New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Department of the Treasury
Division of Taxation
Rebate Eligibility

October 1, 2006 - September 30, 2009
The Honorable Christopher J. Christie  
Governor of New Jersey

The Honorable Stephen M. Sweeney  
President of the Senate

The Honorable Sheila Y. Oliver  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Division of Taxation, Rebate Eligibility for the period of October 1, 2006 to September 30, 2009. If you would like a personal briefing, please call me at (609) 292-3700.

Stephen M. Eells  
Assistant State Auditor  
January 21, 2010
# Table of Contents

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Objectives</td>
<td>1</td>
</tr>
<tr>
<td>Methodology</td>
<td>1</td>
</tr>
<tr>
<td>Conclusions</td>
<td>2</td>
</tr>
<tr>
<td><strong>Findings and Recommendations</strong></td>
<td></td>
</tr>
<tr>
<td>Verification of PTR Eligibility - Background</td>
<td>3</td>
</tr>
<tr>
<td>Age or Disability Eligibility</td>
<td>3</td>
</tr>
<tr>
<td>Income Eligibility</td>
<td>4</td>
</tr>
<tr>
<td>Ownership Eligibility</td>
<td>5</td>
</tr>
<tr>
<td>Verification of Property Tax Deduction Eligibility - Background</td>
<td>6</td>
</tr>
<tr>
<td>Senior Deduction Income Eligibility</td>
<td>6</td>
</tr>
<tr>
<td>Selection and Testing Methods of Deduction Programs by the Division</td>
<td>7</td>
</tr>
<tr>
<td>Auditee Response</td>
<td>8</td>
</tr>
</tbody>
</table>
We have completed an audit of the Department of the Treasury, Division of Taxation property tax rebate and deduction programs for tax year 2007. The scope of the audit was limited to eligibility requirements for Property Tax Freeze (PTR) and Senior and Veteran Property Tax Deductions. The primary purpose of these programs is to provide property tax relief to taxpayers. The PTR program effectively freezes property taxes for eligible New Jersey senior citizens and disabled persons by reimbursing them for property tax increases subsequent to their base year of eligibility. The base year is the first year that all eligibility requirements are met. PTR reimbursements for tax year 2007 were disbursed in fiscal year 2009 to 154,600 taxpayers and totaled $165 million. Property Tax Deductions provide an annual $250 decrease in taxes for eligible senior citizens and veterans and are credited directly to the taxpayer property tax bill. Property Tax Deductions for tax year 2007 totaled $90 million and were credited to 362,000 taxpayers.

An objective of the audit was to determine if the division has processes in effect that monitor eligibility requirements for property tax reimbursements and deductions. We also determined whether the reimbursements and deductions paid for tax year 2007 were related to the programs and were recorded properly in the accounting systems.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.
In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the Department of the Treasury, and policies of the division. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of reimbursement and deduction transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the programs and the internal controls. Also, we analyzed internal and external data sources through queries, matches, and data mining techniques to verify eligibility.

A statistical and nonstatistical sampling approach was used. Our samples of reimbursement and deduction transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were randomly and judgmentally selected for testing.

**Conclusions**

We found that tax year 2007 property tax reimbursement and deduction transactions included in our testing were related to the programs and were properly recorded in the accounting systems. However, in making this determination, we noted weaknesses in the verification of eligibility process performed by the division for the PTR and property tax deduction programs which require management’s attention. We have noted numerous other sources of data and data analysis techniques which should be performed to more accurately substantiate eligibility and enable the division to discontinue improper payments to ineligible applicants.
Verification of PTR Eligibility - Background

For tax year 2007 the Property Tax Freeze Program (PTR) reimbursed the difference between the amount of property taxes that were paid in a taxpayer’s base year and the amount of property taxes that were paid in 2007. To qualify for the PTR, a taxpayer must have been age 65 or older or receiving federal social security disability benefits as of December 31, 2006. The taxpayer’s total income must have been less than $60,000. Recent legislative changes have increased the income limits in tax years 2008 and 2009 to $70,000 and $80,000, respectively. Also, the taxpayer must own and reside in a primary residence for at least three years prior to their base year of eligibility. A legislative change for 2009 will decrease the primary residency requirement from three to two years for certain taxpayers. During our audit we identified various sources of data to accurately substantiate eligibility requirements which the division was not utilizing.

Age or Disability Eligibility

The division requires a taxpayer 65 or older to submit a valid copy of their driver’s license, birth certificate, or other valid form of identification with their first year PTR application (PTR-1). A disabled homeowner is required to submit a copy of their social security disability award notification during their initial application process. Prior to 2002 the division did not require new PTR recipients to provide proof of age or disability documentation. For tax year 2007 there were 50,000 PTR recipients who entered the program before 2002. Although the division now requests age or disability documentation, no procedures are performed to verify the accuracy of the information they receive or to follow up when taxpayers fail to provide this information.
The PTR-1 application is submitted to the Division of Revenue, where it is processed onto the Generic Tax System (GENTS). If proof of age or disability is not present the Division of Revenue does not notify the Division of Taxation. In addition, the Division of Taxation does not have adequate system edits to recognize age or disability discrepancies.

We randomly sampled 38 PTR reimbursements from tax year 2007 and noted 15 exceptions for inadequate age or disability documentation. Also, we identified 6,000 recipients who were less than 65 based on a federally sourced date of birth. We determined that 4,800 of these recipients were recorded on the GENTS system as being greater than 65 for PTR eligibility. A sample of 20 disclosed 18 recipients had filed as disabled but were incorrectly processed by the Division of Revenue as greater than 65.

Furthermore, we matched the 6,000 recipients who were less than 65 to Federal 1040 data. We determined that 405 PTR recipients, who received $318,000 in reimbursements, claimed no social security on their federal returns, indicating a high potential for ineligibility based on a disability. We tested a sample of ten and found that seven PTR recipients had no social security documentation on file.

**Income Eligibility**

To be eligible for a 2007 PTR a senior homeowner’s income or combined income must be less than or equal to $60,000. The division is not utilizing Federal 1040 data to verify income limits. The division houses federal data within its Taxation Data Warehouse Unit (TDW). Through cooperation with TDW, a match was performed between 2007 PTR participants and their corresponding federal tax returns. The match resulted in 1,247 PTR claims, totaling approximately $1.3 million, which had qualified sources of income greater than the PTR income
threshold. PTR instructions clearly state income limitations for program qualification and what sources of income are included or exempt from this calculation. Additionally, a detailed income worksheet is prepared by the taxpayer annually that should provide all reportable income earned. The division uses this information as a verification source. Based on our testing we noted taxpayers were not reporting the same qualified income sources on their PTR compared to amounts reported on their federal tax forms.

Ownership Eligibility

PTR eligibility instructions require the taxpayer to both own and live in the residence three years prior to the year in which they are claiming a tax reimbursement. Although the division has access to New Jersey Property Tax Systems (MODIV) real estate sales data, it does not utilize this information to verify the three-year residency requirement. For tax year 2007, using data analysis techniques, we identified a population of PTR recipients that have a high likelihood of being ineligible due to not meeting the three-year ownership criteria. We focused on property sales with a dollar value greater than $1,000 in order to reduce the risk of including transfer of ownership transactions such as life estates. Our analysis identified 824 likely ineligible taxpayers that received $359,000 in PTR reimbursements. We sampled ten transactions more closely and noted no deed evidence to suggest that nine of the PTR recipients satisfied the three-year ownership eligibility requirement.

Recommendation

We recommend the division:

- Update the screening instructions for the Division of Revenue to indicate whether proof of age is submitted with a PTR-1 application. The Division of Taxation should verify the initial PTR-1 age or disability documentation and reimbursements should not be approved until proper support is provided. Also, the Division of
Taxation can verify disabled PTR applicant’s social security disability status on an annual basis by performing a match of Social Security Benefit Statement (SSA 1099) information. Furthermore, processing of PTR applications by the Division of Revenue needs to be improved.

- Utilize available tax data to verify that all PTR claims are within the specified income limitations.

- Match PTR applicants to MODIV real estate sales data and utilize data analysis techniques to identify ineligible PTR payments.

Verification of Property Tax Deduction Eligibility - Background

Currently, municipalities are responsible for administering and monitoring the Property Tax Deduction programs. All deductions are reimbursed to the municipality by the State. Additionally, they receive an administrative fee that is based on how many deductions they administer per year.

Senior Deduction Income Eligibility

One of the eligibility criteria for a 2007 Senior Property Tax Deduction is that a homeowner’s income or combined income must not exceed $10,000, after permitted income exclusions. Municipalities are required to distribute and collect form PD-5. This form requires the taxpayer to confirm they did not exceed the prescribed senior deduction income limit in the previous tax year and do not expect to in the upcoming tax year. Municipalities are unable to verify this information. In addition, the division is not utilizing a combination of Federal and State 1040 data to verify income limits. We matched
the entire statewide property tax deduction population for tax year 2007 against a combination of Federal and State 1040 reported income data and found 9,162 cases, totaling $2.3 million, where the taxpayer exceeded the income limit and therefore was ineligible to receive the deduction.

**Selection and Testing Methods of Deduction Programs by the Division**

The division currently audits municipalities for the Property Tax Deduction programs. From calendar year 2006 through 2008 the division performed an average of six municipal audits a year, which consisted of 100 percent testing of their senior and veteran deduction populations. The audits have only been performed in two counties. The audits have been able to identify an average exception rate of five percent. We noticed there are common errors among the audit exceptions found and the division could utilize information resources available to assess high risk populations to aid in selecting audits. By using a more risk based sampling approach in selecting and conducting its audits, the division could have a greater monitoring presence throughout the state.

**Recommendation**

We recommend the division:

- Enhance the PD-5 form to include an authorization statement that indicates the income information confirmed by the taxpayer will be compared with federal and state tax return information for eligibility verification.

- Utilize available tax data to verify that senior deductions are within the specified income limitations.
- Perform a more risk based sampling approach in selecting and conducting its audits of municipalities for property tax deduction compliance.
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Re: Audit – Rebate Eligibility  

Dear Mr. Eells:  

Thank you for the opportunity to evaluate the audit findings and recommendations for the property tax rebate and deduction programs for tax year 2007. Please know that the Division of Taxation welcomes the recommendations provided by the Office of the State Auditor and has every intention of enhancing its processes concerning the eligibility criteria for the property tax reimbursements and deductions. Our plans are subject to the limitations caused by reduced staffing and technology resources.  

Before responding to the recommendations in this report, I believe it important to raise the issues of the difficulty and inefficiency faced by the Division of Taxation that is tasked with administering multiple rebate programs, each with its own set of rules, requirements and deadlines, each subject to last minute yearly modification by the legislature due to the shifts in available revenues. The end result is a lack of consistency and continuity creating confusion for the public trying to determine eligibility and increased risk of errors on the various applications by the applicants. Having to react and adjust to last minute legislative changes also increases the risk of errors by the Division's programmers and processors.  

As to the recommendations in this report, the Division of Taxation has already engaged its processing partner agency, the Division of Revenue, in discussions to improve the screening protocols for the PTR forms. Additional analysis by Division staff has also commenced regarding the verification of the PTR eligibility, including the identification of additional potential data sources for the eligibility verification process. As always, the desire to implement potential improvements is tempered by available resources of staff and funds. For the property tax deduction programs operated by the municipalities, the Division intends to work with the municipalities to modify the PD-5 form, ever mindful of the confidentiality of tax information and the privacy expectations of individuals, and to refocus the Division's local property audit resources toward a risk based audit sampling approach for a greater monitoring presence throughout the 566 municipalities, as suggested.  

It has been a pleasure working with your professional and perceptive auditors.  

Very truly yours,  
Cheryl Pulmer  
Acting Director  
Division of Taxation  

http://www.state.nj.us/treasury/taxation/

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