

GAO

Report to the Chairman, Subcommittee
on Private Retirement Plans and
Oversight of the Internal Revenue
Service, Committee on Finance,
U.S. Senate

January 1993

**TAX
ADMINISTRATION**

**Overstated Real Estate
Tax Deductions Need
To Be Reduced**



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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

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January 19, 1993

The Honorable David Pryor
Chairman, Subcommittee on Private
Retirement Plans and Oversight of
the Internal Revenue Service
Committee on Finance
United States Senate

Dear Mr. Chairman:

This report responds to your request that we determine the (1) extent, if any, to which individual taxpayers have overstated the federal deduction for real estate tax payments, as well as related tax losses; and (2) reasons for any overstated deduction.

From 1982 to 1990, individuals' federal deductions of real estate taxes increased 81 percent—from \$27 billion to \$49 billion. To determine the extent to which deductions were overstated and taxes were lost, we analyzed the results of IRS' audits of randomly selected taxpayers for 1988 and IRS' methodology for computing tax losses. To identify reasons for the overstated deductions, we reviewed about 1,500 audits of 24,000 randomly selected taxpayers who claimed the deduction for 1988 in 3 locations—Montgomery County, Maryland; New Jersey; and Minnesota.

For audited taxpayers in Montgomery County, we checked local real estate tax bills to identify the amount of deductible real estate taxes and nondeductible user fees. We then checked their tax returns to see whether they deducted user fees. According to IRS rulings, charges for services such as water and sewer are user fees, not taxes. We surveyed 170 of the other largest local governments to determine the number with real estate tax bills containing user fees. Census data show that these governments each collected at least \$100 million in 1991 real estate taxes, accounting for 60 percent of the national total.

For audited taxpayers in New Jersey and Minnesota, we checked state records to determine whether they received cash rebates of real estate taxes. We then checked their tax returns to see whether the rebates were reported, as required.

Results in Brief

For 1988, IRS audits show that individuals overstated their real estate tax deductions by an estimated \$1.5 billion nationwide. We estimate that this

level of noncompliance has resulted in a nearly \$300 million federal income tax loss for 1988 and has increased to about \$400 million for 1992.

However, our review of these audits in three locations shows that the level of noncompliance and resulting tax loss were much greater. IRS detected only an estimated \$37 million (29 percent) of \$127 million in overstated deductions that arose from user fee and rebate errors.¹ Examiners would have detected much more noncompliance had they followed IRS audit guidelines on checking source documents to verify taxpayers' support for deductions.

The overstated deductions arose from taxpayers (1) deducting Montgomery County user fees and (2) not reporting New Jersey and Minnesota cash rebates. The reasons for such noncompliance included (1) inadequate IRS instructions on what to deduct or report, and (2) confusing real estate tax bills that did not clearly distinguish taxes from user fees.

In addition, our survey of 170 of the other largest local governments showed that 82 had real estate tax bills that, like Montgomery County, contained user fees. Of the 82, at least 49 had bills that did not clearly distinguish between taxes and user fees. Although we did not review tax returns from taxpayers in these 170 locations, we have no reason to believe that the compliance level was any better than in Montgomery County, where 9 of 10 randomly selected taxpayers deducted the user fees.

We make several recommendations that should help taxpayers to correctly report this deduction and enhance the quality of IRS audits.

Background

According to Census data for April 1990 to March 1991, real estate taxes totalled \$159 billion—a 27-percent increase from \$125 billion in 1988.² Although about 66,000 local governments may assess real estate tax, just 171 local governments collected \$95 billion (60 percent) of all 1991 real estate tax collections.

¹These estimated amounts include \$2 million of the \$22 million of user fee errors in Montgomery County and \$35 million of the \$105 million of rebate errors in the two states.

²IRS officials said the disparity between Census data on real estate taxes of \$159 billion and the \$49 billion deducted on Schedule A of 1990 tax returns is due primarily to (1) businesses that paid real estate taxes but did not file a Schedule A and (2) individuals who paid real estate taxes but did not itemize deductions on Schedule A.

Section 164 of the Internal Revenue Code allows taxpayers to deduct real estate taxes when calculating taxable income. These taxes have been deductible since the income tax was adopted in 1913. User fees for such services as water, sewer, and trash collection, however, are not taxes and are not deductible.

Compliance with section 164 is important not only to the federal government but also to state and local governments. In 1991, 31 states (e.g., Maryland) and the District of Columbia tied ("piggybacked") itemized deductions on their income tax returns to the amounts allowed for federal income tax purposes. Thus, overstated federal deductions for real estate taxes could result in tax losses for such jurisdictions. In some states, income tax losses could carry through to local governments that base their tax systems on what the state collects, such as those in Maryland.

Several issues of fairness relate to the deduction for real estate taxes. Because the purpose of this review was to identify ways to improve taxpayers' compliance with current tax laws, we did not attempt to develop proposals to change the law to address these equity issues. Even so, equity is an important issue to recognize in the broader context.

For example, the real estate tax deduction offers greater benefits to those who pay tax at the highest rates. Second, those who do not itemize deductions receive no tax benefit. Third, some local governments fund services through taxes, which taxpayers can deduct, while others charge user fees and special assessments, which taxpayers cannot deduct. Fourth, taxpayers who reside in localities that rely on real estate taxes to fund many services can deduct higher amounts for paying these taxes than taxpayers in localities with few services.

From an economic perspective, distinctions between taxes, user fees, and special assessments are mostly artificial. A local government can choose any of these sources to fund a service. However, for income tax compliance, the distinctions can be very important. Taxpayers who do not know that user fees and special assessments are usually nondeductible can inadvertently include them in their federal deductions for real estate taxes. This leads to a loss of federal income taxes.

Local government bills for real estate taxes can contain various charges for services. Section 164 generally defines charges that are deductible as

real estate taxes on federal income tax returns. At our request, IRS elaborated on three criteria for determining deductibility, as follows:

(1) A charge is deductible as a tax if it is based on the assessed value of the property (e.g., a tax of \$1 for every \$100 of the assessed value of the property); is made uniformly on property throughout the community; and is used for general community or governmental purposes (e.g., for public schools). Such a charge is deductible as a real estate tax, regardless of what it is called.

(2) A charge (or “special assessment”) is not deductible if it is for an improvement that increases the property value (e.g., building a new sidewalk in front of the property). The cost of the improvement is added to the property value. Conversely, a special assessment is deductible only if it is used to maintain an existing public facility (e.g., cost, including interest, to repair a sidewalk).

(3) Charges for services to a property or person (or “user fees”) are not taxes and are not deductible. Such user fees include a unit fee for a service (e.g., a \$5 fee for every 1,000 gallons of water); a periodic fee for a residential service (e.g., \$20 per month per house for trash collection), or a flat fee for a local government service (e.g., mowing a lawn that grew higher than permitted under a local law).

A less detailed description of these criteria is contained in IRS Publication 17 (Your Federal Income Tax For Individuals). However, Form 1040 instructions do not discuss such criteria beyond referring to IRS Publication 530 (Tax Information for Homeowners). Publication 530 discusses special assessments but not user fees. Since both of these charges generally are not deductible, we use the term “user fees” to refer to both types.

Our work identified three basic ways that local governments bill taxpayers for real estate taxes.

- The bill includes only real estate taxes because the locality does not charge user fees for services such as trash collection. To be a “tax,” payments must generally be based on a percentage—which is the same for all homeowners in the locality—of the property value. Thus, tying the payment to property value generally allows deduction of the entire bill, regardless of the nature of the services.

- The bill itemizes payments for taxes and user fees on multiple lines and combines all types of payments into a total amount. To comply with the tax code, taxpayers should subtract the user fees from the total and deduct only the real estate taxes.
- The bill includes only real estate tax payments because user fees are billed separately. This method allows taxpayers to deduct all amounts on the tax bill.

Taxpayers may also pay real estate taxes through a mortgage escrow account. If they do so, each payment from the account would include a prorated amount of the real estate taxes as well as any user fees. When the mortgage escrow company receives the real estate tax bill, it would pay the bill from the escrow fund. The escrow company then would send taxpayers an annual statement that shows one amount for all payments made to a local government, which may include user fees in addition to real estate taxes.

User fees as a source of revenue for local governments have increased primarily due to (1) reductions in federal revenue sharing and (2) state or local laws that cap or restrict the growth in real estate taxes. Two examples of state laws that cap or restrict such taxes are California's "Proposition 13" and Massachusetts' "Proposition 2-1/2." By increasing user fees to finance services, local governments can keep their tax rates lower. In July 1990, the National League of Cities reported that 76 percent of 576 local governments surveyed increased fees for services and 43 percent established new fees.

In 1991, 33 states had programs to rebate taxpayers' real estate taxes. These programs totalled \$1.5 billion. Many states target their programs to special groups, such as the elderly, low income, or disabled. However, 10 states had universal rebate programs, i.e., available to all homeowners, except those whose income exceeded a specific level (e.g., \$60,000 annually in Minnesota).

Real estate tax rebates must be included in income to the extent that the prior year's itemized tax deduction resulted in a tax benefit. Rebates of previously deducted real estate taxes are fully taxable if the previous year's itemized deduction exceeds the standard deduction by at least the amount of the real estate tax rebate. Rebates of the current year's taxes are to be subtracted from the deduction for that year.

However, Form 1040 instructions do not discuss these rules on accounting for rebates. Rather, taxpayers are referred to IRS Publication 525 (Taxable and Nontaxable Income), which contains instructions for taxpayers on how to determine the amount of rebate that is taxable.

Although many states have taxpayers' Social Security numbers (SSN), tax law does not require states to send information returns to IRS and taxpayers on their rebates of real estate taxes. On the other hand, states are required to send information returns on refunds of state income taxes. Other sections of the tax law require information returns on such payments as wages, interest, and dividends.

According to IRS studies, information returns improve voluntary compliance. They remind taxpayers of payments to report on their tax returns. If taxpayers receive information returns and know IRS also receives them, more taxpayers voluntarily report the related income on their tax returns. IRS computer matches these information returns to tax returns to identify taxpayers who do not report the income or file a tax return.

In addition to such information reporting, IRS receives tax information from states and certain large local governments through formal sharing agreements, as authorized by the Internal Revenue Code. Information shared under these agreements is not necessarily also sent to taxpayers. Further, the shared information must be protected from unauthorized disclosure and be used solely for tax administration and compliance.

About every 3 years since 1963, IRS has audited random samples of individual returns to estimate voluntary compliance nationwide. The most recent audits cover tax years 1982, 1985, and 1988. These audits—done under the Taxpayer Compliance Measurement Program (TCMP)—are IRS' most rigorous. IRS' audit guidelines require examiners to verify taxpayers' support for deductions.

TCMP audits for 1988 included about 55,000 returns, of which about 24,000 had a deduction for real estate tax. Because IRS randomly selected the audited taxpayers, IRS used the audit results from the 24,000 returns to estimate nationwide noncompliance for all 40 million returns with a deduction for real estate tax for 1988.

Objectives, Scope, and Methodology

To determine the extent, if any, to which real estate tax deductions were overstated nationwide and taxes were lost, we collected and analyzed IRS' national estimates of noncompliance for 1988. IRS used TCMP audit results to make these national estimates. We used IRS' methodology to compute tax loss for 1988 and then projected the tax loss to 1992. Appendix IV provides details on this methodology.

To identify reasons for any overstated deductions, we reviewed all available TCMP audit cases (1,487) for 3 locations—Montgomery County, Maryland; New Jersey; and Minnesota—where taxpayers deducted real estate taxes for 1988.³ We also surveyed all 37 of the 317 IRS examiners who did 3 or more of these audits to determine how well they understood IRS' audit requirement on verifying information provided by taxpayers.

We specifically reviewed two ways that individual taxpayers may overstate their real estate tax deductions. In Montgomery County, we analyzed whether taxpayers erroneously deducted user fees. In New Jersey and Minnesota, we analyzed whether taxpayers accounted for cash rebates when claiming their deductions.

Of the 1,487 audit cases, 136 involved taxpayers in Montgomery County. We selected this county as 1 of 171 local governments that collected over \$100 million in real estate taxes and had accessible 1988 real estate tax bills. We analyzed whether the 136 taxpayers deducted county user fees appearing on real estate tax bills and whether IRS examiners detected such errors. To do so, we visited the Montgomery County tax office to review taxpayers' real estate tax bills. We also asked County officials to estimate the costs to report real estate tax data to IRS. We surveyed the other 170 large local governments to see whether they, like Montgomery County, had user fees on their tax bills.

To determine individuals' noncompliance in reporting state rebates of real estate taxes, we first identified 32 states that had rebate programs for 1989. We called officials in each state to obtain recent data on their programs and asked them to estimate costs to report rebates. From this work, we identified 10 states that offered universal rebate programs. Of these, we selected New Jersey and Minnesota for further review because they had among the largest universal programs over a 3-year period. These two states rebated cash amounts of \$345 million in 1988, \$302 million in 1989, and \$752 million in 1990.

³We did not review another 275 TCMP cases for these 3 locations. We requested them, but IRS officials said the cases were not available. See appendices I, II, and III for details.

We then reviewed 950 TCMP audits of New Jersey residents and 401 TCMP audits of Minnesota residents. We compared TCMP audit results for these taxpayers with the amounts rebated to them by these states. This comparison allowed us to identify the amount of noncompliance and determine whether the examiners detected it.

We obtained supplemental data from officials in the three locations on the universe of taxpayers who met our selection criteria. Using these data and IRS' weights for developing estimates from TCMP data, we were able to generalize our results to the population of taxpayers in the three locations. (See apps. I, II, and III for our sampling methodology for each location.)

We did our work between July 1991 and September 1992 according to generally accepted government auditing standards.

Taxes Lost Because Montgomery County Residents Deducted User Fees

We estimate that 83,000 (91 percent) of the 92,000 Montgomery County taxpayers in our 1988 population erroneously deducted \$21.6 million in user fees. These errors caused an estimated federal, state, and local tax loss of \$7.6 million. This amount consisted of \$6 million in lost federal taxes, \$1.1 million in lost Maryland income taxes, and \$0.5 million in lost Montgomery County taxes (the County tax was 50 percent of the state tax). Appendix I explains how we estimated these tax losses.

Our review of the TCMP cases helped us to identify several causes for this noncompliance. First, taxpayers may not have known that user fees are nondeductible. The Form 1040 instructions did not state that user fees are nondeductible, but they did refer taxpayers to IRS Publication 530. However, Publication 530 discussed only special assessments, not user fees. While the more encompassing Publication 17 described user fees and special assessments and their nondeductibility, it must be requested from IRS and is not cited in the Form 1040 instructions on deducting real estate taxes. If taxpayers did not see a need to make this request, they may have inadvertently deducted the user fee.

Also, the high error rate by professional tax return preparers suggests that the instructions in Publications 17 and 530 on these charges may need to be clarified. About 80 percent of professional tax return preparers, who presumably know tax laws, made mistakes on the user fee issue compared to 97 percent for taxpayers who prepared their own returns.

Another possible cause relates to mortgage escrow statements. Of the Montgomery County taxpayers audited, 61 percent used mortgage escrow statements to support their real estate tax deductions. These statements reported annual payments made from the escrow, including amounts paid to the local government. However, the statements did not itemize amounts paid for user fees and special assessments versus real estate taxes. A taxpayer who used this statement—rather than a real estate tax bill—to determine the deduction may have inadvertently deducted user fees and special assessments included in the amount paid from the escrow.

Finally, some taxpayers may have realized that they could overstate their deductions without IRS detecting it, except in an audit. The Montgomery County tax office did not report the taxpayers' real estate tax payments to IRS.

Poor Quality Audits Cause IRS To Understate Its Nationwide Estimate of Noncompliance for Real Estate Tax Deduction

IRS' most recent TCMP data show that individual taxpayers overstated their real estate tax deduction by an estimated \$1.5 billion for 1988—an increase of 17 percent since 1985. We estimate that this noncompliance created a \$300 million federal tax loss in 1988 and a \$400 million loss in 1992 (see app. IV).

However, our review of the 1,500 TCMP cases revealed that the basis for the tax loss estimate—the amount of noncompliance—was understated. IRS' TCMP audits did not capture all overstated real estate tax deductions arising from user fee and cash rebate errors. For example, IRS examiners identified only an estimated \$1.6 million (7 percent) of the \$21.6 million in Montgomery County user fees deducted on the tax returns. As a result, the amount of lost federal taxes was much higher.

The primary reason was that examiners did not regularly review real estate tax bills, which would show the nondeductible fees. Rather, they relied on escrow statements or other information provided by individual taxpayers to support their deductions.

In 1975, IRS issued a revenue ruling on user fees in Montgomery County. It concluded that user fees for water and sewer services were not tax deductible. Given this IRS ruling, we believe that IRS' examiners should have known about the county's user fees appearing on the tax bills and checked whether taxpayers deducted them. Nevertheless, the examiners rarely questioned taxpayers about these user fees. Of 136 TCMP returns, examiners questioned user fees in only 10 cases.

Further, the examiners rarely reviewed real estate tax bills, which are the only reliable documents to verify whether user fees have been erroneously deducted. For example, the tax bill was used as support for the deduction in only 18 of the 136 audits we reviewed. Instead, examiners accepted canceled checks or escrow statements as support in 105 of the 136 audits. In the remaining 13 cases, we found no evidence of any support for the deduction.

Relying solely on canceled checks or escrow statements as support is insufficient to determine whether user fees were deducted. IRS audits identified only 1 user fee error in the 105 cases that relied on escrow statements or checks. The examiner in this case caught the error without using the tax bill because he queried the taxpayer about deducted user fees, regardless of the support provided. For the 105 cases, we identified another 81 errors by reviewing real estate tax bills.

Even if these bills do not clearly distinguish taxes versus user fees, the bills still offer better support for the deduction. All of the bills we reviewed had multiple lines, some of which gave indications that user fees were included on the bill. On the other hand, escrow statements and checks show only one amount for payments made to local governments. Thus, they would not clearly indicate an overstated deduction, as long as that amount equaled the deducted amount.

Using real estate tax bills could also help IRS examiners to identify intentional noncompliance. A county official at one of the 170 local governments we surveyed pointed out to us that a taxpayer who owes \$1,000 in real estate tax could write a check for \$2,000.⁴ Then, that taxpayer could request a refund on the overpayment and, if audited, show the cancelled check to the examiner to support a \$2,000 deduction. By using information from the real estate tax bill, the examiner could detect the overstated deduction.

An alternative to each examiner asking local governments for real estate bills would be for a local government to annually share data on real estate tax payments with IRS on computer tape. This would ensure that examiners have quicker access to the data. We asked Montgomery County officials to provide an estimate of the costs to share the data, but they did not do so. Regardless, these costs should be considered in any

⁴County officials at some of the other local governments said they will not accept a check whose amount exceeds the amount on the tax bill. Doing so blocks such intentional noncompliance.

deliberations on how best to get local government data on real estate tax payments.

Sharing the data on computer tape would negate the need for all local governments to send information returns to IRS. Although cost data were unavailable, we do not believe that burdening 66,000 local governments with information reporting is necessary, particularly when less than 1 percent collect 60 percent of the real estate taxes. While we acknowledge the disparate treatment of focusing on taxpayers in "large" local governments, we believe that starting there makes sense, especially when our tax system tolerates other inequities for compliance or policy reasons. Also, such governments are more likely to have automated systems, which would ease the burden of sharing.

Nor do we believe that local governments need to send information returns to taxpayers. Local governments already provide taxpayers with real estate tax bills. If the bill clearly identifies nondeductible user fees, taxpayers will have the information needed to voluntarily comply. If not, the bill would need to be clarified to allow taxpayers to comply.

We also noted inconsistencies in how IRS examiners addressed user fees. Some examiners checked user fee errors on some returns but not others. For example, one examiner lowered the deduction \$414 because of user fee errors on two returns but ignored user fees on seven other returns, missing \$1,400 in overstated deductions. Another examiner mistakenly increased a real estate tax deduction by \$151, which was the amount by which the canceled check exceeded the deduction. The taxpayer had correctly subtracted user fees from the deduction. However, this examiner made no adjustment on another return with the same situation. In 12 audits, this examiner neither questioned the deducted user fees nor asked to see the tax bills. On 7 of the 12 returns, we detected user fee errors totalling \$2,254.

Such errors during TCMP audits concern us. We believe that if TCMP audits—IRS' most rigorous—miss overstated real estate tax deductions, other IRS audits will have similar errors. Because local governments do not report real estate tax information to IRS, improving audit performance in identifying the overstated deductions is essential.

User Fee Noncompliance May Exist in 82 Other Locations in 17 States

The deduction of user fees we found in Montgomery County may be occurring elsewhere. Our survey of 171 local governments found that Montgomery County and 82 other local governments (49 percent) had real estate tax bills that included user fees in the total amount to be paid. These local governments collected 32 percent of all real estate taxes collected nationwide in 1991 (see app. V).

Of the 83 local governments, 55 provided copies of their bills. Of these 55, we found that 49 local governments (89 percent) in 17 states had bills that did not clearly show whether the charges were taxes or user fees. These confusing bills may lead taxpayers to inadvertently deduct these fees. They also make examiners do more work to identify the deductible amount.

Among the other six local governments, including Montgomery County, we found it was easy to distinguish user fees from taxes. For example, Montgomery County's bill labeled user fees as "service charges" and other charges as "taxes." However, the bill lacked a statement telling taxpayers that service charges were "not tax deductible." Appendix VI describes the criteria we used to evaluate the level of difficulty in distinguishing taxes from user fees for the 55 bills. The appendix also contains sample bills.

Given that 91 percent of randomly selected taxpayers in Montgomery County deducted user fees and that 49 of the 55 local governments had more confusing tax bills than Montgomery County, taxpayers' noncompliance in the 82 locations may be just as serious as in Montgomery County. To the extent that taxpayers in these locations deducted user fees, the TCMP estimate of \$1.5 billion in overstated real estate tax deductions for 1988 is understated. Similarly, our estimated \$400 million in lost 1992 taxes, which used 1988 TCMP results, also would be understated (see app. IV for details on the estimate).

Taxes Lost From Taxpayers Not Properly Reporting Cash Rebates of Real Estate Taxes

We estimate that 575,000 (57 percent) of the 1.01 million taxpayers in our New Jersey and Minnesota populations did not properly report \$105 million in cash rebates—\$101 million in New Jersey and \$4 million in Minnesota. These unreported payments resulted in an estimated federal tax loss of \$25 million.

Our review of the TCMP cases suggests that a possible reason for such underreporting is that taxpayers forgot about receiving the rebate. Both states sent rebate payments months before taxpayers prepared federal tax

returns. For example, New Jersey sent its payments in July—at least 8 months before taxpayers had to file federal returns. Even if taxpayers remembered the rebate, however, Form 1040 instructions on deducting real estate taxes did not tell taxpayers how to report rebates, making errors more likely.

IRS audits detected an estimated \$35 million (33 percent) of the \$105 million in overstated deductions. Examiners frequently did not ask the taxpayer about rebates and did not check with the states to determine whether the taxpayer had received a rebate. Our findings and the assumptions used in estimating the lost taxes in New Jersey and Minnesota are described in appendixes II and III, respectively.

To explore ways to improve taxpayers' rebate compliance, we contacted 32 states—including New Jersey and Minnesota—about the nature and size of their rebate programs. We also asked them to estimate the costs to annually report rebate data to IRS. We did not receive enough complete and comparable cost data to draw firm conclusions. Of the 12 states that did provide estimates, costs to either create or enhance an existing system for reporting rebate data totaled about \$3 million, ranging from \$8,300 to \$1.8 million. Such costs should be factored into any decision that IRS makes on obtaining rebate data from the states.

The tax revenues from state reporting of rebates could be significant. In two states alone, 57 percent of randomly selected taxpayers did not report their rebate income, leading to a tax loss of an estimated \$25 million. If this noncompliance rate is as high in the other 31 states with rebate programs, the tax losses could be large enough to justify information reporting to help taxpayers to comply and IRS to identify those who do not comply.

Conclusions

IRS needs to take action to reduce overstated real estate tax deductions, which lead to millions in tax losses for federal, state, and local governments. First, to improve voluntary compliance, IRS needs to clearly define user fees, special assessments, and rebates in Form 1040 instructions. One option could be to include the three criteria that IRS developed to help taxpayers distinguish deductible taxes from nondeductible charges. Another option is for IRS to develop a worksheet that taxpayers could use to calculate the deduction. The worksheet could contain lines for subtracting user fees and special assessments from the

total amount on the real estate tax bill, as well as for accounting for rebates, refunds, and any other items.

To reduce the confusion created by the tax bills, IRS could work cooperatively with local governments on revising the bills to clearly distinguish user fees and special assessments and label them as "nondeductible." IRS could start with the 49 local governments in our review whose bills appeared to be the most confusing. Compliance should further improve if these bills notify taxpayers that data on their tax payments may be sent to IRS. IRS studies have shown that more taxpayers will voluntarily comply if they know that IRS has been notified. We believe that such revisions will not be costly and could significantly reduce the confusion that leads to taxpayers' noncompliance.

To detect taxpayers who do not voluntarily comply, IRS can enhance the quality of its audits. By checking local records on user fees and state information on rebates, examiners can better determine whether taxpayers complied. Had IRS examiners done so, they would have detected more noncompliance in cases we reviewed.

To further identify taxpayers who do not comply, IRS could use its authority to negotiate information-sharing agreements with local governments whose tax bills include user fees. Under these agreements, IRS could work out cost-effective ways to obtain data on individuals' real estate tax payments to local governments.

If local governments shared such data, IRS would not need to have numerous examiners visit or call local governments to obtain the tax data. Moreover, if local governments included SSNs on the computer tape, IRS could link payments on the tape to taxpayers' returns. The data also could provide IRS with a significant source for identifying potential nonfilers and property owned by tax delinquents.

Local governments could also benefit. To the extent that they had the capability and resources, local governments could begin computer matches with their state governments. Such matches could result in offsets to state income tax refunds to taxpayers who have not paid local real estate taxes. States could use such matches to identify state tax delinquents.

Although local governments could benefit, we do not believe that 66,000 local governments need to incur costs to share the data. These costs could

be high for local governments that would have to automate property records or contact property owners to obtain SSNS. Nor do we believe that it is cost effective for local governments to provide taxpayers with information returns when they already provide taxpayers with real estate tax bills.

Rather, the initial data sharing could focus on the less than 1 percent of local governments that collect \$100 million or more annually. Although such a focus would create inequities because IRS would not receive data from smaller localities, we believe it is justified. These large local governments collect most real estate taxes nationally and are more likely to have the automated capability to track and share data with IRS.

Taxpayer compliance in reporting rebates also needs to improve. Congress may wish to consider requiring states to send information returns on rebates to IRS and taxpayers. Our review of tax laws and discussions with IRS officials indicate that IRS does not have the authority to require these returns for state rebates. However, tax law already requires states to file information returns on a similar type of income—refunds for state taxes.

Information returns on rebates would remind taxpayers to report their rebate income and give IRS a tool to identify those who do not. Developing or enhancing an automated system to report rebate data will generate some costs. Although limited in scope and detail, estimates provided by states we contacted indicate that the costs would not be excessive.

Matters for Congressional Consideration

We believe that Congress should consider legislation that would require states to annually send IRS and taxpayers an information return on any cash rebates for real estate tax payments.

Recommendations to the Commissioner of Internal Revenue

We recommend that the Commissioner of Internal Revenue take the following actions:

- Include rules on the tax deductibility of user fees, special assessments, and rebates in the Form 1040 instructions and consider ways, such as an optional worksheet, to help taxpayers calculate the real estate tax deduction.
- Work cooperatively with local governments to revise their real estate tax bills in order to identify user fees and special assessments, label these

charges as not tax deductible, and notify taxpayers that the local government may report the deductible tax to IRS.

- Notify examiners to check local records on user fees and state records on rebates to verify real estate tax deductions.
- Negotiate agreements with local governments on their sharing of data on real estate tax payments by individuals, and use the data in IRS' enforcement programs.

Agency Comments and Our Evaluation

In a July 29, 1992, meeting, the Deputy Assistant Commissioner, Examination Division, generally agreed with our recommendations to IRS. He said working with local governments to clarify charges on tax bills would be consistent with IRS' Compliance 2000 initiative; it relies on cooperation between IRS and others, such as local governments, to resolve compliance problems.

As for improving instructions and requiring a worksheet, he said IRS plans to expand its instructions in Publications 17 and 530 and for Form 1040. IRS also agreed to consider designing a worksheet to help taxpayers prepare 1993 returns. However, IRS is not yet convinced that a worksheet will solve the compliance problem because local governments' tax bill formats vary so widely. To the extent that our recommendation on modifying tax bills results in a more uniform format, we believe that the worksheet will become even more effective.

Finally, IRS also agreed that examiners should check local or state records, when appropriate, to verify a taxpayer's support for a deduction. This could include having audited taxpayers present their tax bills to identify nondeductible user fees.

Comments From State and Local Government Representatives and Our Evaluation

Officials from the National Association of Counties said large local governments could incur significant costs if required to provide IRS with computer tapes on real estate tax payments. Doing so would require additional computer programming, production, and staff costs. They said they have consistently opposed new federal mandates under which the costs are not reimbursed. Reimbursement is particularly important given the downturn in the economy, which reduces local government revenues.

We agree that providing IRS with tax payment data would increase costs for the 1 percent of local governments that would be affected. A reimbursement option is available through the 31 states that would also

benefit from improved taxpayer compliance at the federal level. Because these states "piggyback" their tax returns to the federal tax return, they will generate additional state income taxes to the extent that providing the real estate tax data to IRS increases taxpayer compliance. This increase in state income taxes could be substantial given the \$1.6 million in 1988 Maryland income taxes lost from just Montgomery County taxpayers not complying with the federal tax laws on user fees.

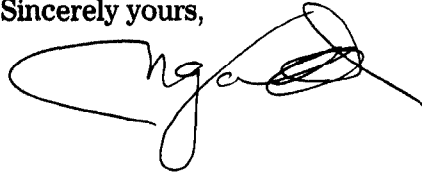
Officials from the National Conference on State Legislatures said piggyback states may choose to reimburse local governments for sharing tax data with IRS for the reasons stated above. Because local governments are largely extensions of the state government, many states already indirectly reimburse local governments for various mandates. The officials said states provide over 40 percent of the revenue that local governments receive.

With this revenue linkage, they agreed that increased state revenues from improved federal compliance will flow to local governments to some degree. They supported the idea of states receiving tax revenues that are owed but not paid. They also supported efforts to improve compliance because noncompliance created inequities for taxpayers who correctly accounted for user fees and rebates. While these officials said states would prefer to avoid additional reporting, they generally supported our recommendations, especially given the noncompliance rate and opportunity to collect state taxes owed but not yet paid.

As agreed with the Subcommittee, unless you publicly announce the contents of this report earlier, we plan no further distribution of the report until 30 days from the date of this letter. At that time, we will send copies to the Commissioner of Internal Revenue; the Governors of Maryland, New Jersey, and Minnesota; and other interested parties. Copies will also be made available to others upon request.

Major contributors to this report are listed in appendix VII. If you have any question regarding this report, please call me on (202) 272-7904.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'ngandhi', with a large, stylized flourish extending to the left.

Natwar M. Gandhi
Associate Director, Tax Policy
and Administration Issues

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Abbreviations

IRS	Internal Revenue Service
SSN	Social Security Number
TCMP	Taxpayer Compliance Measurement Program

GAO Methodology Used To Detect Real Estate Tax Deduction Errors in Montgomery County, Maryland

This appendix lays out the methodology we used to determine (1) the extent to which individual taxpayers in Montgomery County, Maryland, overstated their real estate tax deductions due to user fee errors; and (2) how effectively IRS examiners detected such errors in TCMP audits. We did not attempt to project our study results beyond Montgomery County because we did not have the resources to make national estimates.

Montgomery County is one of 171 local governments nationwide that collect over \$100 million annually in real estate taxes. About half of these local governments include user fees on real estate tax bills. Appendix V identifies these local governments.

Methodology and Data Derived

1. We defined our universe as individual taxpayers from Montgomery County who deducted real estate taxes on Schedule A of their 1988 tax returns. We used TCMP-audited tax returns for our sample because they are randomly selected and could be used, in conjunction with additional data on the number of taxpayers in the universe, to project our results to all Montgomery County taxpayers. Using these data, we could generalize our results to the universe at a 95 percent confidence interval and at an error rate of 5 percent or less. We also used TCMP tax returns because IRS examiners are required to examine every entry, which provided a good basis for studying examiner effectiveness.
2. Using IRS' TCMP database, we extracted our universe by focusing on the primary SSN from all returns. We identified Montgomery County SSNs by selecting returns with ZIP Codes that fell within the county's boundaries. This process generated 155 SSNs.
3. We requested the 155 tax returns and related TCMP audit workpapers from IRS. We received 137 (88 percent) returns—all available at the time. However, only 136 were useable because the audit files were not available for one return.
4. For taxpayers in our sample, we visited the tax office in Montgomery County to review tax bills and records. We did this to distinguish between the amounts of payments for real estate taxes versus user fees.
5. We extracted and analyzed the following data from each 1988 tax return:
 - filing status,
 - real estate taxes deducted,

Appendix I
GAO Methodology Used To Detect Real
Estate Tax Deduction Errors in Montgomery
County, Maryland

- adjusted gross income,
- taxable income, and
- use of paid preparers.

6. Using data from the 136 available audit files, we analyzed the extent to which IRS examiners

- considered the user fee issue,
- lowered the deduction due to user fee and other errors, and
- used appropriate documents and contacted third parties to verify the real estate tax deduction.

7. We compared the amount of the real estate tax deduction on each return with the amount on real estate tax bills to identify overstated deductions due to user fee errors and calculate the tax effect. We categorized cases accordingly, depending on the results of the comparison.

- If the tax bill contained no user fees that the taxpayer could improperly deduct, we did no further analysis.
- If the taxpayer properly excluded the user fees from the deduction, we verified this adjustment with the tax bill. We considered these cases as in full compliance.
- If the tax bill matched or nearly matched the deducted amount and included user fees, but the taxpayer did not subtract the fees from the real estate tax deduction, we considered this to be an overstated deduction.
- If the tax bill did not equal the deducted amount but included user fees and the taxpayer did not subtract fees from the deduction, we considered this to be a possible overstated deduction. Differences could be explained by taxpayers deducting taxes for multiple properties, claiming the deduction on the Schedule C, or making an error. We assumed that the proportion of these cases that had overstated deductions equalled the proportion for cases in which we identified overstated deductions.

Tables I.1, I.2, and I.3 show the statistical results of projecting our sample data to our universe of taxpayers.

**Appendix I
GAO Methodology Used To Detect Real
Estate Tax Deduction Errors in Montgomery
County, Maryland**

Table I.1: TCMP Tax Returns Available and Reviewed

	Sample
Tax returns requested	155
Tax returns unavailable	18
Tax returns available	137
Returns reviewed with user fees on tax bill	105
Returns reviewed without user fees on tax bill	32
Total returns and tax bills reviewed	137

Table I.2: Analysis of 105 Cases With User Fees on Tax Bill

	Sample	Universe estimates	Upper limit	Lower limit
User fees correctly adjusted (9 cases)	\$1,883	\$1,066,958	\$1,756,754	\$366,794
Associated federal tax	\$556 ^a	\$284,122	^b	^b
User fees deducted in error (61 cases)	\$16,607	\$15,826,245	\$18,646,983	\$12,851,671
Associated federal tax	\$4,548 ^a	\$4,435,810	^b	^b
User fee deduction uncertain (35 cases)	\$9,878	\$6,209,116	\$8,347,727	\$4,010,149
Associated federal tax	\$2,520 ^a	\$1,627,016	^b	^b

^aTaxes were calculated by applying marginal tax rates, based on filing status, to user fee amounts.

^bWe only estimated the tax loss for the universe estimate.

Table I.3: Analysis of Federal, State, and County Tax Losses From 96 Montgomery County Cases in Which User Fees Were Not Correctly Adjusted

	Cases	Federal	State	County	Total
User fee errors	61	\$4,435,810	\$791,312 ^a	\$395,656 ^b	\$5,622,778
Prorated uncertain	35	1,529,076 ^c	287,020 ^d	143,510 ^b	1,959,606
Total	96	\$5,964,886	\$1,078,332	\$539,166	\$7,582,384

^aTaxes were calculated by applying Maryland marginal tax rates to user fee amounts.

^bMontgomery County tax is 50 percent of state tax amount.

^cProrata calculation of federal tax on uncertain cases:

$$\begin{aligned} & \$4,435,810 / (\$284,122 + \$4,435,810) = 93.98\% \\ & .9398 \times \$1,627,016 = \$1,529,076 \end{aligned}$$

^dProrata calculation of Maryland state tax on uncertain cases:

$$\begin{aligned} & \$4,435,810 / (\$284,122 + \$4,435,810) = 93.98\% \\ & .9398 \times \$305,405 = \$287,020 \end{aligned}$$

GAO Methodology Used To Detect Real Estate Tax Deduction Errors in New Jersey

This appendix discusses the methodology we used to determine (1) the extent of real estate tax deduction errors on federal tax returns by New Jersey taxpayers who did not report their rebate from the state, and (2) the effectiveness of IRS examiners in detecting unreported rebates during TCMP audits.

New Jersey is 1 of 10 states with universal rebate programs. Its program rebated the most money—\$299 million in 1988 and \$688 million in 1990. In fiscal year 1993, this program will cover only homeowners who are older than 65 and earn less than \$40,000 annually.

Methodology and Data Derived

1. We defined our universe as taxpayers from New Jersey who deducted real estate taxes on Schedule A of their 1988 tax returns. We used TCMP-audited tax returns for our sample because they were randomly selected and could be used, in conjunction with additional data on the number of taxpayers in the universe, to project data from our study. Using these data, we could generalize our results to the universe at a 95 percent confidence interval and at an error rate of no more than 5 percent. Also, IRS examiners are required to audit every entry on a return selected for TCMP, which provides a good basis for studying examiner effectiveness.

2. Using IRS' TCMP database, we extracted our universe, focusing on the primary SSN from all returns with real estate taxes deducted. We identified New Jersey SSNs by selecting returns with ZIP Codes that fell within the state's boundaries. This process generated 1,080 SSNs.

3. We requested the 1,080 tax returns and related TCMP audit workpapers from IRS. We received 962 (89 percent) returns—all available at the time—of which 950 had complete data.

4. We extracted and analyzed the following data from the 950 tax returns:

- filing status,
- real estate taxes deducted,
- other income,
- adjusted gross income,
- taxable income, and
- use of paid preparers.

We documented data for both real estate tax deductions and other income. Rebate payments must be included in income to the extent that the prior

**Appendix II
GAO Methodology Used To Detect Real
Estate Tax Deduction Errors in New Jersey**

year's tax deduction resulted in a tax benefit. Rebates of previously deducted real estate taxes are fully taxable if the previous year's itemized deductions exceeded the standard deduction by at least the rebate amount. Because the taxpayers in our sample received rebates on taxes paid the previous year, we assumed that they itemized deductions the previous year and thus received a tax benefit from the rebate.

We then compared the data with New Jersey's rebate records. This comparison enabled us to identify unreported rebate income, calculate the tax effect of noncompliance, and determine to what extent preparers affected compliance.

5. Using data from TCMP audit files on the 950 tax returns, we analyzed whether IRS examiners

- considered the rebate issue,
- made adjustments for nonreported rebate income and other real estate tax errors, and
- used appropriate documents and contacted third parties to determine whether rebate income was received or to verify rebate amounts.

6. We then compared the 950 SSNs to the state rebate records to determine whether the taxpayer received a tax rebate and, if so, the amount. If a rebate was not reported on the tax return but New Jersey records indicated the taxpayer received a rebate, we considered it to be unreported income or an overstated tax deduction.

7. Table II.1 shows the number of 1988 tax returns we requested, received, and reviewed. Our New Jersey universe totals 1,255,819 tax returns that had a Schedule A deduction for real estate taxes. Overall, 2,614,807 New Jersey taxpayers filed a tax return for 1988.

Table II.1: TCMP Tax Returns Available and Reviewed

Tax returns	TCMP Sample
Requested	1,080
Received	962
Insufficient data to analyze	12
Available and reviewed	950

8. Tables II.2 and II.3 show that 759 of the 950 taxpayers in our New Jersey sample received real estate tax rebates in 1988. Of the 759 returns, 317 (42 percent) properly reported the rebate while 442 (58 percent) showed

**Appendix II
GAO Methodology Used To Detect Real
Estate Tax Deduction Errors in New Jersey**

no evidence of reported rebates. IRS examiners identified only 118 (27 percent) of the 442 unreported cases and missed 324 (63 percent) of the unreported cases.

Table II.2: Unreported Rebate Income

Rebate income	Sample		Universe estimates	Upper limit	Lower limit
	Returns	Dollars	Dollars		
Per state records	759	\$137,945	\$181,732,506		
Reported	317	58,470	80,296,863	\$94,334,349	\$66,259,383
Unreported	442	80,186	100,816,840	113,796,046	87,837,634
Total	759	\$138,655^a	\$181,113,703^a	\$208,120,395	\$154,097,017

^aDifference from state amount reflects the net error where taxpayers reported the wrong rebate amount.

Table II.3: Unreported Rebate Income Undetected by IRS

Unreported rebate income	Sample		Universe estimates	Upper limit	Lower limit
	Returns	Dollars	Dollars		
Detected by IRS	118	\$21,183	\$32,665,153	\$58,067,402	\$7,262,904
Undetected by IRS	324	59,003	68,151,687	78,834,000	57,469,374
Total unreported	442	\$80,186	\$100,816,840	\$136,901,402	\$64,732,278
Tax on Undetected Rebates	324	\$21,382	\$24,696,958 ^a	^b	^b

^aTaxes were calculated by applying marginal federal tax rates to refund amounts.

^bWe only estimated the tax loss for the universe estimate.

GAO Methodology Used To Detect Real Estate Tax Deduction Errors in Minnesota

This appendix discusses the methodology we used to determine (1) the extent to which Minnesota taxpayers did not report state refunds of real estate taxes on their federal tax returns, and (2) how effectively IRS examiners detected unreported state refunds during TCMP audits.

Minnesota is 1 of 10 states with universal rebate programs and ranked second in terms of total dollars. The program included cash refunds and tax credits. Minnesota refunded \$45 million in 1988 and \$63 million in 1990. Tax credits totaled \$660 million in 1989.

To receive a cash refund, only taxpayers with income under \$60,000 are eligible. Real estate taxes exceeding various percentages of household income are refunded up to a maximum of \$400. Generally, an additional cash refund is available when the taxes increase more than 10 percent from the prior year on the same property and the amount of increase exceeds specified amounts. Also, taxpayers receive a homestead credit against their property tax bills of 54 percent of the gross tax up to \$725 for the first \$68,000 of market value.

Methodology and Data Derived

1. We defined our universe as taxpayers from Minnesota who deducted real estate taxes on Schedule A of their 1988 tax returns. We used TCMP-audited tax returns for our sample because they were randomly selected and, in conjunction with additional data on the number of taxpayers in the universe, could be used to project our results. Using these data, we could generalize our results to the universe at a 95 percent confidence interval and at an error rate of 5 percent or less. We also used TCMP returns because IRS examiners are required to audit every entry on a return, which offers a good basis for studying examiner effectiveness.
2. Using IRS' TCMP database, we extracted our universe, focusing on the primary SSN from returns on which taxpayers deducted real estate taxes. We identified Minnesota SSNs by selecting returns with ZIP Codes that fell within the state's boundaries. This process generated 527 SSNs.
3. We requested the 527 tax returns and related TCMP audit workpapers from IRS. We received 438 (83 percent) returns—all available—of which 401 had sufficient data to analyze.
4. We extracted and analyzed the following data from the 401 tax returns:
 - filing status,

**Appendix III
GAO Methodology Used To Detect Real
Estate Tax Deduction Errors in Minnesota**

- real estate taxes deducted,
- other income,
- adjusted gross income,
- taxable income, and
- use of paid preparers.

We documented data for both real estate tax deductions and other income. Because the taxpayers in our sample received rebates on taxes paid for the previous year, we assumed that they itemized deductions the previous year and thus received a tax benefit from the rebate. We compared the data to Minnesota records on property tax refunds. This enabled us to identify unreported refunds and to calculate the tax effect of noncompliance.

5. We also extracted data from the TCMP audit files on the 401 returns to analyze whether IRS examiners

- considered the refund issue,
- made adjustments for nonreported refund income and other real estate tax errors, and
- used appropriate documents and contacted third parties to determine whether refund income was received or to verify refund amounts.

6. We then compared the 401 SSNs against state refund records to determine whether a taxpayer received a tax refund and, if so, the amount. If a tax refund was not reported on the tax return and Minnesota records indicated the taxpayer received a refund, we considered it to be unreported income or an overstated deduction of the real estate tax.

7. Table III. 1 shows the 1988 tax returns from Minnesota that we requested, received, and reviewed. Our universe totaled 602,958 federal tax returns that had a Schedule A deduction for real estate taxes. Overall, Minnesota taxpayers filed 1,414,685 tax returns for 1988.

Table III.1: TCMP Tax Returns Available and Reviewed

Tax returns	TCMP sample
Requested	527
Received	438
Insufficient data to analyze	37
Available and reviewed	401

Appendix III
 GAO Methodology Used To Detect Real
 Estate Tax Deduction Errors in Minnesota

8. Tables III.2 and III.3 show that 13 tax returns in our Minnesota sample of 401 returns for 1988 involved a state refund. Of these 13 returns, 3 properly reported the refund and 10 returns had no evidence of reported refunds. Of the 10 returns, IRS audits identified only 4, missing 6 of the unreported cases.

Table III.2: Unreported Refund Income

Refunds	Sample		Universe estimates	Upper limit	Lower limit
	Returns	Dollars	Dollars		
Per state records	13	\$4,188	\$5,877,369 ^a	a	a
Properly reported	(3)	(1,050)	(1,838,483) ^a	a	a
Unreported	10	\$3,138	\$4,048,886	\$8,411,125	\$1,281,311

^aThe sample was too small to permit reliable universe estimates.

Table III.3: Unreported Refunds Undetected by IRS

Unreported refunds	Sample		Universe estimates	Upper limit	Lower limit
	Returns	Dollars	Dollars		
Detected by IRS	4	\$1,609	\$2,344,248 ^a	a	a
Undetected by IRS	6	1,529	1,704,638 ^a	a	a
Total unreported	10	\$3,138	\$4,048,886	\$8,411,125	\$1,281,311
Tax on refunds undetected	6	\$229 ^b	\$255,696 ^b	c	c

^aThe sample was too small to permit reliable universe estimates.

^bTaxes were calculated by applying marginal federal tax rates to refund amounts.

^cWe only estimated the tax loss for the universal estimate.

GAO Estimates of Federal Tax Losses

Using 1985 TCMP audit results, IRS estimated the tax lost from overstated real estate tax deductions. We used IRS' basic methodology and 1988 TCMP audit results to compute this type of tax loss. We made this estimate for 1988 and then projected this tax loss to 1992. To do this, we used data on the growth in real estate tax deductions between 1988 and 1990.

For example, real estate tax deductions grew about 20 percent between 1988 and 1990. To be conservative, we assumed a 10-percent growth between 1990 and 1992. As a result, we estimated that the 1992 deductions would total \$54 billion. We then applied a noncompliance rate of 3.6 percent, which equals the rate for 1988.

This methodology and our assumptions follow.

Table IV.1: Potential Federal Tax Losses From Overstated Real Estate Tax Deductions

	Tax year 1988	Tax year 1992
Gross overstated real estate tax deductions	\$1,461,653,000 ^a	\$1,943,482,900 ^b
Average marginal tax rate	X .2038 ^c	X .2038 ^d
Tax loss	\$ 297,844,880	\$ 396,081,810

^aFrom 1988 TCMP results on audits of individuals.

^bComputed by multiplying an estimated \$54.46 billion in real estate taxes that were deducted on a Schedule A by the 1988 noncompliance rate of 3.57 percent.

^cFrom IRS' Tax Gap Appendix (July 1988, table A-30).

^dUsed for 1992 at the suggestion of IRS.

Local Governments That Itemize User Fees

Table V.1 lists 83 local governments that included user fees on their tax bills and collected more than \$100 million in real estate taxes for the 12 months ending in March 1991. They collected over \$51 billion, or 32 percent of the \$159 billion in total real estate tax collections. Table V.1 lists them in descending order of tax collections.

Table V.1: Tax Collections and Population of Local Governments With Itemized User Fees on Their Tax Bills

Dollars in millions		
Local government	Area population (1988)	Real estate tax collections (1991)
Los Angeles, CA	8,587,800	\$5,263.5
Cook, IL	5,284,300	5,045.4
Orange, CA	2,257,000	1,801.3
Maricopa, AZ	2,029,500	1,523.4
San Diego, CA	2,370,400	1,428.3
Oakland, MI	1,052,500	1,424.5
Dade, FL	1,813,500	1,285.2
Hennepin, MN	1,008,800	1,224.7
Santa Clara, CA	1,432,000	1,191.1
Broward, FL	1,187,000	1,106.2
Cuyahoga, OH	1,430,800	1,057.4
Palm Beach, FL	818,500	1,057.0
King, WA	1,438,900	1,023.9
Fairfax, VA	770,200	1,011.4
Erie, NY	958,700	872.7
Milwaukee, WI	930,100	870.9
Du Page, IL	760,800	859.8
Fulton, GA	640,800	750.9
Monroe, NY	700,300	734.2
Alameda, CA	1,241,100	731.9
Franklin, OH	938,100	722.0
Montgomery, MD	704,900	720.8
Bexar, TX	1,211,700	694.8
Contra Costa, CA	765,200	664.2
Multnomah, OR	563,700	655.7
Pinellas, FL	821,000	588.7
Hamilton, OH	874,000	579.7
Orange, FL	611,500	578.4
Hillsborough, FL	815,100	569.7
San Francisco, CA	731,600	553.2

(continued)

Appendix V
Local Governments That Itemize User Fees

Dollars in millions

Local government	Area population (1988)	Real estate tax collections (1991)
Lake, IL	495,300	542.5
San Mateo, CA	628,300	525.3
Onondaga, NY	461,500	465.3
Kern, CA	520,000	433.6
Prince George's, MD	701,000	431.3
Ramsey, MN	478,900	424.2
Sacramento, CA	976,900	416.7
Baltimore, MD	689,300	398.6
Ventura, CA	647,300	395.9
Salt Lake, UT	720,000	375.4
Worcester, MA	675,400	374.3
Johnson, KS	345,700	373.7
Duval, FL	673,500	372.0
Lake, IN	487,900	362.1
Denver, CO	492,200	348.1
Dane, WI	352,800	323.7
Arapahoe, CO	391,200	323.6
Washington, OR	292,800	322.3
Lee, FL	309,100	312.0
Sedgwick, KS	402,100	305.4
Summit, OH	514,000	300.7
Waukesha, WI	302,200	297.6
Lucas, OH	466,300	289.6
Jefferson, CO	430,200	281.2
Fresno, CA	614,800	278.7
Dutchess, NY	262,200	274.2
Pierce, WA	559,100	267.6
Volusia, FL	348,400	257.9
Wake, NC	388,100	257.5
El Paso, CO	393,900	257.2
Anne Arundel, MD	417,600	245.5
Hampden, MA	449,900	243.4
Ingham, MI	276,300	234.8
Snohomish, WA	422,700	229.0
Sonoma, CA	366,000	227.3
Sarasota, FL	260,600	227.0

(continued)

Appendix V
Local Governments That Itemize User Fees

Dollars in millions

Local government	Area population (1988)	Real estate tax collections (1991)
Santa Barbara, CA	343,100	216.0
Brevard, FL	388,300	215.0
San Joaquin, CA	455,700	212.6
Jefferson, AL	679,100	210.2
Dakota, MN	253,400	201.1
Solano, CA	314,100	180.6
Charleston, SC	302,200	176.8
Polk, FL	395,800	175.0
Greenville, SC	315,000	163.3
Stark, OH	374,500	160.3
Stanislaus, CA	341,000	152.5
Spokane, WA	356,400	151.8
Richland, SC	285,900	148.5
Forsyth, NC	266,300	141.4
Lorain, OH	270,500	138.8
Mahoning, OH	271,900	109.6
Tulare, CA	297,900	103.6
Total	67,874,400	\$51,443.2

Source: Bureau of the Census, Department of Commerce, Quarterly Summary of State and Local Tax Revenues, January through March 1991.

Analysis of Real Estate Tax Bills

Using tax bills from 55 of 83 local governments that included user fees on bills, we analyzed the difficulty in distinguishing the user fees from the taxes. The other 28 did not provide bills. The following describes three criteria used to determine difficulty:

1. If a bill clearly labeled user fees, we judged it as easy to understand. Figure VI.1 shows such a sample tax bill.

Figure VI.1: Real Estate Tax Bill Easy To Interpret

TAXES FOR CHARLESTON COUNTY AND NORTH CHAS PUBLIC SERVICE DISTRICT 4-1							DATE	
REAL PROPERTY TAXES FOR PERIOD COMMENCING 01-01-1990							09-25-1991	
ANNUAL SOLID WASTE DISPOSAL USER FEE								
DIST.	TYPE	RECEIPT NO.	TAX MAP REFERENCE	MORT. CODE	MORTGAGE LOAN ID	TOTAL ASSESSMENT	MILLS	TOTAL TAX
41	00	90-0A1997				780	263.2	205.30
NO. OF BLDGS.	ACRES	ASSESSMENT RATIO(S)		PLEASE RETURN ALL COPIES WITH PAYMENT TO:				
1	0.00	0.84		W.O. THOMAS, JR., COUNTY TREASURER P.O. BOX 878, CHARLESTON, S.C. 29402-0878				
PROPERTY DESCRIPTION							USER FEE	38.00
<input type="checkbox"/> IF CHANGE OF ADDRESS IS DESIRED, CHECK BOX AND ENTER CORRECT ADDRESS							PAY THIS AMOUNT ▶	243.30
							*****249.45	01-15-1991
							AMT DUE AFTER	
							*****263.83	02-01-1991
44.85	County Government - General		5.15	Park - Recreation Com.		13.34	COOPER RIVER PK/PLYG COMM	
6.01	County Government - Debt Ret.		0.39	Substance Abuse Com.		1.01	COOPER RIVER PK/PLYG BONDS	
70.20	School Board - General		2.34	Trident Technical College		45.40	NORTH CHAS PSD OPERATING	
16.61	School Board - Debt Retirement			TOTAL		205.30		
THE INFORMATION ABOVE IS A BREAKDOWN OF HOW YOUR TAX DOLLARS ARE DISTRIBUTED. * UNDER FISCAL CONTROL OF CHARLESTON COUNTY COUNCIL							4111500098	

Appendix VI
Analysis of Real Estate Tax Bills

2. If a bill distinguished between user fees and taxes but used confusing terminology, we judged it as somewhat difficult to understand. Figure VI.2 shows such a sample tax bill.

Figure VI.2: Real Estate Tax Bill Moderately Difficult To Interpret

CITY OF SOUTHFIELD ROMAN J. GRONKOWSKI, TREASURER P.O. BOX 2055 26000 EVERGREEN RD., SOUTHFIELD, MI 48037 1991 CITY AND SCHOOL TAX	Assessed Valuation	State Equalized Valuation	
	BLDG 38,300 LAND 6,250 TOTAL 44,550	38,300 6,250 44,550	
	SIDWELL #		
0000210413A114568S2426377019			CITY TAX <u>737.68</u> COUNTY SCHOOL <u>96.46</u> PARTIAL SCHOOL <u>802.57</u> ADMINISTRATION FEE <u>16.37</u> MISCELLANEOUS <u>451.05</u> R W TOTAL TAXES <u>2104.13</u>
PAYABLE TO: ROMAN J. GRONKOWSKI, TREAS. 3 1/2% added Sept. 1, 1991 and 1/2 of 1% on 1st day of each month thereafter through Feb. 28, 1992. Payable only to County Treasurer, C. Hugh Dohany thereafter.	VILLAGE NO. 7 EXC NWLY 33.68 FT & NWLY 39.39 FT LOT 293		
SOUTHFIELD, MICH 094 @0014568@	MISCELLANEOUS LEGEND RI D=Dust Control O=Other R=Rubbish W=Delinquent Water A=DDA Millage		
	PAYABLE JULY 1, 1991 THRU AUGUST 31, 1991 WITHOUT PENALTY/FISCAL YEAR JULY 1, 1991 THRU JUNE 30, 1992 SPS		

3. If a bill did not separate user fees from taxes and used confusing terminology, we judged it as very difficult to understand. Figure VI.3 shows such a sample tax bill.

Appendix VI
Analysis of Real Estate Tax Bills

Figure VI.3: Real Estate Tax Bill Difficult To Interpret

CLASSES OF PROPERTY-1990					PROPERTY ADDRESS OF RECORD	OWNER OF RECORD OCT. 31, 1990				
Residential @ 12% of market value										
Farm residential @ 12% of market value										
Vacant lots @ 12% of market value						***** CAR-RT-SORT ** CR36				
Agriculture land @ 30% of use value										
All Other real estate @ 30% of market value										
SAMPLE ONLY										
ACREAGE	CLASS	VALUATION	MILL LEVY	GENERAL TAX	* OTHER TAX	HALF TAX	TOTAL DUE	AMOUNT PAID	CHECK NO.	
	R	10,583	130.355	1,379.55	214.67	797.11	1,594.22			
TAX BREAKDOWN		790.69	309.74		263.25		15.87			
		SCHOOL	CITY	TOWNSHIP	COUNTY	FIRE DISTRICT	STATE	OTHER LEVIES		
TAXED LOT 1				BLOCK A			WESTLINK VILLAGE TWELFTH ADD.			
SEE REVERSE SIDE FOR IMPORTANT INFORMATION					* OTHER TAX: SPECIAL ASSESSMENT PRINCIPAL: 138.94					
OTHER IMPORTANT INFORMATION:					OTHER TAX: SPECIAL ASSESSMENT INTEREST: 75.73					
NOTE: UNPAID PRIOR YEARS TAXES? NO										
HALF OR FULL PAYMENT DUE DEC. 20, 1990										
ALL LATE PAYMENTS WILL BE ASSESSED INTEREST PENALTY (18% PER ANNUM) PLUS APPLICABLE LATE FEES. DETACH AND RETURN BOTTOM PORTION WITH PAYMENT. KEEP TOP PORTION FOR YOUR RECORDS.										

**Appendix VI
Analysis of Real Estate Tax Bills**

Of the 55 bills, we found that 6 (11 percent) were easy to understand, 18 (33 percent) were somewhat difficult, and 31 (56 percent) were very difficult. Table VI.1 shows the difficulty level of tax bills from the 55 local governments, listed in descending order of tax collections.

Table VI.1: Real Estate Tax Bill Difficulty

Local government	Not difficult	Somewhat difficult	Very difficult
Orange, CA			X
Maricopa, AZ			X
Oakland, MI		X	
Dade, FL		X	
Santa Clara, CA			X
Broward, FL		X	
Cuyahoga, OH		X	
Palm Beach, FL		X	
King, WA			X
Erie, NY		X	
Du Page, IL			X
Fulton, GA			X
Monroe, NY			X
Alameda, CA			X
Montgomery, MD	X		
Contra Costa, CA			X
Multnomah, OR			X
Hamilton, OH			X
Hillsborough, FL		X	
San Francisco, CA			X
San Mateo, CA			X
Kern, CA			X
Prince George's, MD			X
Ramsey, MN	X		
Baltimore, MD			X
Ventura, CA			X
Worcester, MA		X	
Johnson, KS			X
Duval, FL		X	
Lake, IN			X
Dane, WI	X		
Arapahoe, CO			X

(continued)

**Appendix VI
Analysis of Real Estate Tax Bills**

Local government	Not difficult	Somewhat difficult	Very difficult
Washington, OR			X
Lee, FL		X	
Sedgwick, KS			X
Waukesha, WI	X		
Lucas, OH	X		
Jefferson, CO			X
Dutchess, NY			X
Pierce, WA			X
Wake, NC		X	
Sonoma, CA			X
Sarasota, FL		X	
Santa Barbara, CA			X
Brevard, FL		X	
San Joaquin, CA			X
Charleston, SC	X		
Polk, FL		X	
Greenville, SC		X	
Stark, OH		X	
Stanislaus, CA			X
Spokane, WA		X	
Forsyth, NC			X
Mahoning, OH		X	
Tulare, CA			X
55	6	18	31
100.00%	10.91%	32.73%	56.36%

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