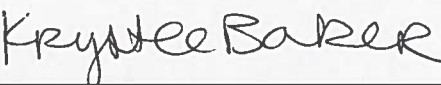
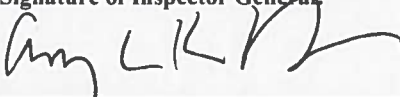


Case Title: Homestead Exemption – Actual Value Initiative	Type of Investigation: Compliance & Policy Review	Type of Report: <input checked="" type="checkbox"/> Final <input type="checkbox"/> Supplemental
Period of Investigation: August 2015 – October 2016	Department/Program: Office of Property Assessment Revenue Department	

CITY OF PHILADELPHIA OFFICE OF THE INSPECTOR GENERAL



Policy Recommendation Report *The Homestead Property Tax Exemption*

Distribution	No.	Signature of Investigator Making Report:
Revenue Department	1	
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I. Summary

In 2014, the Office of the Inspector General (OIG) started a long-term initiative to review and evaluate the City's administration of the Homestead Exemption – a reduction in taxable property value that is available for Philadelphia homeowners' primary residences. This effort identified over 500 properties throughout Philadelphia where substantial evidence indicated that the Homestead Exemption was misapplied. As a result, the City is losing significant tax revenue – approximately **\$682,958** in tax years 2014, 2015 and 2016 combined. And, this figure represents only a fraction of the additional revenue that is potentially available through accurate administration and enforcement of the Homestead Exemption tax benefit.

In order to ensure fairness for Philadelphia taxpayers and generate revenue that could make an impact on the entire City, the OIG recommends that the City: (i) continue to audit taxpayers who received the Homestead Exemption; (ii) update the application for the exemption; (iii) require and review supporting documentation; and (iv) assess back-taxes, interest and penalties.

Part II of this report presents background information about Philadelphia's current property tax system and exclusion rules. Part III outlines the OIG's investigation and research; Part IV presents the results of that research. Part V estimates the amount of uncaptured tax revenue and offers the OIG's recommendations for improvement.

II. Background

In tax year 2014, the City of Philadelphia implemented a new method to assess property taxes. Known as the Actual Value Initiative (AVI),¹ the new tax structure was designed to more fairly assess property values – considering things like size, age, location, condition, use and comparably similar properties. A new tax rate would then be applied to these updated values, establishing the final property tax owed.²

While AVI purportedly made the tax system more efficient and fair, it also caused some residents' tax burdens to increase, in some cases up to 400%. In order to provide relief, the Code also included a partial exclusion for Philadelphia homeowners' primary residences – the "Homestead Exemption."³ This exemption can be applied to properties in which the owner resides, reducing the taxable value of the home by up to \$30,000.⁴ All eligible homeowners are entitled to the exemption regardless of age or income.

In 2014, the application process was simple and the Homestead Exemption was widely granted. After listing basic information such as name, address and email, applicants responded to the following questions:

- Is this property your primary residence?

¹ <http://www.phila.gov/OPA/Assessments/Pages/HowOPAAssessProperty.aspx>.

² The Real Estate Tax, Code §19-1300, and the School Tax, Code §19-1800, are both based on the assessed value of real property. For purposes of this report, the terms "property tax" and "tax rate" are intended to describe both of these consistent taxing authorities.

³ Philadelphia Code §§ 19-1301.1, 19-1801.1.

⁴ If a homeowner's property is mixed use, with a portion used for commercial or rental space, the Homestead Exemption can be proportionally applied to the part of the property that serves as the primary residence.

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- Do you claim anywhere else as your primary address?
- Is this residence part of a cooperative where some or all of the taxes are paid jointly?
- Is your property used for something other than your primary residence, such as a business or rental property?

Based on the application alone – the answers to these straightforward questions – the Homestead Exemption was either granted or denied. No other information or documentation was required, and the City took no steps to investigate and/or verify the representations made on these applications. In fact, the Homestead Exemption application remains the same to this date – no changes have been made since it was first created.

It is important to note that this application process was a deliberate policy decision of City administrators. In an effort to improve access to a City-related benefit, and to ensure low barriers of entry for those who might require tax relief, the application was streamlined and purposefully limited in scope.

Of course, this method of administering the Homestead Exemption resulted in a very liberal application of the \$30,000 reduction in taxable property values.

III. OIG Investigation

In February 2014, the OIG received an anonymous complaint about a property in Northeast Philadelphia where the Homestead Exemption was allegedly misapplied. The complainant alleged that the property was a rental, and therefore not entitled to the full \$30,000 exclusion amount.

After investigating, the OIG found ample evidence to substantiate the allegation; including: an active rental license, inconsistent PWD billing records, and the owners' PennDOT driver's licenses that listed home addresses outside of Philadelphia. The OIG brought this evidence to the Office of Property Assessment (OPA), and the Homestead Exemption was subsequently removed.

This isolated investigation, however, raised larger questions about the Homestead Exemption – there was potentially a significant amount of uncaptured property tax revenue due to misapplied exemptions across Philadelphia. The OIG also learned that OPA openly approved as many requests for the Homestead Exemption as possible, as a matter of policy, intending to revisit the administration of this tax benefit at a later time.

Working together with OPA, the OIG undertook the larger project of examining the Homestead Exemption more broadly. Investigators obtained a list of approximately 2,000 Philadelphia properties where the homeowner listed a secondary mailing address, suggesting a possible misrepresentation of the property's eligibility for the Homestead Exemption.

Starting with this selection of properties, all of which received the exemption at some point, OIG investigators conducted significant background research in order to determine the taxpayer's primary residence. Investigators examined:

- deeds, mortgages, and other recorded documents in Philadelphia and other counties throughout the United States;

- PennDOT driver’s license records;
- Philadelphia Water Department billing information and usage records;
- permits, licenses, and other records associated with the Department of Licenses + Inspections;
- social media websites; and
- open source internet search engines.

After this review, investigators compiled all relevant information and analyzed the results for each property. Where substantial evidence suggested that the Homestead Exemption was misapplied, the OIG worked with OPA to begin the process of removing the exemption and correcting the taxable value.

IV. OIG Findings

This research identified a total of **558** properties where the taxpayer was granted a Homestead Exemption but evidence suggested that the property did not qualify under the Code. This included properties that were: (i) openly rented to other tenants; (ii) vacant; and/or (iii) used for something other than a primary residence. The OIG provided OPA with the research results and the supporting documentation.

Using the information from the OIG investigation, OPA began the process of removing the Homestead Exemption in select cases.⁵ The taxable values for many of these properties has already been corrected, but many more are still outstanding.

Importantly, administrative responsibility for the Homestead Exemption has since been transferred from OPA to the Revenue Department (Revenue), and the OIG has also provided Revenue with the research results and supporting documentation. The OIG remains committed to the proper administration of this tax break for true Philadelphia homeowners.

V. Analysis & Recommendations

Understanding the challenges of administering a new property tax assessment method, and the articulated policy aims, this investigation has identified potentially significant tax revenue that is currently not captured. Out of a sample of 1,947 properties that were granted Homestead Exemptions, the OIG identified 558 that may not have been entitled to the tax break. In tax years 2014 and 2015, each misapplied Homestead Exemption cost the City \$402 (1.34% of \$30,000) in missed tax revenue per year. In 2016, each unwarranted exemption cost the City \$419.94 (1.3998% of \$30,000). So, in total, 558 misapplied Homestead Exemptions represent potential tax revenue of **\$682,958** across tax years 2014, 2015 and 2016 combined – as shown in Table 1.

Table 1: Uncaptured Tax Revenue Due to Misapplied Exemptions

Tax Year	Value of \$30,000 Exemption	Value of 558 Exemptions
2014	\$402.00	\$224,316.00
2015	\$402.00	\$224,316.00
2016	\$419.94	\$234,326.52
Total		\$682,958.52

⁵ After the OIG identified a number of properties that did not appear to qualify for the Homestead Exemption, OPA sent letters to identified properties. If no response was provided within a period of time, the Homestead Exemption was removed. If a response was received, OPA would make a determination based on the information provided by the OIG and property owner.

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Although this figure is an estimate that is based on a small selection,⁶ it highlights a larger problem. The OIG only examined a very small subset of properties, and 28% (558/1947) showed significant evidence of an unwarranted tax break. If OPA and/or Revenue were to closely review the *full set* of properties where taxable value was reduced due to Homestead Exemptions, the City could likely identify *far more* tax revenue that has gone uncollected.

Such an examination could screen for some simple factors that are indicative of misapplied exemptions, like: (i) properties owned by corporations and/or other business entities; (ii) properties with active rental or vacant property licenses; and (iii) two or more properties with the same owner information. Given the open manner in which Homestead Exemptions were initially granted, a review of properties that display one or more of these characteristics would likely identify much more available tax revenue that has gone uncollected. This figure could easily approach several million dollars.

Ultimately, the City of Philadelphia must improve administration and enforcement of the Homestead Exemption. In addition to a continued review of Homestead Exemption properties, the OIG recommends the following, in the interest of gaining accuracy and generating additional tax revenue:

1. *Update the Exemption Application.*

The City's current application for the Homestead Exemption is purposefully straightforward – it is the result of a decision to help Philadelphians access the benefit. Access is important, but granting the exemption in this manner also carries an associated cost, as demonstrated here. An open up-front process increases the probability of an over-inclusive set of exemptions – and therefore more revenue is at risk. The cost of unwarranted exemptions must be evaluated along with all other policy considerations, and some low-impact front-end screening could yield valuable savings for the City.

Notably, other states and local governments require much more information from applicants for similar tax exemptions.⁷ Such information includes: (i) employer information, (ii) voter registration, (iii) schools of dependent children, (iv) vehicle registration, and (v) driver's license information. While these application questions alone cannot ensure 100% accuracy, they can supplement the already existing questions and create a more comprehensive picture for tax administrators to consider when awarding the exemption.

2. *Require & Review Supporting Documentation.*

Similarly, the City should not simply accept applicant statements as true. Where relevant, an application for the Homestead Exemption should be supported with appropriate documentation; like copies of a driver's license, registration card, utility bills, and/or anything else that can help the City confidently

⁶ All properties in the OIG's sample had a secondary mailing address listed on the account. All taxpayers are entitled to further examination of the evidence that the property was or was not a primary residence. And, not all taxpayers claimed the full \$30,000 exemption amount.

⁷ For example, in Orleans Parish, Louisiana, applicants for a similar tax exemption must appear in-person at the assessor's office and furnish: (i) proof of ownership; (ii) a valid state identification that lists the property as the applicant's home address; (iii) an energy bill; and (iv) telephone or cable bill.

<http://nolaassessor.com/docs/homestead%20exemption%20and%20special%20assessment%20levels.pdf>.

award the tax break. The request for supporting documentation will also discourage misrepresentations and attempted fraud.

3. *Assess Back-Taxes, Penalties & Interest.*

Lastly, the Philadelphia Code specifically contemplates enforcement of the Homestead Exemption and provides for back-taxes, interest and additional penalties in some cases.⁸ According to §19-1301.1, taxpayers are liable to repay discounts from misapplied exemptions, plus interest and a 10% penalty. So far, the City has only initiated these enforcement efforts in two instances. The back-end enforcement effort should be far more aggressive, especially considering the fact that the City purposefully grants the Homestead Exemption with slight initial screening.

At a minimum, the OIG recommends that the City initiate action to recoup the resultant tax revenue that was lost in previous years due to unwarranted exemptions.

⁸ See Philadelphia Code § 19-1301.1(6).