FLORIDA LEGISLATURE Report No. 95-47

Office of
Program Policy Analysis
And Government Accountability

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Director

April 1, 1996

REVIEW OF THE ADMINISTRATION OF THE DOCUMENTARY STAMP TAX BY THE DEPARTMENT OF REVENUE

REPORT ABSTRACT

The Department of Revenue has proposed legislation that will eliminate the use of physical stamps to save an estimated $146,000 annually, but to realize these savings the Department will need to reduce administrative costs that will escalate if physical stamps are eliminated.

Although annual collections from documentary stamp tax audits have increased by $3.3 million during the past five years, the productivity of the Department's audits could be further enhanced.

County clerks retain about $4 million annually from documentary stamp tax collections to process a report that the state is unable to use effectively.

PURPOSE OF REVIEW

In this review, we examined: (1) how the Department of Revenue's proposed legislation to eliminate the use of physical stamps will effect its costs of administering the tax; (2) the productivity of the Department's documentary stamp tax audits and options for improving the efficiency of these audits; and (3) the cost-effectiveness of paying county clerks to provide information to the Department for use in its analysis of county property appraiser tax rolls.

BACKGROUND

State law requires that the public pay an excise tax in the form of a documentary stamp tax on certain documents specified by law. The tax generated $695 million during fiscal year 1994-95, of which $408 million was deposited in the General Revenue Fund. The tax also provides funding for state environmental land purchasing programs, such as Preservation 2000, and is the primary funding source for state and local government housing programs.

Florida's tax is levied at different rates on different tax bases. Currently, the tax is imposed at the rate of 70 cents per $100 of consideration (e.g., amount paid, fair market value) for deeds and other documents related to realty, and 35 cents per $100 of consideration for all other taxable documents (e.g., promissory notes, stock certificates). The tax is due whether or not the document is recorded with the clerk of the circuit court (county clerk). Recording a document provides notice to all persons as to the ownership of or encumbrance against a property.

The tax can be paid in three ways: (1) by purchasing physical stamps from a county clerk or the Department, which are affixed to the document; (2) by paying the tax at a county clerk's office, which is evidenced by the attachment of a meter tape to the document; or (3) by paying the tax at a county clerk's office or through an authorized business, which is evidenced by a notation on the document (notation method). County clerks may accept tax payments using the notation method on recorded documents. Businesses (e.g., financial institutions) and individuals may register with the Department to pay the tax using the notation method for documents not recorded by county clerks (e.g., obligatory notes from car dealers or finance companies). State law allows businesses or individuals to become registered taxpayers if, over a six-month period, they average at least $150 worth of stamp purchases or at least 50 taxable transactions per month.

State law authorizes the county clerks to retain 0.5% of the value of the tax collected as compensation for their costs to collect this state tax. In addition, state law requires that a report be filed with the county clerk when a deed is recorded and authorizes the county clerk to retain 1% of the value of the tax collected on the recording of deeds as compensation for processing these reports.

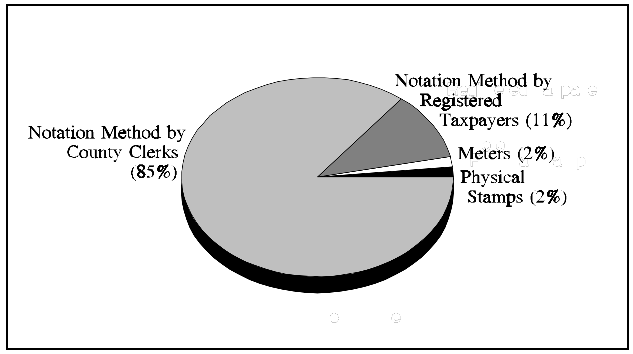
ELIMINATING PHYSICAL STAMPS

The Department of Revenue estimates that $146,000 will be saved annually by eliminating the use of physical documentary stamps. However, to realize these savings, the Department must develop strategies for containing the other costs associated with administering this tax.

The Department has proposed legislation (House Bill 2259, Senate Bill 2732) that eliminates the use of physical stamps as a method of paying documentary stamp tax. [1] The Department estimates this proposal should save $146,000 annually in central office expenses and personnel costs associated with printing, selling, maintaining, and ensuring the security of the physical stamp inventory. Physical stamps represented only 2% of total documentary stamp tax collections during fiscal year 1994-95 (see Exhibit 1). Eliminating the use of physical stamps should reduce the inconvenience to the taxpayer (who must currently purchase stamps by mail or in person) and reduce some of the Department's costs of administering this tax.

As an alternative to the use of physical stamps, the Department has proposed that any person averaging at least five taxable transactions a month be required to register and file a return to remit the tax to the Department. Taxpayers with less than five transactions per month would be required to file a report form for each taxable transaction with the Department. To determine the impact the proposed legislation would have on taxpayers, we interviewed six businesses that purchase documentary stamps. The only concern expressed by the businesses was how they would evidence payment of the tax on the nonrecorded document. [2] Two of the businesses thought it would be less work to file a return with the Department.

Exhibit 1
Physical Stamps Represented Only 2%
Of Total Documentary Stamp Tax Collections
During Fiscal Year 1994-95



Source: Department of Revenue tax returns and orders for physical stamp sales.

The proposed legislation would increase the number of registered taxpayers, which may allow the Department to more effectively enforce the payment of the tax on nonrecorded documents.

Currently there are 1,805 active registered taxpayers. Using information obtained from state regulatory agencies on the number of businesses that could potentially be preparing taxable, nonrecorded documents, we estimated that at least 13,000 additional businesses may be required to register under the Department's proposal.

The Department has not developed a strategy for ensuring businesses that prepare taxable, nonrecorded documents are paying the tax. However, requiring more businesses to become registered taxpayers will allow the Department to create a complete database of businesses paying the tax that could be matched against databases from state regulatory agencies (e.g., the Department of Banking and Finance) to identify businesses that handle nonrecorded documents but have not paid the tax, which could ultimately increase tax revenues. Currently, the Department's efforts to enforce payment of this tax are limited primarily

[1] The Department's proposal also includes eliminating the use of meters as a method of paying documentary stamp tax.
[2] The proposal would require these businesses to make a notation on the document, as currently allowed for registered taxpayers.

to reviewing recorded documents filed at county courthouses for proper payment of tax (refer to discussion on page 4).

In order to realize the estimated annual cost savings of $146,000, the Department needs to develop strategies for containing the costs of handling the increased number of registered taxpayers.

Requiring more taxpayers to file returns will increase the Department's workload for processing taxpayer returns and other costs associated with administering this tax, unless the Department changes its current administrative practices. For example:

- Costs to mail tax returns will increase. The Department mails documentary stamp tax returns on a monthly basis; tax returns for other taxes are mailed annually. During fiscal year 1994-95 the Department spent $4,705 to mail tax returns to county clerks and registered taxpayers. If physical stamps are eliminated, the cost of mailing returns on a monthly basis could increase by as much as $40,000. However, the Department could reduce this cost to about $8,000 by mailing a supply of tax returns once a year.
- Costs to mail delinquency notices and correct taxpayer accounts will increase. During fiscal year 1994-95, the Department spent $3,234 to mail documentary stamp tax delinquency notices to registered taxpayers. However, the Office of the Auditor General determined that 40% of the notices it reviewed were sent in error to taxpayers who did not owe additional tax. The Department and Auditor General staff attribute the error rate to data entry errors, which result in remittances being credited to the wrong accounts. [3] If physical stamps are eliminated, the increase in the number of returns filed, coupled with the current error rate, would increase the Department's costs for mailing delinquency notices in error. For example, assuming a delinquency rate similar to that experienced in fiscal year 1994-95, the annual cost for mailing delinquency notices could increase by as much as $23,600, of which approximately $9,400 could be attributable to notices sent in error.
- Workload for conducting educational audits will increase. The Department audits newly registered taxpayers as a means of educating the taxpayer on the tax. The number of these audits would increase if proposed legislation to eliminate physical stamps is passed. However, some registered taxpayers and auditors we contacted indicated the educational audit may not be necessary for every newly registered taxpayer, because in most instances the tax calculation is straightforward and some businesses already have had experience paying the tax. Given the Department's limited resources and backlogs in reviewing recorded documents (as discussed on page 5), auditing every newly registered taxpayer may not be cost-effective.

Recommendations

To eliminate the Department's costs for printing, selling, maintaining, and ensuring the security of a physical inventory of stamps, we recommend that the Legislature abolish the use of physical stamps. To minimize the costs associated with increasing the number of registered taxpayers and returns, we recommend that the Legislature amend the Department's proposal to allow businesses to file returns less frequently based on the amount of tax owed. Alternatively, the Legislature could increase the number of taxable transactions to above five per month before a business is required to become registered.

To ensure that the Department realizes its estimated savings from eliminating physical stamps, we recommend that the Department:

- Mail a supply of tax returns to county clerks and registered taxpayers annually;
- Continue its efforts to improve data entry accuracy to reduce the number of delinquency notices sent to taxpayers in error; and
- Change its practice of automatically auditing all newly registered taxpayers and develop alternative strategies for educating taxpayers, which could include: targeting businesses that are less likely to have experience with paying the tax for educational audits; and developing business-specific educational materials that could be provided to newly registered taxpayers.

To ensure that the tax is paid on nonrecorded documents, we also recommend that the Department use state regulatory agency information

[3] The Department plans to implement imaging technology in March 1996 to scan in tax return information to help reduce data entry errors; however, the documentary stamp tax will not be included in the initial use of this system.

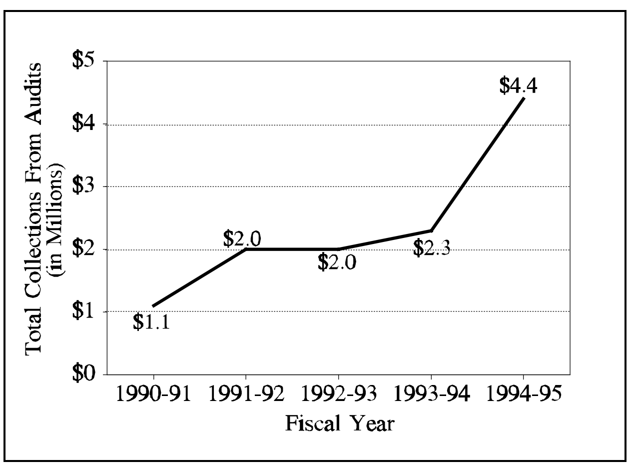
to identify businesses that process nonrecorded documents and have not paid the tax. This information could be used to educate taxpayers and enforce payment.

AUDIT PRODUCTIVITY

Collections from documentary stamp tax audits have increased by $3.3 million over the past five years, but audit productivity could be further enhanced.

The Department assigns documentary stamp tax audits when: (1) a business registers as a taxpayer (primarily an educational audit); (2) an auditor identifies a business that has not paid documentary stamp tax on a non-recorded document while conducting an audit of another tax (e.g., sales tax); or (3) an auditor identifies, during a review of recorded documents filed with the county clerks, a document indicating that the correct amount of tax may not have been paid. Most of the Department's documentary stamp tax audit resources are devoted to reviewing recorded documents and accounted for 94% of the audits completed for this tax during fiscal year 1994-95. Collections from documentary stamp tax audits have increased by $3.3 million since fiscal year 1990-91 (see Exhibit 2). Department staff attribute this increase, in part, to several audits with unusually large dollar assessments.

Exhibit 2
Documentary Stamp Tax Audit Collections Have Increased by $3.3 Million Since Fiscal Year 1990-91



Source: Department of Revenue Audit Tracking System.

The review of recorded documents is labor-intensive and time-consuming.

Identifying recorded documents for potential audit requires a labor-intensive and time-consuming review of the clerks' official record books to identify documents (e.g., mortgages, deeds) that indicate the correct amount of tax may not have been paid. Once a document that has a potential tax liability is identified, the auditor sends a letter requesting the individual to provide information to verify whether additional tax is owed. The auditor reviews the information provided, determines whether additional tax is owed, and notifies the individual of the Department's intent to assess tax, penalty, and interest, at which time the Department creates an audit assignment. For all other taxes, the audit assignment is made before the auditor reviews taxpayer records to determine whether additional tax is owed. We interviewed audit staff in seven of the Department's offices. From these interviews and our review of Department records and policies, we identified four factors that may be affecting the reported productivity and efficiency of the audits of recorded documents.

Although our analysis of Department productivity data indicates that collections per audit hour have increased by 55% since fiscal year 1990-91, collections per hour are sometimes overstated due to inconsistent reporting of time spent on audits of recorded documents.

The Department records information about the number of audit hours devoted to each audit assignment as part of its efforts to monitor audit productivity. The Department has not provided audit staff with clear guidance on how to report time spent on these audits. As a result, audit staff have adopted different methods for reporting time spent on audits. For example, some audit staff allocate audit time spent before the official audit assignment is made, while others do not. As a result, the average amount of time reported per audit varies from one-half hour to four hours among the regions we contacted. This impairs the Department's ability to compare audit productivity between different regions of the state and compare the productivity of these audits to other tax audits.

The use of automation to select recorded documents for review could reduce the use of the current labor-intensive method of audit selection and help eliminate the backlog in reviewing recorded documents.

The Department directs its auditors to review 100% of the clerks' official record book entries within six months of the filing date of the recorded documents. However, five of the seven offices we contacted have substantial backlogs in reviewing official record books. For example, one office is reviewing documents recorded in 1991. In addition, audit staff from two offices said reviews of recorded documents are not currently being conducted in some counties in their region (due to the relatively low volume of recorded documents filed in these counties) and one region is not currently conducting any reviews of official record books. The longer it takes auditors to review official record books, the greater the amount of interest that will be owed on any tax liability identified by the Department. One audit supervisor commented that large interest assessments increase the likelihood that the individual will protest the audit assessment. The backlogs also make it more difficult for the auditors to notify individuals of the owed tax, as the individuals may have moved.

The use of automation could improve the efficiency of the audit selection process by reducing the number of hours auditors must spend reviewing recorded documents and helping eliminate backlogs. The Department's Property Tax Administration Program purchases automated information from vendors about property sales and associated documentary stamp tax payments in 26 counties. This information could be used by auditors to select recorded documents for review. Using automated information to identify potential tax liabilities could reduce the time devoted to reviewing the clerks' official record books, help the Department to reduce its backlog in reviewing recorded documents, result in more timely notification about taxes owed, and provide audit coverage in counties where it is not considered cost-effective to review recorded documents.

The Department should revise the threshold for audits of recorded documents to make optimal use of its auditing resources.

The Department has established a materiality threshold of $25 for conducting audits of recorded documents. Audit staff, however, have concluded that using this threshold is not cost-effective and use different informal thresholds ranging from $100 to $200. These informal thresholds have little or no relation to auditing costs, which could vary between regions depending on factors such as the extent of automation in the county courthouses and traveling distance to the courthouses. One auditor mentioned that the audit threshold in his office was established to provide reasonable coverage of county property sales. The Department should revise its audit threshold for this tax to consider auditing costs and coverage of the taxbase.

Auditors generally do not contact closing agents who routinely make tax payment errors to prevent future errors from occurring.

Taxes on recorded documents are collected and remitted to the Department by the county clerks. An internal Department report estimated that 95% of the documents requiring the tax are filed by closing agents (e.g., attorneys, title companies), who record the documents and calculate the tax owed for their clients. If the closing agent fails to ensure that the correct amount of tax is paid, the Department assesses the client for the owed tax, penalty, and interest. The audit assessment often comes as a surprise to these individuals, who may have little or no knowledge of the tax since they have relied on the closing agent to correctly file the documents.

Contacting closing agents who routinely make tax payment errors would help prevent future errors from occurring. Department auditors stated they do not contact closing agents regarding specific tax payment errors. Some auditors commented that information filed with the Department is confidential and thus believe they must obtain power of attorney from individuals before contacting their closing agent. Although taxpayers have the right to have their tax information kept confidential, the amount of the tax paid and the basis for the assessment are included in the recorded document, which is a public record. Auditors from two offices said they contact closing agents who routinely make errors without disclosing information on specific documents in an effort to prevent future errors from occurring. One auditor does this by conducting a compliance audit if the closing agent is registered to collect the tax on unrecorded documents; the other auditor sends agents educational materials that relate to the type of error made.

Another approach to improving proper payment of this tax would be to require closing agents to register with the Department to collect and remit the tax on recorded documents to the Department. This would be similar to the Department's proposed requirement that certain businesses register to collect and remit the tax on nonrecorded documents. The notation on the document at recordation would provide evidence to the county clerk that the tax has been collected by the closing agent, who would be responsible for filing a return and remitting the tax to the Department. This approach would allow the Department to audit the closing agent (reducing the time needed for the labor-intensive review of clerks' official record books) and would make the closing agent responsible for ensuring that any tax, penalty, and interest owed is paid. This approach would be similar to the method used for collecting sales tax.

Recommendations

To improve the productivity and efficiency of the audits of recorded documents, we recommend that the Department:

- Clarify how auditing staff are to report hours to assigned audits of recorded documents to more accurately reflect the time devoted to these audits and to improve the Department's ability to monitor audit productivity;
- Use automated information available from the Property Tax Administration Program for audit selection, which could assist the Department in reducing the existing backlogs and in improving audit coverage in counties where recorded documents are not currently reviewed; and
- Revise the dollar threshold for audits of recorded documents to consider auditing costs and coverage of the taxbase to make optimal use of its auditing resources.

To help reduce tax payment errors, we recommend that the Department develop procedures advising auditors as to what contact should be made with closing agents who routinely make tax payment errors. Alternatively, the Legislature could amend Ch. 201, F.S., to require that closing agents be registered taxpayers. This would allow the Department to audit closing agents and help to reduce tax payment errors.

COUNTY CLERK COMMISSION

County clerks retain about $4 million annually to process a report that the Department has been unable to use effectively. The information from this report may be obtained at less cost from other sources.

Section 201.022, F.S., provides that the seller, buyer, or agent for the buyer of real property must execute and file a report (Form DR219) with the county clerk in conjunction with recording a deed transferring interest in real property. The report provides information about the transfer, such as the parcel identification number and amount paid for the property, and is held confidential pursuant to s. 195.027, F.S. The county clerk forwards a copy to the county property appraiser and the original report is picked up by Property Tax Administration Program field staff, who forward the original to the Department's central office in Tallahassee. The law also provides that the county clerk may retain a commission for processing the report. According to Department records, county clerks retained $4.1 million in commissions during fiscal year 1994-95 for processing the DR219.

Pursuant to state law, the Propery Tax Administrtion Program is responsible for ensuring that all property is placed on property tax rolls and is uniformly assessed at just value. The program analyzes county property tax rolls annually. Each year, program central office staff conduct a statistical analysis (sales ratio studies) comparing county appraisers' real property sales data to the appraisers' property tax roll data. In addition, every two years program field staff conduct an indepth review of each county property tax roll, which includes independent property appraisals. The program has intended to use the DR219 as an independent source of reliable information about real property sales.

The Department has been unable to use the DR219 effectively.

Since its inception in 1986, the DR219 has been required to be filed with the county clerks and provided to the Department. The law and the report have been revised several times to make the DR219 more useful to the program. In 1992, s. 201.022, F.S., was revised to allow county clerks to retain 1% of the value of the documentary stamp tax paid on the deed as compensation for the cost of processing the report. The 1% fee compensates the clerk based on the value of the property, not the administrative costs to process the report. In 1991, the report format was revised to allow Department staff in Tallahassee to enter the information into a database using the Department's older scanning equipment, so the information could be used by program central office staff to conduct sales ratio studies.

In 1995, the Department stopped scanning the DR219 because its equipment was not capturing all of the needed report information and began to input the information manually. According to the initial results of a Department review of 1995 records, complete information was not being obtained from the DR219 and could not be matched to property tax roll data. For example, the completion rate for the sales price variable ranged among the counties from 65% to 99% (e.g., because DR219 information was not properly filled out or was not input into the database). In addition, matches using the parcel identification number varied among the counties from 0% to 82% (e.g., because the parcel identification number is formatted differently on the DR219 than on the property tax roll data). In 1996, the Department began a pilot project in five counties to encourage the county clerks to ensure that the reports are completed properly and to improve the Department's ability to use the DR219 information for its sales ratio studies. [4]

Some of the program's field staff use the information on the DR219 to conduct their independent property appraisals. However, program field staff in some regions of the state (e.g., southern) said it is not practical to use the DR219 due to the volume of real property sales and the resulting number of DR219s. The program purchases property sales information from private vendors in 26 counties as an alternative source of information.

The law provides that the county clerks may be denied the 1% fee for processing the DR219 when there is a manifest failure to maintain proper records or to make proper reports. Although some county clerks have not ensured that the DR219s are being completed properly, the Department has still allowed them to retain the 1% fee. Department staff said this is due in part to difficulty determining what constitutes a manifest failure. To help ensure the report is properly filled out, the Department has periodically conducted training on the DR219 for county clerk staff since 1992. However, the Department has not developed rules and policies to clarify the county clerks' responsibilities for ensuring the DR219 is completed properly, what would constitute a manifest failure to fulfill those responsibilities, or the basis for denying the 1% fee.

Receiving a copy of each DR219 may not be the most cost-effective approach for the Department to obtain this information.

Other options are available for obtaining the information captured on the DR219. For example:

- Information on property sales is available from private vendors at a lower cost. As noted earlier, the program is purchasing property sales information for 26 counties from private vendors at a cost of $16,597 for fiscal year 1995-96 (annual costs between counties range from $381 to $1,270) to obtain information needed for its independent property appraisals. Program staff said that the information provided by these vendors contains most of the information obtained on the DR219 and is a reliable source of information in a more accessible format. Interviews with vendors indicate they compile a complete and independent record of sales transactions by reviewing courthouse records. The vendors currently provide their products in 32 counties and have plans to expand into 8 additional counties.

- DR219 information could be filed electronically by title companies or county clerks to reduce the Department's data entry workload and errors. Department staff indicate that some county clerks have equipment that may enable them to transfer DR219 information electronically to the Department. In addition, the Department currently authorizes title companies that maintain DR219 information on computers to use an electronic version of the DR219 that allows them to print out a hard copy of the report, instead of manually filling out the report. The title companies file the hard copy of the electronic version of the report with the county clerks who provide them to the Department for manual entry into its database. These title companies could be authorized to provide this information electronically to the Department.

[4] As noted earlier, the Department plans to implement imaging technology which could eventually be used to scan DR219 information into a database.

Recommendations

To provide an independent source of reliable information for the Department's analysis of county property tax rolls at less cost, we recommend that the Legislature amend s. 201.022, F.S., to:

- Require that the DR219 be submitted and be maintained as a public record as a condition for recording a deed. This would ensure that the report information continues to be available to the Department;
- Allow the Department to use the most cost-effective means for obtaining the information contained on the DR219 (e.g., purchasing from private vendors, electronic filing by title companies or county clerks, Department staff); and
- Eliminate the 1% fee paid to county clerks for processing the report. If the Legislature wants to compensate the county clerks for accepting the DR219, the law could be amended to require the DR219 to be recorded as an additional page of the deed. This would allow county clerks to collect a $4.50 recording fee on each DR219, which would have generated $2.9 million in fees to county clerks during fiscal year 1994-95. Alternatively, the law could be amended to require the DR219 be filed with the county property appraiser, which would not require a recording fee.

AGENCY RESPONSE

The Executive Director of the Department of Revenue agreed to review our recommendations and described actions the Department is taking to address our concerns.

This review was conducted in accordance with generally accepted government auditing standards and included appropriate performance auditing and evaluation methods. Copies of this report may be obtained by telephone (904/488-1023), by FAX (904/487-3804), in person (Claude Pepper Building, Room 332, 111 W. Madison St.), or by mail (OPPAGA Report Production, P.O. Box 1734, Tallahassee, FL 32302).

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