Department of Legislative Services
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# Comptroller of Maryland
# Revenue Administration Division

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Presentation to the Joint Audit Committee

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# Report Overview

The report contained 8 findings, including 3 repeat findings from the prior report.

## Key Findings

Local Income Tax Distribution – Local tax revenues were incorrectly distributed in one county. RAD had not fully determined the underlying cause(s) for the distribution errors and lacked sufficient procedures to consistently identify the proper taxing areas for distribution purposes.

Tax Credits – Required documentation was not always on file to support credits claimed by taxpayers for taxes paid to other states.

Tax Adjustments – Controls over critical financial and nonfinancial adjustments to taxpayer accounts to ensure their propriety were lacking.

# Local Income Tax Distributions (Finding 1)

RAD had not determined the underlying cause(s) for erroneous subdivision codes assigned to numerous taxpayers in one county, which affected distributions of local income taxes.

- A review conducted by the Comptroller of Maryland disclosed that addresses for 14,861 of 500,000 returns filed by Montgomery County taxpayers were not properly coded (had an incorrect subdivision code) in the State's automated tax system.
- The erroneous coding resulted in local income taxes totaling approximately $8.7 million being incorrectly distributed to certain special taxing areas within Montgomery County and the County at large for tax years 2010 through 2014.

# Local Income Tax Distributions (Finding 1)

- Certain steps were taken to correct the distribution errors, which resulted in 15 taxing areas receiving a net under-distribution ranging from $10,000 to $6.1 million and 8 taxing areas receiving a net over-distribution ranging from $5,000 to $4.9 million.
- But RAD did not pursue an additional 1,393 returns filed for tax year 2014 (local taxes totaling $2.2 million) for which taxpayer addresses could not be identified via automated processes as legitimate Montgomery County addresses.
- Without a detailed analysis, the extent of the coding problems, including whether other jurisdictions were affected, is unknown.

# Local Income Tax Distributions (Finding 2)

Policies and procedures to ensure that the proper subdivision codes were assigned to taxpayers in the automated tax system were not sufficient.

- Comprehensive written procedures were not provided to the RAD employees responsible for identifying the proper subdivision codes when automated processes were unsuccessful.
- Incomplete and non-current sources of address data were used to identify the proper codes.
- RAD lacked procedures to ensure that codes recorded in the tax system for taxpayers, based on prior year returns, were accurate.
- Current tax forms did not facilitate the identification of a taxpayer's correct taxing area when an address change occurs after the tax year but before filing the return for that year.

# Out-of-State Tax Credits (Finding 3)

Required documentation was not always on file to support out-of-state tax credits claimed on paper tax returns.

- Our examination of 20 MD tax returns submitted in paper format for tax year 2013 that claimed out-of-state tax credits totaling $35 million disclosed 6 returns for which credits totaling $27.2 million were allowed by RAD, even though the required documentation, such as a copy of the other state's tax return, was not on file.

RAD's procedures stipulate that out-of-state tax credits be disallowed if the required documentation is not submitted by the filer.

According to RAD's records, out-of-state tax credits totaling $112 million were claimed by taxpayers on approximately 14,300 paper tax returns for tax year 2013.

# Adjustments to Taxpayer Accounts (Finding 4)

Significant financial adjustments to corporate taxpayer accounts processed by one RAD unit were not always subject to the required supervisory review.

- There was no documented supervisory review for 3 of 10 adjustments tested that reduced corporate taxpayer liabilities by $23.4 million.
- System output reports to identify all adjustments for review were not used as required by formal RAD procedures.

Between July 2012 and June 2015, this unit processed adjustments that reduced corporate tax liabilities by $696.5 million.

# Adjustments to Taxpayer Accounts (Finding 5)

Nonfinancial adjustments to critical taxpayer account information, such as address changes and identification numbers, were not adequately controlled. A review of procedures in place at three units responsible for processing 34,000 such adjustments during fiscal year 2015 disclosed:

- Automated output reports of adjustments processed were not used, as required, by supervisory personnel in two units to identify adjustments for review.
- Although output reports were used by the third unit, not all adjustments were subject to review, and the reviews performed did not include an examination of source documentation supporting the adjustments.
- All 10 adjustments reviewed (primarily address changes) for one of the three units lacked required documentation to support their propriety.

# Other Findings

Finding 6 – Information Systems

Critical database security and audit events were not logged and change reports were not reviewed for propriety. As a result, unauthorized or inappropriate activities affecting the integrity of taxpayer data could occur without detection by management.

Finding 7 – Cash Receipts

- RAD did not reconcile its records to ensure that all checks that it remotely deposited were subsequently shredded, reducing the possibility of misappropriation.
- Certain employees with access to checks received in the mail could also process critical adjustments to taxpayer accounts.

Finding 8 – Replacement Refund Checks

Replacement checks, totaling $125 million during the audit period, were not always reviewed for propriety.

# Conclusions

RAD should

- determine the underlying causes of erroneous address coding, and the full extent of all distribution errors;
- establish and implement policies and procedures so that taxpayer addresses are assigned to the proper taxing area;
- ensure that required documentation is submitted and retained to support out-of-state tax credits;
- enhance its procedures to ensure that all adjustments to corporate and individual taxpayer accounts are subject to a documented review for propriety; and
- implement the recommended actions to ensure that critical database events are logged and reviewed, and to improve controls over cash receipts and replacement checks.