

AUDIT REPORT

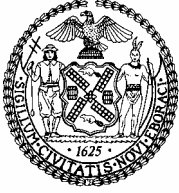


CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF FINANCIAL AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

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

FP06-064A

December 13, 2005



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

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, §93, of the New York City Charter, my office has audited the adequacy of the Department of Finance's classification procedures for real properties in the borough of Staten Island listed as Tax Class 1 on the assessment rolls.

Under the New York City Real Property Tax Law, Class 1 properties are those that either contain three residential units or less, or contain some commercial usage provided that 50 percent or more of the property is used for residential purposes. We audit agency procedures such as this to ensure that they are in accordance with applicable law and result in the correct determination of revenues due the City.

The results of our audit, which are presented in this report, have been discussed with Department of Finance officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

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

Very truly yours,

A handwritten signature in cursive script that reads "William C. Thompson, Jr.".

William C. Thompson, Jr.

WCT/fh

Report: FP06-064A
Filed: December 13, 2005

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*The City of New York
Office of the Comptroller
Bureau of Financial Audit*

**Audit Report on the Tax Classification of
Real Property in the Borough of Staten Island
By the Department of Finance**

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AUDIT REPORT IN BRIEF

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

Audit Findings and Conclusions

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

We identified 47 properties listed as Class 1 on the assessment rolls that appeared to be misclassified. Using Finance guidelines, we determined that these properties should have been classified as Class 4. Had these properties been correctly classified, we calculate that Finance would have billed the owners an additional \$295,559 property taxes for Fiscal Year 2005 and subsequent years.

Audit Recommendations

We recommend that Finance should:

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

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

INTRODUCTION

Background

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

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

- *Class 1*: Residential properties (with three units or less) and “Mixed Commercial/Residential Use” (mixed-use) properties (with three or less units) provided 50 percent or more of these spaces are used for residential purposes. This includes the following types of primarily residential property: one-, two-, and three-family homes, condominiums of three stories or less that were originally built as condominiums; condominiums of three dwelling units or less that were previously one-, two-, or three-family homes; single-family homes on cooperatively owned land (also known as bungalows); and certain vacant land zoned for residential use or, if not in Manhattan south of 110th Street, vacant land adjoining improved Class 1 property.
- *Class 2*: All other primarily residential properties, including any residential condominiums not in Class 1. This includes co-ops but does not include hotels, motels, or similar property.
- *Class 3*: Real estate of utility corporations and special franchise properties, excluding land and certain buildings.
- *Class 4*: All other properties, such as stores, warehouses, hotels, and any vacant land not classified as Class 1.

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

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

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

This is the fifth of a series of audits currently being conducted on Finance tax classification procedures. The first audit covered the borough of Brooklyn¹, the second audit covered the borough of Queens², the third audit covered the borough of Bronx³, and the fourth audit covered the borough of Manhattan⁴.

Objective

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

Scope and Methodology

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

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

Finance provided us with a list of 1,128 Class 1 mixed-use properties in Staten Island. We selected all 1,128 properties in the borough of Staten Island for review. In July 2005, we visited each of the properties to determine whether they were correctly classified. Our determination was based on the percentage of commercial space at each of the properties, since properties with more than 50 percent of the space used for commercial purposes cannot be

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

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

³ Audit Report on the Tax Classification of Real Property in the Borough of Bronx by the Department of Finance (FP05-120A), issued June 30, 2005.

⁴ Audit Report on the Tax Classification of Real Property in the Borough of Manhattan by the Department of Finance (FP05-131A), report in process as of November 21, 2005.

classified as Tax Class 1—§ 1802 of the RPTL states that “all one, two and three family residential real property, including such dwellings used in part for nonresidential purposes but which are used **primarily** [Emphasis Added] for residential purposes,” are to be classified as Class 1 properties. Properties that are more than 50 percent commercial cannot be considered “primarily for residential purposes.” For the properties we noted that were misclassified, we applied formulas provided by Finance to calculate the amount of additional tax due based on the appropriate tax classification for each property.

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

Discussion of Audit Results

The matters covered in this report were discussed with officials from Finance during, and at the conclusion of, this audit. A preliminary draft report was sent to Finance officials and was discussed at an exit conference held on October 21, 2005. On November 9, 2005, we submitted a draft report to Finance officials with a request for comments. We received a written response from Finance officials on November 28, 2005.

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

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

FINDINGS AND RECOMMENDATIONS

Finance does not have adequate procedures in place to ensure that mixed-use properties in the borough of Staten Island that are listed as Class 1 on the assessment rolls are correctly classified. Although Finance routinely inspects Class 2, 3, and 4 properties to ensure that they are correctly classified on the assessment rolls, it does not conduct such inspections of Class 1 properties. Instead, Finance inspects Class 1 properties only when it is informed by the Department of Buildings that the properties are being altered or renovated. Consequently, 44 mixed-use properties were listed as Class 1 on the assessment rolls that appeared to be misclassified.

Improper Classification of Mixed-Use Properties

Our inspection of the 1,128 mixed-use properties revealed that 44 were misclassified. These properties should have been listed as Class 4 because more than 50 percent of the properties' space was used for commercial purposes. Had those 44 properties been correctly classified, we calculate that Finance would have billed the owners an additional \$284,505 in property taxes for Fiscal Year 2005 and subsequent years (based on each year's tax rate and the assessed value of the properties).⁵

Examples of misclassified properties are as follows:

- 1146 Forest Avenue was listed on the assessment rolls as a "Primarily One-Family with One Store or Office" (Tax Class 1, Building Code S1). Our inspection of the property disclosed that the entire building was used as a professional office. (See Appendix I for a photograph of the property.) Accordingly, Finance should have classified this property as a "Professional Building" (Tax Class 4, Building Code O7). For Fiscal Year 2005, Finance billed the owner of this property \$2,442 rather than the \$8,085 due based on the appropriate Class 4 tax classification.
- 1865 Victory Blvd. was listed on the assessment rolls as a "Primarily One-Family with One Store or Office" (Tax Class 1, Building Code S1). Our inspection of the property disclosed that the building had a store and showroom on the first floor and an office on the second floor. (See Appendix II for a photograph of the property.) Accordingly, Finance should have classified this property as a "Store Building; Two-Story or Store/Office" (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property \$2,373 rather than the \$10,126 due based on the appropriate Class 4 tax classification.
- 3875 Victory Blvd. was listed on the assessment rolls as a "Primarily One-Family with One Store or Office" (Tax Class 1, Building Code S1). Our inspection of the property disclosed that the entire building was used as a veterinary clinic. (See Appendix III for a photograph of the property.) Accordingly, Finance should have classified this property

⁵ We recognize that according to Real Property Tax Law §1805, Finance will have to phase-in the additional taxes over a five-year period. The \$284,505 that was calculated assumed that the properties were always correctly classified as Class 4 properties, therefore, no phase-in would have been required.

as a “Store Building; Two-Story or Store/Office” (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property \$2,429 rather than the \$8,267 due based on the appropriate Class 4 tax classification.

Improper Classification of Other Class 1 Properties

During our visits to the sampled properties, we identified three other properties that were improperly classified as Class 1 residential. Had these properties been correctly classified, we calculate that Finance would have billed the owners an additional \$11,054 in property taxes for Fiscal Year 2005.

For example, 702 Forest Avenue was listed on the assessment rolls as a “Two Story – Detached” residential building (Tax Class 1, Building Code A1). Our inspection of the property disclosed that the building was used as a salon and spa. (See Appendix IV for a photograph of the property.) Accordingly, Finance should have classified this property as a “Store Building; Two-Story or Store/Office” (Tax Class 4, Building Code K2). For Fiscal Year 2005, Finance billed the owner of this property \$2,763 rather than \$5,710 due based on the appropriate Class 4 tax classification.

Finance Response: In its response, Finance stated that “Of the 47 properties cited in this draft, 1 required a partial change to Class 2 rather than Class 4, and the remainder were as indicated by the Comptroller’s draft audit report (with the exception of 3 properties yet to be re-inspected). Finance estimates that additional taxes approximately \$34,882 (3 properties as indicated will be re-inspected as soon as possible) are owed on these properties.”

Auditor Comment: Finance’s estimate that only \$34,882 in additional taxes is due for Fiscal Year 2005 is based on the fact that Real Property Tax Law §1805 requires that Finance phase in any additional taxes owed on misclassified properties over a five-year period. The fact that the \$295,559 stated in the report could not have been collected for Fiscal Year 2005 but requires a phase-in period does not alter the fact that Finance agrees that all 47 properties (with the exception of 3 properties yet to be re-inspected) cited in the report are misclassified.

Recommendations

Finance should:

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

Finance Response: “We agree. Finance has or will have inspected all the identified properties and has or will have reclassified properties that Finance agreed were misclassified.”

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

Finance Response: “We agree. Finance has made the necessary adjustments to the ‘06/’07 tentative assessment roll for the properties Finance agreed were misclassified.”

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

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

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



1146 Forest Avenue: Finance records inaccurately listed this property as a “Primarily One-Family with One Store or Office” (Tax Class 1, Building Code S1).



1865 Victory Blvd.: Finance records inaccurately listed this property as “Primarily One-Family with One Store or Office” (Tax Class 1, Building Code S1).



3875 Victory Blvd: Finance records inaccurately listed this property as a “Primarily One-Family Building with One Store or Office” (Tax Class 1, Building Code S1).

APPENDIX IV



702 Forest Avenue: Finance records inaccurately listed this property as a “Two Story - Detached” residential building (Tax Class 1, Building Code S1).



**FINANCE
NEW • YORK**
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

BY FAX AND HAND DELIVERY

November 28, 2005

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

**Re: Audit Report on the Tax Classification
of Real Property in the Borough of
Staten Island by the Department of Finance
FP06-064A**

Dear Mr. Brooks:

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

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

The Comptroller's audit of 1,128 Class 1 mixed-use properties has determined that 44 were apparently misclassified and should have been classified as Class 4. Assuming these properties were always misclassified, the audit indicates a loss of \$284,505 in property taxes for Fiscal Year 2005 and subsequent years. During visits to sampled properties, an additional 3 properties were found to be similarly misclassified for an additional loss of \$11,054 in property taxes for Fiscal Year 2005. In all, the audit cites the possible misclassification of 47 properties for a potential total loss of \$295,559.

Finance has subsequently re-inspected all but three of these 47 properties which were inaccessible at the time of this response (and 25 others included in an earlier preliminary draft), as recommended by the audit: Of the 47 properties cited in this draft, 1 required a

partial change to Class 2 rather than Class 4, and the remainder were as indicated by the Comptroller's draft audit report (with the possible exception of 3 properties yet to be re-inspected). Finance estimates that additional taxes totaling approximately \$34,882 (3 properties as indicated will be re-inspected as soon as possible) are owed on these properties.

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

Recommendation 1:

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

Finance's Response:

We agree. Finance has or will have inspected all the identified properties and has or will have reclassified properties that Finance agrees were misclassified.

Recommendation 2:

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

Finance's Response:

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

Recommendation 3:

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

Finance's Response:

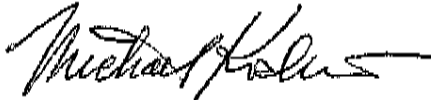
We disagree. By law, Finance is only required to inspect Class 1 properties every three years. Through the use of state-of-the art technology, Finance will in effect be collecting property specific information on an annual basis. The agency is currently working with the Department of Information, Technology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

Finance greatly appreciates the efforts of your audit staff as it completes audits of the five boroughs and their assistance in providing relevant information that enables us to conduct these inspections and make the necessary adjustments.

Finance's goal is to provide as efficiently as possible, as accurate and fair an assessment roll as is possible utilizing the agency's resources. The Comptroller's findings and recommendations are valuable and helpful and do not negate the agency's success in meeting its stated objectives.

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

Sincerely,



Michael Koslow
Audit Coordinator

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