

COUNCIL AGENDA: 10/18/05

ITEM NO.: 2.6



OFFICE OF THE
CITY AUDITOR

**SALES AND BUSINESS TAX
AUDIT RESULTS**

FOR THE QUARTER ENDED
JUNE 30, 2005

A REPORT TO THE
SAN JOSE
CITY COUNCIL

Report No.: 0605

September 27, 2005

Honorable Mayor and Members
of the City Council
801 North First Street, Room 600
San Jose, CA 95110

Transmitted herewith is a report on the *Sales And Business Tax Audit Results For The Quarter Ended June 30, 2005*. Our audit on sales and business taxes is in accordance with the City Auditor's 2004-2005 Audit Workplan.

If you need additional information in the interim, please let me know.

Respectfully submitted,



Gerald A. Silva
City Auditor

GS:lg

Attachment

cc: Del Borgsdorf
Kay Winer
Rick Doyle
Scott Johnson
Andy Heath
Danielle Kenealey

SCOPE AND METHODOLOGY

Our objectives in the audit of sales and business taxes are to identify:

- San Jose retail businesses that do not file sales tax returns;
- Misallocation of the local portion of the sales taxes paid by San Jose businesses; and
- San Jose businesses that have not paid or have underpaid the San Jose business tax.

In conducting our ongoing audit of sales and business taxes, we performed the following procedures:

- Compared the San Jose telephone and other directories with sales tax and business tax databases to ensure that companies and individuals doing retail business in San Jose were using a San Jose sales tax identification code;
- Visited business locations at the city of San Jose's periphery and compared these businesses' locations to the sales tax and business tax databases to ensure that businesses within the San Jose borders were using a San Jose sales tax identification code and had a current San Jose business license;
- Called businesses to request copies of their sales tax returns;
- Reported any identified nonfiling or misallocation of sales taxes to the State Board of Equalization;
- Reported any nonpayment of San Jose business taxes to the Finance Department for collection. We identified these businesses by comparing to the business tax database (1) the San Jose telephone directory, (2) fictitious name listings from the County, (3) other directories, (4) the contractor database in the City Clerk's office, (5) the Department of Information Technology printout--SIC property owner list, (6) real property databases, and (7) known out-of-town consultants who conduct business with the City; and
- Contacted the personnel departments or representatives of businesses and confirmed the average number of full- and part-time employees of the business. We reported to the Finance Department the businesses that we identified in which the number of full-time equivalent employees differed from the number recorded in the City's business tax database.

SALES AND BUSINESS TAX AUDIT RESULTS

During the quarter ended June 30, 2005, our ongoing audit of sales and business taxes produced the following results. We identified:

- 15 San Jose retail businesses as having underpaid sales taxes to San Jose. We estimate that the local portion of the sales taxes that should have been allocated to San Jose by these businesses and sales tax revenues to be received from these businesses during the next six periods amount to \$200,760. The State Board of Equalization confirmed that \$245,009 in sales taxes was credited to the City of San Jose as a result of our current and prior period audit findings.

The fourth quarter results reflected \$8 in identified additional revenues for each dollar of audit staff cost.

Table I and Chart I summarize our sales and business tax audit targets and results for the quarter ended June 30, 2005.

Historically the Revenue Unit Staff target for each quarter has been set at \$250,000, generating over a \$1 million per year. For the last three quarters staff has been experiencing an average of \$202,918 per quarter. This is due to many factors. Although we are still averaging 900 leads per quarter our dollar amount per finding has significantly dropped as well as our number of quality leads. Secondly, staff is doing a better job educating our businesses which is resulting in less sales tax errors being corrected. Third, we our experiencing a significant amount of big sales tax producers closing or consolidating their business. Traditionally this played a big role in our ability to correct their errors. Finally, staff is seeing the Board of Equalization create more exemptions for businesses. For example, businesses that do digital transmissions instead of sending software to their clients are no longer subject to sales tax. In addition, one area which staff used to find several tax errors was in the vehicle leasing industry. Now, as a result of Regulation 1642 (Bad Debt) those businesses can now legally ask for refunds of sales tax for clients who defaulted on their loans. Since Regulation 1642 San Jose has lost \$419,095 which before was partially misallocated and our audit staff was able to correct the problems.

We will continue to monitor sales tax for this fiscal year since we are still averaging over \$6 in identified additional revenues for each dollar of audit staff cost per year. Should we continue to experience a decline in our audit finding for two consecutive years we will make the appropriate target adjustment for fiscal year 2006-07.

TABLE I

**SUMMARY OF SALES AND BUSINESS TAX AUDIT RESULTS
FOR THE QUARTERS ENDED SEPTEMBER 30, 2004,
DECEMBER 31, 2004, MARCH 31, 2005, JUNE 30, 2005 AND
2004-05 YEAR-TO-DATE RESULTS AND TARGETS**

	Quarter Ended 9-30-04	Quarter Ended 12-31-04	Quarter Ended 3-31-05	Quarter Ended 6-30-05	2004-05 Year-To-Date Results	2004-05 Year-To-Date Targets
Number of businesses or other entities brought into compliance or assisted	24	26	18	15	83	80
Estimated Revenues	\$250,358	\$205,627	\$202,368	\$200,760	\$859,113	\$1,000,000
Actual Revenues	\$251,159	\$250,252	\$254,162	\$245,009	\$1,000,582	\$1,000,000

SALES AND BUSINESS TAX ESTIMATED AUDIT FINDINGS AND TARGET
Quarters Ended 9/30/04, 12/31/04, 3/31/05, And 6/30/05

