prior to finalization, they are not included in the "FY08 Audit Assessment Composition" table above.

In FY07, five audit cases were issued provisional assessments totaling \$20,744 (tax, penalties, and interest), and carried over to FY08. The invoice status of four of these cases changed from provisional to final invoices totaling \$16,867.

Two provisional audit assessments totaling \$8,869 were not finalized as of June 30, 2008 (one of which originated in FY07). In these cases, property owners were requested to present supporting documentation to substantiate their claims. These cases were carried over to FY09.

D. Audits Dropped/Closed

A review of City records and documentation provided by the auditees resulted in 15 cases being dropped or closed. Cases are "closed" if an auditee can prove they are in compliance with the BLT Ordinance. Cases may be "dropped" if the statute of limitations has been exceeded. Cases may also be "dropped" if the auditors determine that the information available at the time of sample selection was inaccurate.

E. Issuance of Administrative Citations

Five administrative citations were issued during FY08. In December 2006 Council granted the auditor job classifications the authority to issue administrative citations to auditees who are not in compliance with BMC 9.04.285 or 9.04.035. The issuance of an administrative citation serves as a means to address BMC violations and to promote quick resolution of the audit cases.

F. Business License Tax Appeals

Two rental property owners appealed their BLT audit assessments. One owner cancelled the scheduled appeal hearing and never rescheduled. The second property owner obtained an appeal hearing in which the Hearing Officer waived \$608.31³ of the \$14,439 audit assessment. Auditees have the opportunity to appeal BLT audit assessments to the Hearing Officer in the City Manager's Office, by submitting a written appeal request, within 30 calendar days from the date of a final or provisional invoice.

G. Audit Cases Referred to Finance

Adequate Documentation Not Provided

One audit case initiated in FY08 will be transferred to Finance. Cases are referred to the Finance-Revenue Collection Division for follow-up when the auditee fails to:

³ The waived amount is comprised of \$315.30 in taxes and \$293.01 in penalties and interest.

- Respond to audit letters and telephone calls,
- Provide the auditor with adequate documentation to perform an audit, or
- Pay the administrative citation issued by the auditor.

Unpaid Audit Assessments

As of June 30, 2008, the BLT accounts receivable consisted of 17 cases totaling \$149,173. Seven of the 17 cases, with billed amounts totaling \$43,003, were forwarded to Finance to lien.

The Auditor’s Office provides the Finance-Revenue Collections Division with accounts receivable reports identifying the audit cases that have been assessed by the auditors and for which payments have not been received. Finance staff uses various means to collect BLT due, including adding the unpaid audit assessments to the property owners tax bill.

H. Projected Business License Tax Revenue

Business License Tax revenue from compliance audits has historically been projected at \$125,000 to \$150,000 annually per full-time equivalent (FTE) employee assigned. There was 0.84 FTE assigned to the program during FY08, including supervisory time. In FY08, for every dollar spent on salaries, fringe benefits, and BLT Program administration, the auditors identified and billed approximately \$1.00 in BLT penalties and interest.

Billings are expected to increase by at least 64% in FY09.⁴ Cash collected from BLT audits is anticipated to increase in FY09 by at least 60%.⁴ The BLT revenue identified during our audits is not a one-time windfall, but becomes a part of the future revenue stream.

FY08 Total Billed	FY08 Auditor Salaries*	Ratio
\$95,660	\$93,658	1.02: 1

** Auditor Salaries = auditor salaries + supervisory salaries + fringe benefits divided by .80 to account for vacation, sick leave, training, and other administrative time.*

I. Collections

BLT audit collections totaled \$105,976 during FY08. Of this, \$65,944 was collected from prior year billings, including a total of \$22,214, collected by the County Assessor’s Office through the owner’s property tax bills.

⁴ Year-to-date FY09 records indicate billings totaling approximately \$157,000, and expected cash receipts totaling \$169,600.

J. Business License Tax Program Database Improved

The Auditor's Office maintains its BLT program audits in a Microsoft Access database. During FY08, the auditors also invested staff time updating and modifying the BLT system to facilitate data entry, reporting, and information retrieval that helps manage the BLT audits more efficiently. These continued improvements reduce the amount of time the auditors spend verifying and reconciling BLT information.

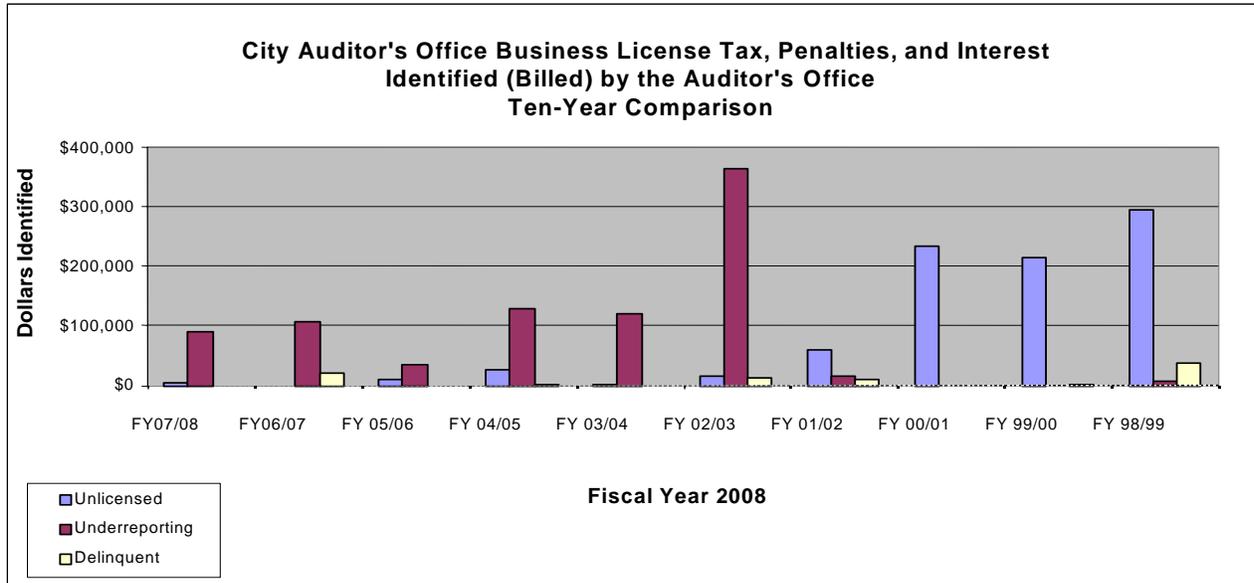
K. Cumulative Statistical Information

During the last ten years, the City Auditor's BLT Audit Program has identified 633 businesses and residential rental property owners that owed the City \$1,817,559 in tax, penalties, and interest. During this same ten-year period, payments totaling \$1,592,010 were received. Since the inception of the program in 1982 unpaid tax, penalties, and interest identified by the City Auditor's Office BLT Audit Program has totaled \$4,964,470.

**Business License Tax, Penalties and Interest
Identified (Billed) by the Auditor's Office
Ten-Year Comparison**

Fiscal Year	Unlicensed Businesses		Under-reporting of Gross Receipts		Delinquent Licenses		Total	Number of Hours Spent	% of FTE @ 80% Productive Time*
								(A)	(A)/0.8/2,080
07/08	1	\$ 4,987	32	\$ 90,673	0	\$ 0	\$ 95,660	1,398	0.84
06/07	0	\$0	22	\$106,919	2	\$ 21,541	\$128,460	1,515	0.91
05/06	5	\$ 9,584	6	\$ 34,418	0	\$ 0	\$ 44,002	973	0.58
04/05	5	\$ 25,281	7	\$130,160	1	\$ 1,421	\$156,862	1,918	1.15
03/04	1	\$ 2,770	15	\$121,766	1	\$ 534	\$125,070	1,806	1.09
02/03	8	\$ 15,162	31	\$366,680	8	\$ 13,351	\$395,193	3,457	2.08
01/02	54	\$ 59,701	8	\$ 15,020	1	\$ 7,653	\$ 82,374	2,236	1.34
00/01	115	\$233,571	2	\$ 934	0	\$ 0	\$234,505	1,915	1.15
99/00	112	\$214,361	0	\$ 0	2	\$ 1,875	\$216,236	1,553	0.93
98/99	186	\$295,323	5	\$ 7,283	3	\$ 36,591	\$339,197	2,536	1.52
TOTAL	487	\$860,740	128	\$873,853	18	\$ 82,966	\$1,817,559	19,307	

** Productive Time is calculated based on 2,080 work hours per year @ 80%. The 80% figure is used so that the cost of the hours spent includes an allowance for sick leave, vacation days, holidays, training, and other administrative uses of time.*



V. CONCLUSION

BLT audit work has historically been cost-effective in generating revenue by identifying unlicensed and underreporting businesses. The audit work also acts as a deterrent to those who might consider underreporting or neglect to obtain a license.

The BLT revenue identified during our audits is not a one-time windfall, but becomes a part of the future revenue stream. In FY08, 56% of our BLT billings were comprised of unpaid tax, and the remaining 44% were penalties and interest. The BLT audit generally includes unpaid tax for a three-year period. Accordingly, for each \$100,000 in tax identified by audit, about \$18,667 ($\$56,000 / 3$ years) in tax for each succeeding year can be expected, as long as the audited businesses are generating consistent gross receipts.

The Auditor's Office billed approximately \$157,000 in Business License tax, penalties, and interest during FY09 (a 64% billing increase from FY08) and expects to collect \$169,000 in BLT payments.

In FY10, the Auditor's Office and Finance are planning a joint effort aimed at increasing Business License tax revenues by identifying unlicensed businesses and billing them for unpaid Business License tax, penalties, and interest.