

**State of New Jersey
Office of the State Comptroller**



***ADMINISTRATION OF PROPERTY TAX
RELIEF PROGRAMS
FOR MULTI-UNIT PROPERTIES***

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April 9, 2015

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I. Introduction

The Office of the State Comptroller (OSC) has identified a flaw in the administration of the Homestead Property Tax Credit program which, if corrected, has the potential to save the State millions of dollars every year. Under this program, certain homeowners are eligible for a reduction to their property taxes. However, this benefit is reduced when the homeowner does not occupy 100 percent of a multi-unit property. For example, the owner of a two-family home who occupies only one of two equally sized units would be entitled to 50 percent of the total Homestead Property Tax Credit. We have determined that the administrator of this program, New Jersey's Division of Taxation (Taxation), currently has no reliable way of verifying the percentage of property that is actually occupied by the program's applicants.

While information pertaining to the number of units in a property is readily available locally, it is not required to be reported to Taxation. By simply requiring this information to be reported, Taxation can easily verify the accuracy of a homeowner's representation and could potentially prevent the State from losing millions of dollars. OSC, in fact, utilized such existing information to identify a significant number of homeowners who have incorrectly reported occupying 100 percent of a property, and thus, improperly received the full Homestead Property Tax Credit.

OSC has additionally identified two other property tax relief programs that share the same flaw, which can similarly be corrected, potentially saving the State millions of additional dollars. At the conclusion of this report we offer specific recommendations to address the flaw we have identified in these three programs. We also are referring the names of the individuals we have identified as having improperly received a property tax benefit to Taxation for appropriate action.

II. Background

A. Tax Relief Benefit Programs

1. Homestead Property Tax Credit

The Homestead Property Tax Credit (“homestead credit”) is provided pursuant to the Homestead Property Tax Credit Act, *N.J.S.A.* 54:4-8.57 to -8.66. The Legislature first provided for homestead rebates in 1976 to provide property tax relief to homeowners, first in the form of a rebate check and currently in the form of a credit that reduces total property tax obligations. New Jersey residents who own and occupy a home in New Jersey and meet certain criteria are eligible for this benefit, provided their property taxes were paid for that year and they meet certain income limits. In recent years the income limit has been \$150,000 for homeowners aged 65 or older or who are blind or disabled; for homeowners under age 65 and not blind or disabled, the income limit has been \$75,000.

In 2011, approximately 2,500,000 properties were initially identified by Taxation as eligible to receive the homestead credit. Utilizing a data processing system called MOD-IV and other databases, Taxation prequalified certain residents for the homestead credit and removed from the list those taxpayers who were ineligible to receive the benefit – *e.g.*, those who exceed the maximum income limit or who are delinquent in paying their property taxes.

Ultimately, for tax year 2011, Taxation sent out approximately 1,600,000 homestead credit applications and approximately 843,000 taxpayers received the credit for that year. The total amount of benefits paid out for tax year 2011 was \$395,506,069. Most 2011 benefits were paid to municipalities to apply as a credit to homeowners’ property tax bills in August 2013. The average benefit amount for seniors and disabled homeowners was \$515, while the average benefit amount for all other homeowners making less than \$75,000 was \$405.

Similar to what occurred for the 2011 homestead credit, the benefit for 2012 is being carried forward into a later tax year. In this case, the 2012 homestead credit will be applied to May 2015 property tax bills. It is expected that average 2012 benefits will roughly mirror those paid out for 2011. The Legislature has appropriated \$395.2 million for this program in fiscal year 2015.

2. Property Tax Reimbursement

The Property Tax Reimbursement program, also known as the “Senior and Disabled Person’s Freeze Act,” is an additional program authorized pursuant to *N.J.S.A. 54:4-8.67* to -8.75. This program reimburses senior citizens and disabled persons who meet certain eligibility criteria for property tax increases to their principal residence. From 2009 to 2013, an applicant’s annual income could not exceed \$70,000 to be eligible for the benefit. The amount of the reimbursement, which is paid in the form of a check, is based on the difference between the property taxes due and paid for the current year and the property taxes due and paid for the first year the applicant met all the eligibility requirements for the program. According to State figures, the average property tax reimbursement for the 2011 tax year was \$1,173 per recipient. For fiscal year 2015, the Legislature has appropriated \$203.1 million for the property tax reimbursement program.

3. Property Tax Deduction

The Property Tax Deduction is authorized by the Property Tax Deduction Act, *N.J.S.A. 54A:3A-15* to -22. Under this Act, eligible homeowners and tenants who pay property taxes on their principal residence in New Jersey, either directly or through rent, may qualify for either a tax deduction of up to \$10,000 or a refundable credit. This benefit reduces gross income if the taxpayer takes the deduction. For example, a homeowner with \$95,000 in gross income can

deduct the \$7,850 he pays in property taxes on his one-unit principal residence from his gross income, thereby yielding an income tax savings of \$436. The Legislature has appropriated \$542.5 million for the tax deduction benefit program for fiscal year 2015.

B. Benefit Standards

The Homestead Property Tax Credit Act limits the benefit to a “homestead” that is used as a “principal residence.” *N.J.S.A. 54:4-8.58 to -8.60*. The term “homestead” is defined, in relevant part, as a “dwelling house and the land on which that dwelling house is located.” *N.J.S.A. 54:4-8.58*. Dwelling house is any residential property with four or fewer units, but only one of the units can be used for commercial purposes, and certain types of properties are excluded, such as condominiums. *Ibid*.

To qualify as a “principal residence” the property must be “actually and continually occupied by an applicant as his or her permanent residence, as distinguished from a vacation home, property owned and rented or offered for rent by the claimant, and other secondary real property holdings.” *Ibid*. For multi-unit homesteads, the Act allows only for a homestead credit in an amount that is proportionate to the share of the property taxes assessed and levied against the residential unit occupied as a principal residence. *See N.J.S.A. 54:4-8.59(d)*.

The legislation authorizing both the property tax reimbursement and deduction contain similar terms and definitions as used in the legislation for the homestead credit and thus, the percentage of the property that an applicant occupies similarly determines the amount of benefit he or she should receive. Each tax benefit program (homestead credit, property tax reimbursement and property tax deduction) is considered to be a “tax preference provision . . . not to be construed liberally, but instead . . . strictly interpreted against those claiming the preference.” *See generally Allied Textile Printers Corp. v. Director of Taxation*, 145 N.J. Super.

456, 461 (App. Div. 1976), *certif. denied*, 74 N.J. 271 (1977); *Vavoulakis v. Director, Div. of Taxation*, 12 N.J. Tax 318, 328 (Tax 1992), *aff'd*, 13 N.J. Tax 322 (App. Div. 1993). In other words, the programs' eligibility standards are to be closely followed and firmly enforced.

III. Methodology

Our investigation began with a complaint alleging that eight homeowners in the Town of Kearny were receiving a larger homestead credit than they were otherwise entitled to because a portion of their multi-unit primary residence was occupied by other tenants. Taxation confirmed that each property owner received 100 percent of the homestead credit for 2011, and information requested from the Kearny tax assessor generally corroborated the complainant's allegations.

In order to ascertain whether this was occurring on a statewide basis, we collaborated with Taxation to develop search parameters to aid in identifying other homeowners receiving excess benefits. After excluding residences with multiple filers with the same last name, we focused on properties with two characteristics:

- **Properties receiving 100 percent of the homestead credit in 2011; and**
- **Properties with addresses that were listed on more than one State tax return.**

This search yielded a list of approximately 65,000 addresses (larger list). We refined the search further by extracting from the larger list those properties with secondary address information such as apartment or floor number because it was more likely that such properties contained multiple units. That further refinement yielded a list of over 4,700 addresses (smaller list).

We interviewed a municipal tax assessor, a county tax administrator and vendors for Taxation's and tax assessors' data collection systems to determine what property tax information is captured by municipal tax assessors and how much of it is being reported to Taxation. We

then took a random sample of 25 addresses from the smaller list and, to be as comprehensive as possible, we also randomly selected 76 addresses from the larger list, for a total of 101 unique properties for further review. We then requested information from Taxation and from the municipal tax assessors for these 101 properties. Finally, we interviewed Taxation officials to determine whether a potential solution to the deficiency we uncovered was feasible.

We sent a draft of this report to Taxation, a vendor for the data collection system, the Kearny tax assessor and another municipal tax assessor who provided background for the report. The responses we received were considered in preparing this final report and were incorporated herein where appropriate.

IV. Findings

A. Multiple Unit Information is Regularly Recorded at the Local Level

Municipal tax assessors should continuously record and maintain individual property data including the type, use and number of dwelling units within a property. This information is used to aid assessors in determining the complete and accurate value of each parcel of real property within a municipality. Many tax assessors record this information on documents known as property record cards. Tax assessors may also record the information in a computer software program called the Computer Assisted Mass Appraisal (CAMA) system, which can produce a computer generated property record card. OSC was told the information recorded in the property record cards, CAMA system or other local records includes the number of units within a property.

The *Real Property Appraisal Manual for New Jersey Assessors* provides a coding system for tax assessors to classify residential structures. Different building class codes exist for single

family and multi-family residential dwellings from two to four units. These codes are also regularly inputted into the property record cards and CAMA.

Thus, information regarding the number of dwelling units within a property is normally noted by tax assessors and generally can be found in property record cards, the CAMA system or other local record.

B. Inappropriate Award of Property Tax Credit

OSC was able to use the available data collected by local tax assessors to identify properties that contained multiple dwelling units. Information from the Kearny tax assessor listed the number of units within the properties and corroborated the allegation that seven of the eight addresses from the original complaint were multi-unit dwellings in 2011. These seven homeowners received a total of \$5,485 in homestead credit benefits for 2011 when they were only entitled to \$2,588 based on the number of dwelling units in their residences, creating an overpayment of \$2,897.

Specific examples of these overpayments included one homeowner with a property containing three dwelling units who received the full homestead credit of \$925 for his property when, in fact, he was only entitled to receive a homestead credit of \$308, resulting in an excess benefit of \$616. Two other homeowners with two-unit properties received excess homestead credit amounts of \$376 and \$424, respectively. The address for each of the seven properties was listed on more than one tax return and there was secondary address information listed on tax forms associated with each property. In all, the seven homeowners were apparently overpaid by approximately 53 percent.

As for the 101 properties selected for further review, a significant number had property record cards clearly showing they contained multiple units. In fact, a majority of such properties

had class codes denoting they were originally constructed that way, demonstrating that their status as multi-unit dwellings had been clearly established for many years. All of these properties were listed on more than one tax return and a majority affirmatively listed secondary address information such as apartment number or floor number on their associated tax returns.

The readily available evidence that OSC reviewed demonstrates that these homeowners should not have received the full homestead credit amount. For example, one homeowner living in a property with three dwelling units received a \$739 homestead credit when he was only entitled to \$246, creating an overpayment of \$493. In this example, at least three tax returns were filed showing a separate apartment number for each of the dwelling units at that property address.

As set forth in the chart below, of the 101 properties we sampled, 29 were ultimately determined to contain multiple dwelling units and therefore the homeowner should not have been receiving 100 percent of the homestead credit:

Sample	Total Number of Properties	Properties Identified as Containing Multiple Dwelling Units	Error Percentage	Overpayment Percentage
Larger List	76	9	12%	54%
Smaller List	25	20	80%	56%
Total	101	29	29%	55%

The total overpayment for the 29 addresses was \$9,016. Extrapolating the 12 percent error rate to the larger list of approximately 65,000 addresses provided by Taxation results in a total potential overpayment of more than \$1.8 million in 2011 alone. Applying the 80 percent error rate to the smaller list of 4,700 properties results in a total potential overpayment of nearly \$900,000.

For 23 of the 29 properties, the municipal assessor had filled out one or both of two fields (number of dwelling units and building class code) on the property record card that would definitively establish the multi-unit status of those properties. Five of the remaining six properties had property record cards suggesting the existence of multiple units, such as multiple kitchens in addition to multiple structures, living rooms and/or dining rooms. We later confirmed the existence of multiple units within these properties from other public information.¹ Thus, 28 of the 29 property record cards contained information showing multiple units within the property.

C. Local Tax Assessors Could Easily Provide Multiple Unit Information to Taxation

As noted, information pertaining to the number of units within a property is regularly collected by municipal tax assessors and largely available in property record cards or the CAMA system. These tax assessors are already required to annually report certain information to Taxation and with limited effort they could similarly report on the number of units within a property.

Specifically, municipal tax assessors are already required to file information with Taxation showing the assessed value of each property in a municipality. In order to meet that requirement, assessors input certain information into Taxation's MOD-IV system. MOD-IV records a snapshot in time of certain information which Taxation has deemed to be relevant to fulfill its statutory obligations. As such, it contains some but not all of the information relating to a parcel of property that must be maintained by the municipal tax assessor. Taxation has not required assessors to record the number of dwelling units and building class code for each property in the MOD-IV system.

¹ According to the tax assessor, one additional property has an illegal apartment above the garage that was not reflected on the property record card.

The feasibility of making the “number of dwelling units” and “building class” fields mandatory in MOD-IV was discussed with the Taxation official responsible for statewide property tax administration. This official told us that making these fields mandatory and requiring the local assessors to populate these fields would “not be an issue.” In fact, some assessors have voluntarily added this information to the MOD-IV database. The official stated that Taxation would be willing to add the “number of dwelling units” and “building class” fields to the list of mandatory fields required to be filled out in MOD-IV.

Additionally, multiple unit information that has already been uploaded to the CAMA system could potentially be automatically transferred to Taxation’s MOD-IV system. One vendor that we spoke with reported that a program to automatically transfer such information from CAMA to matching fields in MOD-IV is already in existence. The Taxation official told us that she would assess whether the other MOD-IV vendors could similarly transfer the data from the CAMA system. She further told us that her staff could also aid the tax assessors in the manual input of the information, if required.

D. The Homestead Credit Application Should Be Clarified

The homestead credit application itself may have contributed to some of the inappropriate filings for the full property tax benefit. For example, the instructions to the application use the term “principal residence” instead of the general term “property,” which potentially creates ambiguity and confusion. Specifically, Line 15a of the homestead credit application requests homeowners to reveal whether their “principal residence” consists of more than one residential unit, whereas Line 15b of the application directs homeowners to enter the percentage of the “property” that they use as their “principal residence.” Furthermore, the instructions provide only one example in that regard:

For example, if your property consists of four units of equal size, one commercial unit and three residential units, and you occupy one of the residential units as your principal residence, enter 25% at Line 15b. This is the percentage of the property you occupy.

NOTE:

(1) If your property consists of more than four units, you do not qualify for the benefit.

(2) If your property contains more than one commercial unit, you do not qualify for the benefit.

While this example is helpful, the application does not define what specifically constitutes a “unit” and the instructions do not explicitly state that only a “unit” that is used as a “principal residence” will qualify for the homestead credit. The inconsistent use of “principal residence” and limited instructions could potentially cause confusion in the application process.

E. Multiple Unit Information Could be Utilized in Review of Two Other Tax Relief Programs

Two other property tax relief programs, the property tax reimbursement and deduction programs identified earlier, are potentially impacted by these findings. Taxation has confirmed that the amount of the benefit for each of these programs is similarly based on the percentage of property the owner occupies as his or her principal residence. Because Taxation does not currently verify the number of units within a property, the potential for inappropriate awards also exists for these programs.

To test the impact of our findings on these other programs we checked to see whether any of the 29 property owners we identified as improperly receiving 100 percent of the homestead credit also applied for and inappropriately received the full property tax reimbursement and/or property tax deduction. Four out of the five homeowners who also applied for and received the full property tax reimbursement, and 12 out of the 15 who also claimed and received the full property tax deduction (or roughly 80 percent in each category), once again inaccurately reported

that they utilized 100 percent of the property as their primary residence and similarly received a greater property tax reimbursement or deduction than they were otherwise permitted.

In total, the four homeowners received excess property tax reimbursements of \$1,588 and the 12 homeowners received excess property tax deductions of \$48,516. For example, our review revealed a property owner who received both a homestead credit and property tax reimbursement in the total amount of \$2,374, resulting in an overpayment of \$1,187, and another owner who received a homestead credit of \$828 and claimed the maximum allowable property tax deduction of \$10,000, resulting in a total excess benefit of \$5,414. Two other beneficiaries of multiple programs similarly applied for and received the full homestead credit and property tax deduction when in fact their properties contained two dwelling units, resulting in excess benefits of \$5,243 and \$5,124, respectively. Taxation officials stated that requiring tax assessors to report the number of dwelling units and building class code for each property in MOD-IV would also enable them to verify the percentage of principal residence claimed by a taxpayer in seeking benefits from the property tax reimbursement and deduction programs.

Taxation officials concurred that in view of the enormity of all three property tax relief programs – more than one billion dollars has been budgeted for these programs in fiscal year 2015 – the effect of this simple change could result in millions of dollars in annual savings for the State.

V. Recommendations and Referrals

Millions of State dollars can potentially be saved every year by simply requiring municipal tax assessors to provide known information to Taxation. Taxation should immediately require all tax assessors to begin reporting in Taxation's MOD-IV system the number of dwelling units and building class codes for each property in their municipalities. This will enable Taxation to verify the information reported by those seeking the homestead credit, property tax reimbursement and property tax deduction as well as identify those who may be ineligible for the full benefit from the outset.

Additionally, Taxation should clarify the instructions for these three tax relief programs. For example, OSC recommends that Taxation consider providing a standard definition of "unit" for all three programs, as it does for the tenant rebate program. *See* N.J.A.C. 18:29-1.1 (defining "unit of residential rental property" as including "its own kitchen and bathroom facilities"). OSC notes that one such concise definition is provided by an international building codes organization:

A single unit providing complete, independent living facilities for one or more persons, including permanent provisions for living, sleeping, eating, cooking, and sanitation.

See § 202 of *Model Code of Building Officials and Code Administrators International, Inc.* (1999).

Taxation should also not use the terms "property" and "principal residence" interchangeably in the homestead credit application. Specifically, at Line 15a Taxation should clarify that applicants should mark "Yes" if their "property" (not "principal residence") has more than one unit. Additionally, the instructions for each program should explicitly state that the tax benefit is available only for the "unit" used as a "principal residence." The instructions should

also provide additional examples to assist the applicant in determining the total percentage of occupancy.

We have referred to Taxation the names of the seven property owners from Kearny and the 29 property owners from our sample who received excess homestead credit amounts in 2011, as well as those who also improperly claimed the property tax reimbursement and deduction, for appropriate action. This action should include the recovery of any amounts paid or credited in error or as a result of misrepresentation. *See N.J.S.A. 54:4-8.66c; N.J.S.A. 54A:9-2.* As noted above, some assessors have already added multi-unit information to the MOD-IV database and, in response to our investigation, Taxation recently sent letters seeking adjustments of the homestead credit to 3,771 taxpayers who did not claim a multi-unit percentage even though their municipal tax assessors had designated the properties as having multiple units. Taxation anticipates over \$1.6 million in savings from this effort. Within the relevant statute of limitations, *see N.J.S.A. 54A:9-4*, Taxation should also identify all other property owners who have erroneously or improperly claimed or received 100 percent of the homestead credit, property tax reimbursement and property tax deduction under similar circumstances and recover such erroneous or misrepresented benefits.