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DEPARTMENT OF
FINANCE

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May 17, 1989
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DIVISIONS:
ACCOUNTING
BUDGET
REVENUE
RISK MANAGEMENT

Budget and Finance Committee
Sacramento, California 95814

Honorable Members in Session:

SUBJECT: Business Operations Tax Audit

SUMMARY

This report is in response to a request of the Budget and Finance Committee to review the decreasing trend in Business Operations Tax (BOT) as compared to Sales Tax revenues. This trend was identified during the midyear review by DRI, the City's economic consultant.

BACKGROUND

The apparent shortfall in anticipated BOT revenues appears to be the result of underpayments by City businesses and the City, due to staff limitations, not aggressively pursuing available programs to discover businesses that may not be aware of or are avoiding the BOT. Prior review of various businesses, performed by Internal Audit during 1987, revealed several businesses which were under reporting or not filing for BOT.

Two alternatives for pursuing these additional revenues were considered. The objective of capturing these revenues can be achieved by contracting with an outside service for a percentage of the amounts collected as a result of the service, or, setting up in-house to perform these services with an augmentation to current City staff.

The Internal Audit Section now has the resources to perform an audit and develop recommended procedures for the review of reported gross receipts and to pursue programs to discover businesses that may be unaware of or are avoiding the BOT. The addition of 1.0 FTE Account Clerk II to the Revenue Division would enable staff to implement and maintain an on-going BOT compliance program.

This staff position would be utilized to perform on-going administration and monitoring of the established program. This position would be responsible for performing steps such as the following:

- o Reviewing existing reports and reports to be developed, to compare the sales tax and business tax files and reporting trends, for businesses which are under reporting or not filing for BOT.
- o Search for businesses without Business Operations Certificates by utilizing business listings from various sources such as association listings of businesses operating within Sacramento.
- o Correspond with businesses to obtain information for review and verification of gross receipts.
- o Determine BOT amounts owed the City by those businesses that have under reported or not filed for BOT.
- o Perform additional procedures developed to ensure compliance with BOT Codes.

FINANCIAL

The preliminary estimate from the Finance Department, Revenue Division, of potential unreported BOT revenues is approximately \$300,000. The 1989-90 Proposed Budget includes a net increase in Business Tax revenue to the General Fund of \$200,000 resulting from an audit program. This estimate was based on performing this function through contracting with an outside service. However, performing this program with in-house staff appears to be an alternative which would be more cost effective. Following is a comparison of the estimated revenue and expenditures of the two options:

	Option 1 Outside Services -----	Option 2 City Staff -----
Gross Revenues	\$300,000	\$300,000
Contract Costs	90,000	0
Account Clerk II	0	31,700
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Net Revenue Increase	\$210,000	\$268,300

* The Administrative support for both options are estimated to be at the same level.

The augmentation of staff and aggressively pursuing the known programs along with other methods and procedures recommended by Internal Audit would help assure BOT compliance. Additionally, establishing this function internally will enhance on-going revenues with the incremental payments from, and continued

monitoring of, all such businesses in future years.

Performing this function through contracting with an outside service would cost the City 30% (\$90,000 per estimated revenues) of the deficiency recoveries plus an additional 30% of the incremental business tax revenue realized by the City for the first 24 months following delivery of the service's report. Contracting with an outside service may then be required each year since it would not allow for potential long-term benefit as a result of augmenting the City staff required to implement and maintain an internal monitoring system.

POLICY MATTERS

Guidelines for the charging of Business Operations Tax are provided for in Sacramento City Code, Business Operations Tax, Chapter 23. Code Section 23.206 requires businesses to keep complete records etc., relevant to establishing and verifying tax liability for examination by the Administrator for a period of at least three years. Policy consideration may be given to the period of unpaid BOT that will be pursued.

Providing for a more thorough and aggressive program for BOT compliance will help assure a more equitable tax policy for all BOT payors.

MBE/WBE EFFORTS

None.

RECOMMENDATION

This report is submitted for committee information. If the committee supports the concept of performing the Business Tax Audits with the use of City staff as opposed to outside contract services, the additional position required will be included in the Proposed Budget when submitted to the City Council.

Respectfully submitted,

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May 23, 1989
All Districts