



ERIC GARCETTI
MAYOR

July 17, 2018

The Honorable Members of the Los Angeles City Council
Office of the City Clerk
City Hall, Room 395

OFFICE OF FINANCE FUNCTIONALITY REGARDING THE RECOGNITION AND RESOLUTION OF SALES TAX MISALLOCATION AND/OR MISCALCULATIONS BY BUSINESSES LOCATED WITHIN THE CITY OF LOS ANGELES TO CONFIRM THAT THE CITY IS RECEIVING ITS FAIR SHARE OF SALES TAX REVENUES COLLECTED BY THE CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION. (C.F. 18-0087)

Dear Honorable Members:

SUMMARY

Per Council instruction regarding the motion introduced on January 26, 2018 (C.F. 18-0087), the Office of Finance (Finance) is providing this report to describe specifics as to how Finance works with the California Department of Tax and Fee Administration (CDTFA) to identify and pursue the misallocation and/or miscalculation of sales tax by businesses located within the City of Los Angeles (City) jurisdiction. Included are the responses to the items listed below:

- Determine the extent of the issue regarding the miscalculation of sales tax throughout the City of Los Angeles.
- Determine if the sales tax receipts are being properly allocated to the City of Los Angeles.
- Provide information regarding potential options to remedy the issue going forward.
- Provide options to retroactively remedy any sales tax miscalculation, erroneous collection, and/or erroneous allocation of sales tax receipts.

The purpose of this report is to clearly explain the responsibilities of the Sales Tax Unit within Finance and how it resolves the items noted above.

RESPONSE

Determine the extent of the issue regarding the miscalculation of sales tax throughout the City of Los Angeles.

The City of Los Angeles currently receives over \$520 million each fiscal year from sales tax allocations provided by the CDFTA. This allocation is based on the City receiving a 1% share of the 9.5% in sales tax charged to the purchaser of goods. Finance has quantified that the amount of incorrectly allocated sales tax monies is less than 1 percent of that annual amount based on the monitoring and correction of allocations performed over the past decade. Finance has identified and collected approximately \$4 million in misallocated sales tax revenue each year with over \$20 million recovered over the past 5 years.

Determine if the sales tax receipts are being properly allocated to the City of Los Angeles.

Finance established a new Sales Tax Unit in 2017 within the Tax and Permit section to further improve the detailed review of sales tax payments from businesses to ensure that they are correctly allocated and to identify any misallocations for correction by the CDTFA. This unit oversees all of the misallocation issues related to sales tax that had previously been performed by a departmental liaison in Sacramento and under contract with an outside contractor. Previously misallocations identified and credited to the outside contractor would also incur a discovery fee of approximately 13% of the amount adjusted by the CDTFA.

Errors in allocations can occur in one of three ways:

- A business incorrectly reports their city taxing jurisdiction when filing their sales tax return
- A business incorrectly reports the allocation of sales tax activity for Los Angeles when they have multiple business locations across different California cities
- CDTFA later determines by audit if a business was incorrectly collecting or reporting sales tax receipts

Incorrect reporting of tax jurisdiction or allocation for multiple locations

The primary focus of the Sales Tax Unit is to review the quarterly CDTFA data to locate and correct any misallocations of the local sales tax. One method to accomplish this is to identify any incorrect Tax Area Codes (TACs) that were specified for businesses within the City of Los Angeles. Staff will review all sales tax accounts located in zip codes that are shared by multiple cities to ensure that those located within city limits have the correct TAC code for Los Angeles specified. Staff will also review accounts related to businesses that have multiple locations throughout the state to identify any allocations that may be missing for the quarter or unusually low.

The Sales Tax Unit will prepare and submit a petition to the CDTFA for each error that is identified and once the petition is reviewed and approved by the state they will correct the error and forward any related funds to the City.

Allocation changes through CDFTA Business Audits

CDFTA will conduct periodic audits of businesses remitting sales taxes to the state to ensure that receipts are being properly collected and reported by businesses. If discrepancies are identified through this process CDFTA will reallocate any resulting changes to the appropriate counties and cities.

Provide information regarding potential options to remedy the issue going forward.

The Sales Tax Unit within Finance continues to vigilantly monitor the allocations and payments made each quarter by the CDFTA and report any errors or anomalies for correction and receipt of funds. Historically approximately 400 petitions would be submitted on behalf of the City annually to correct sales tax allocation errors. Since the establishment of the Sales Tax Unit and the expansion of our reallocation function to include a detailed review of the

The Honorable Members of the Los Angeles City Council

Page 3

July 17, 2018

Local Review Board records, Finance has filed over 800 petitions for this past fiscal year. Finance has also implemented sales tax variance functionality in the Pondera audit system to identify reporting discrepancies as an automated process reducing staff time required for manual review.

Provide options to retroactively remedy any sales tax miscalculation, erroneous collection, and/or erroneous allocation of sales tax receipts.

Once petitions generated by Finance have been filed and approved by CDFTA based on the Date of Knowledge (DOK), protocols established by the CDFTA dictate that the City receive the reallocated sales tax revenue of the business in question retroactively for two quarters prior to the quarter of the DOK and on a go forwards basis. Finance would continue to monitor the sales tax allocations each month as they are reported by the CDFTA to ensure that all petitions are recorded and reviewed by CDFTA in a timely manner and that reallocated funds comply with the maximum two quarter period retroactive timeframe allowed by CDFTA.

Conclusion

Finance has continued to diligently review sales tax allocations to the City and has significantly improved on its ability to identify and correct misallocations, and continues to seek and implement new technologies to continually improve this process.

Finance's work in identifying and resolving sales tax misallocations and miscalculations have resulted in over \$20M of sales tax receipts reallocated to the City over the prior 5 fiscal years. The establishment of a dedicated Sales Tax Unit for reviewing CDFTA data for all payments within the City's jurisdiction and at the County level will further ensure that the City receives its correct allocation.

In addition, Finance's goal of looking for new technology to increase our efficiency is also being applied to our current Sales Tax unit by expanding the use of our Pondera system to provide an automated identification process to augment our current manual approach.

Sincerely,



Claire Bartels

Director of Finance / City Treasurer

cc: Ana Guerrero, Mayor's Office
Matt Szabo, Mayor's Office
Miguel Sangalang, Mayor's Office
Andrew Kaplan, Mayor's Office
Carl Sampson, Office of Finance