

**New Castle County**  
**Property Tax Exemptions**  
**Audit Report**

To: David Culver, General Manager of Department of Land Use  
Gregg E. Wilson, County Attorney and Acting Chief Administrative Officer  
Paul G. Clark, County Executive

**Background**

Title 9, Chapter 81, Subchapter I, Section 8101 of the Delaware State Code states “All real property situated in this State shall be liable to taxation and assessment for public purposes by the county in which the property is located ...” Other sections of the State Code deal with various exemptions from the property tax. For example,

- Title 9, Chapter 81, Subchapter II deals with the tax exemption for persons 65 years of age or older (although the Chapter states that it is up to each municipality to promulgate its own rules and regulations).
- Title 9, Chapter 81, Subchapter I, Section 8105 states “... Corporations created for charitable purposes and not held by way of investment ... shall not be liable to taxation and assessment ...”
- Title 9, Chapter 81, Subchapter I, Section 8106 states “No real property owned and used by the organizations listed below or for the purposes stated below, except that which is held by way of investment, shall be liable to taxation and assessment ...” The Section then lists various organizations.

Chapter 14, Article 6 of the New Castle County Code also deals with property tax exemptions. This article provides further clarification of the State Code and also establishes certain additional exemptions not covered in the State Code (e.g., disability exemption).

New Castle County forgoes a sizeable portion of property tax revenue by granting property tax exemptions, although obviously the granting of such benefits has strong societal impacts. In January 2008, the Assessment Division of the Land Use Department provided us with a report, grouped by exempt type, showing the loss to the assessment roll and the estimated revenue loss from the various tax exemptions. The report did not include “general” exemptions (e.g., charitable) because the Assessment Division informed us that the assessed values on these parcels are not reliable. (The firm that performed the last county-wide reassessment in 1983 merely applied a factor to the 1970 value of each of these parcels; it has been shown over the years that, when one of these parcels is transferred from an exempt entity to a non-exempt entity and the County then re-assesses the property, the 1983 assessed value is greatly overstated.) The report showed that the County is foregoing approximately \$4.1 million in revenues annually on all exemption types other than “general”, with approximately 92% of these revenues being for the senior tax exemption. **Please note that this figure would be much higher were the assessed values for properties having general tax exemptions included.**

Also note that the person who programmed this report used a composite tax rate for properties having a senior or a disability tax exemption because parcels having these exemptions can be located in an unincorporated area or in a municipality and different tax rates apply to these areas.

The County's Land Use Department has four different applications for property tax exemptions:

- Senior tax exemption.
- Disability tax exemption.
- City of Wilmington tax incentive program.
- General tax exemption: used for most exemptions other than the senior, disability, and City of Wilmington tax incentive exemptions. Please note that there are some general exemption types which do not require the completion of an application because the properties automatically receive a property tax exemption per State and/or County Code (such as properties owned by the Federal Government and the State of Delaware).

The Assessment Division of the Land Use Department reviews and approves the applications for the senior, disability, and City of Wilmington tax incentive exemptions. The Law Department reviews and approves the applications for the general exemptions. If an applicant disagrees with the denial of an application for a tax exemption, he/she can appeal the decision to the New Castle County Board of Assessment Review.

### **Audit Objectives and Results**

After performing some preliminary research and after internal discussions, we decided on the following objectives for this audit:

1. Evaluate the controls over the authorization, recording, and ongoing maintenance of property tax exemptions.
2. Evaluate compliance with relevant sections of the State and New Castle County Codes relating to tax exemptions, as well as compliance with Land Use policies and procedures.
3. Evaluate the progress of any recommendations relating to property tax exemptions that were made by the Task Force for the Financial Future of New Castle County Government (e.g., the policies and procedures established to ensure compliance with the legislation passed in 2007 regarding senior and disability tax exemptions). Please note that, subsequent to the audit, Public Financial Management (PFM) was engaged by New Castle County to provide a menu of possible tax enhancements that could diversify the County's revenue portfolio.

### **Scope**

We conducted our audit in accordance with standards promulgated by the Institute of Internal Auditors and the United States General Accounting Office. Our audit testing encompassed existing tax exemptions as of January 4, 2008.

Professional auditing standards require that we plan and perform the audit to obtain reasonable assurance whether internal controls are adequate in all material respects. Our audit of internal control included obtaining an understanding of the internal controls over property tax exemptions, testing the operating effectiveness of the controls, and performing such other procedures as we considered necessary in the circumstances.

Our evaluation of internal control may reveal three categories of internal control deficiencies. The first two categories are of a much greater magnitude than the third category.

- A Material Weakness is a matter that, in our judgment, could adversely affect New Castle County's ability to accomplish its objectives related to property tax exemptions. **There are no Material Weaknesses in this report.**
- A Significant Deficiency is a control exception that is of a lesser magnitude than a material weakness; however, it could potentially have a significant, adverse impact upon the property tax exemption function in the future and, therefore, warrants management's attention. **There are no Significant Deficiencies in this report.**
- Other Reportable Items are opportunities for improvements in the system of internal control. There are 9 Other Reportable Items in this report, beginning on page 5.

In general, our testing involves audit sampling. We evaluate the results of the tests and use professional judgment, based on the number of exceptions and/or the materiality of such exceptions, whether to include exceptions in the audit report and, if so, in which category to include them. In some cases, we perform additional testing to help us obtain additional audit evidence in making such evaluation and determination.

Because the scope of an audit does not allow us to examine every single function and transaction performed by an area, an audit would not necessarily disclose all matters that might be material weaknesses, significant deficiencies, or other reportable items.

### **Opinion**

In our opinion, based on the property tax exemptions in existence on January 4, 2008, adequate internal controls existed in all material respects over the property tax exemption process. We do have 9 comments which are discussed in the Other Reportable Items section of this report.

### **Recognition of Participation and Cooperation**

We would like to thank the General Manager of the Land Use Department, the Acting Chief Financial Officer, and the County Attorney, and their respective staffs, in providing cooperation during the course of the audit.

**Response**

The General Manager of the Land Use Department provided the County Auditor with written responses to certain of the comments and recommendations in this report. These responses have been incorporated into the report.

Cc: Edward Milowicki, Acting Chief Financial Officer  
Nicole Majeski, Acting Deputy Chief Administrative Officer  
Dennis Phifer, Chief of Staff  
Jim Smith, Assistant General Manager, Department of Land Use  
Doug Sensabaugh, Assessment Manager, Department of Land Use  
Emma Prinski, Assessment Supervisor, Department of Land Use  
Members of New Castle County Audit Committee  
Members of New Castle County Council

**General Comment**

Internal Audit's responsibility is to evaluate the internal controls management has in place to enhance the likelihood that management's objectives relating to property tax exemptions will be achieved. Management must evaluate the comments and recommendations in this report and balance the costs of implementing new or enhanced controls versus the benefits to be derived. We realize that management may elect not to implement a new or enhanced control after weighing the costs versus the benefits.

## **Comments and Recommendations** **Other Reportable Items**

### **Audit Objective #1: Evaluate the controls over the authorization, recording, and ongoing maintenance of property tax exemptions.**

#### **Comment # 1: Consider charging a fee for processing tax exemption applications.**

New Castle County does not currently charge a fee for the review and processing of applications for property tax exemptions. Article 6, Section 14.06.1106B of the County Code states: “No application fee is required of owners of potentially exempt property pursuant to this article.”

We performed research of the property tax exemption program in the City of Wilmington and discovered that the City charges an application fee for its “non-profit” exemption and that an application for this exemption must be filed every two years. The City does not charge an application fee for its senior and disability exemptions; however, it does require taxpayers to complete another exemption application every three years.

We did not find anything in the State Code which prohibits the County from charging an application fee. However, we did not perform an exhaustive search.

If the County had a policy of charging a \$50 application fee (as an example), the County would have earned approximately \$106,000 for fiscal year 2007 (for 2,118 applications). Please note that the 2,118 figure includes the senior and disability exemption applications.

#### **Recommendations**

We recommend Land Use Department management (1) research whether State Code contains language which would prohibit the County from charging an application fee and, if not, (2) consider asking County Council to amend New Castle County Code to allow for the charging of an application fee for property tax exemptions. If the Code is amended, Land Use Department management should consider:

- Adopting an immediate application fee for its general tax exemptions (which require research by the Law Department for every application); this application should take into account the amount of time spent by the Law Department in reviewing these applications.
- Adopting an application fee, at a lesser amount than that for the general tax exemption, for the processing of senior and disability tax exemptions.
- Requiring applicants for the general tax exemption to re-submit an application after an interval of a management-determined number of years (or to submit an affidavit attesting to the fact that the organization still meets the necessary requirements). This would help to ensure that such applicants meet the requirements under which the original exemption was granted.

- Requiring applicants for the senior and disability exemptions to re-submit an application after an interval of a management-determined number of years (or to submit an affidavit attesting to the fact that the applicant still meets the necessary requirements). This would help to ensure that such applicants meet the requirements under which the original exemption was granted.

Regarding the third and fourth items above, it should be noted that it is currently the taxpayer's responsibility to notify the County if circumstances have changed whereby he/she is no longer eligible for the exemption. (This is noted on the application.)

Land Use Department management would have to make the decision as to whether to charge an application fee for re-applications.

#### Management Response (provided by General Manager of Land Use Department)

The Assessment Division supports a fee of \$100.00 per General Exemption application, but no fees on any of the additional exemptions we administer. We believe this has been recommended in the past.

#### County Auditor's Comment on Management Response

Management said they support an application fee for "general" exemptions, but did not say anything about whether, and how, this would be implemented.

Management did not provide responses to the second, third, and fourth bullets in the recommendations. Therefore, we take this as an indication that management will not be taking action on these items.

#### **Comment # 2: Re-evaluate documentation required for the senior and disability tax exemptions.**

The senior property tax exemption is for taxpayers 65 years of age or older. The disability tax exemption is for people who are "... unable to engage in any substantial gainful activity by reason of blindness or any other medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months." Both exemptions are based upon one's adjusted gross income (not including any Social Security or Railroad Retirement benefits). To be eligible, a single person's or a married couple's adjusted gross income cannot exceed \$50,000 and the assessed value of the property may not exceed \$125,000. (Note: There is an exception for those properties where the assessed value is greater than \$125,000 but the person applying for the exemption has income of \$3,000 a year or less). The applicant(s) can receive an exemption on up to \$32,000 of the total assessed value of the property. There is an additional exemption for those with disabilities meeting certain additional requirements.

#### **Senior and Disability Tax Exemptions**

The Assessment Division of the Land Use Department requires the applicant(s) to complete an application and attach a copy of the most recent federal tax return. The Assessment Division requires the applicant to sign a statement on the application attesting to the fact that all information provided is true to the best of their knowledge and belief. Although we commend the Assessment Division for requiring the applicant to submit the most recent tax return and for the applicant to sign a verification statement, we still feel there is a risk of someone submitting a fraudulent tax return; that is, the Assessment Division has no way of knowing that the tax return submitted is the actual one that was filed with the IRS. We believe the Assessment Division should also request additional supporting documentation for the income numbers (e.g., W-2's). We do not believe providing such information would be a hardship to the applicant; after all, he/she would have needed such information to prepare his/her tax return. Please note that such information is required if the applicant was not required to file a federal tax return for the applicable year. It should also be noted that the County of Henrico, VA (as an example) requires proof of every income item listed on the application.

### **Disability Tax Exemption**

The Assessment Division of the Land Use Department requires the applicant(s) to complete an application and attach a copy of their Social Security Award Certificate or have their physician describe the extent of the disability and sign the application. The Assessment Division requires the applicant to sign a statement on the application attesting to the fact that all information provided is true to the best of their knowledge. Although we commend the Assessment Division for requiring the applicant to submit a Social Security Award Certificate or have a physician sign the application, and for the applicant to sign a verification statement, we still feel (in cases where the applicant does not provide a Social Security Award Certificate) that there is a risk of someone forging a physician's signature; that is, the Assessment Division has no procedure in place to ensure the legitimacy of the physician's signature. We believe the Assessment Division should also request a signed letter from the physician and then follow through with a phone call to the physician to ensure the legitimacy of the letter. As an example, the State of Florida, for their disability tax exemption, requires a certificate from two professionally unrelated licensed Florida physicians

### **Recommendation**

We recommend that Land Use Department management assess the costs versus benefits of requiring such documentation and then make a decision whether to require such information going forward.

### **Management Response (provided by General Manager of Land Use Department)**

Beginning with the next exemption filing period, Assessments will begin requiring a copy of the applicant's W-2.

County Auditor's Comment on Management Response

Management did not provide a response to the suggested documentation for the disability tax exemption. Therefore, we take this as an indication that management will not be taking action on this suggested documentation.

**Comment # 3: Re-evaluate policies and procedures for evaluating applications for "general" tax exemptions.**

Delaware Code, Title 9, Chapter 81, Section 8105 ("property owned by governmental, religious, or charitable agency") provides an exemption for "property belonging to this State, or the United States, or any county of this State, or owned by any municipality of this State and held for public use, or any church or religious society, and not held by way of investment, or any college or school and used for educational purposes ..." It also provides for an exemption for "corporations created for charitable purposes and not held by way of investment that are in existence on July 14, 1988, together with existing and future charitable affiliates of such corporations that are also not held by way of investment ..."

Chapter 14, Article 6, Division 14.06.100, Section 14.06.101 of the New Castle County Code provides wording similar to the State Code (although apparently more liberal) as follows: "Property not held by way of investment and belonging to any church or religious society, any public school district, any nonprofit school and used for educational or school purposes, or any organization organized and operated for charitable purposes shall be exempt from property taxes."

The exemption referred to in the above two paragraphs is one of the "general" tax exemptions provided by New Castle County. The organization requesting such an exemption must complete an application, accompanied by the organization's IRS exemption letter or by its charter and by-laws, which is submitted to the Assessment Division in the Land Use Department. After the Assessment Division ensures the form is properly completed, an assessment technician will visit the property to ensure the property is being used for the exempt activity(s) stated on the application. If the organization passes this "use test", the application is then sent to the Law Department to have them determine if the organization qualifies for the exemption under the Code. An attorney in the Law Department drafts a formal legal memorandum providing his/her opinion on whether the organization qualifies for the exemption. If the exemption is denied, the applicant has the right to appeal the decision to the County's Board of Assessment Review.

Our testing of a sample of 25 properties having a general tax exemption of "Charitable & Benevolent" revealed the following. Please note that the dates of most of these items pre-date the current County Administration.

- Unless the request for the exemption is denied, no one besides the attorney performing the research is reviewing the legal memorandum. This could result in an

incorrect decision being made (or a decision being made based on faulty reasoning), and it would not be detected.

- We found one legal memorandum, dated January 17, 2007, which did not contain the attorney's reasoning as to how he/she arrived at a decision to grant the exemption. Had another attorney been required to review the memorandum, the non-inclusion of the attorney's reasoning most likely would have been discovered.
- We found one legal memorandum, dated 2004, where we believe the decision could have gone either way based upon the definition of "charity" used by the Law Department from a 1910 Delaware Supreme Court case, and based upon the fact that our review of the tax exemption file did not reveal any documentation provided by the applicant that appeared to "clearly and convincingly establish that he meets all requirements set forth by the statute creating the exemption" (the standard used by the Law Department in its legal memoranda). It should be noted that this application pre-dates the current Administration.

We do realize that the Law Department has limited resources and having a senior attorney review every legal memorandum may not be feasible; perhaps, however, a review could be performed in those situations where the foregone tax revenue is going to exceed a management-determined amount.

- In its legal memoranda on property tax exemption applications, the Law Department generally states: "... to qualify for exemption under Delaware law, it must also demonstrate that the properties are not held by way of investment ... The determinative test of whether a property is held by way of investment is whether there is an intent to use the property primarily for the purpose of securing a profit for its owner ... In the absence of any indication that the properties were acquired or are being operated for the purpose of securing a profit for its owner, I conclude that they are not held by way of investment." The Law Department informed us that they perform proactive research to determine whether the property is "held by way of investment"; however, we could not find any evidence of this (e.g., review of the organization's annual 990 form filed with the IRS) in the files we reviewed. It should be noted that the majority of the files we reviewed pre-dated the current Administration.
- The legal memorandum, dated July 6<sup>th</sup>, 2001, for one application indicated that the applicant leases a room on the property. The memorandum said the rent was de minimis; however, neither the application nor anything in the file indicated how much this rent was. It should be noted that this application pre-dates the current Administration.
- The Assessment Division maintains a spreadsheet of general exemption applications. This spreadsheet contains the date the application was received, the date the assessment technician signed off on the "use test", the date the application was sent to

the Law Department, and the effective date of the Law Department's decision (not the date it made its decision). Our review of the spreadsheet dated 2/19/08 revealed that there were 110 tax parcels awaiting a Law Department decision and that 78 (or 71%) of these were received by the Assessment Division prior to 2007. It should be noted that the 110 parcels do not represent 110 applications as multiple parcels can be on a single application.

We were informed that the Law Department, in February 2008, assigned a second County Attorney to review general exemptions. Hopefully, this has helped to speed up the process.

- One property was approved for the "use test" even though the property had not yet been converted into the exempt activity for which it was claiming the exemption. There was no indication in the file that the Assessment staff member ever returned to the property to ensure the property was converted to the exempt use. It should be noted that this application pre-dates the current Administration.
- The Assessment Technician performing the "use test" merely signs off as evidence that it was performed. He/she does not include any notes referring to how he/she verified the property was being used for the particular exempt activity.

### Recommendations

We recommend that the Law Department:

- Evaluate the costs versus benefits of having a second person review the legal memorandum concerning whether to grant an organization a general tax exemption. Management should consider having a senior attorney review the legal memorandum when the foregone tax revenue is going to exceed a management-determined dollar amount. The Assessment Division could provide this information to Law.
- Include, at a minimum, documentation of the review of the organization's annual 990 form filed with the IRS when determining whether or not a property "is held by way of investment."
- Perform research, should an applicant indicate that a portion of its property is rented, to determine the amount of the rent and take this amount into account in determining whether this portion of the property is "held by way of investment." Documentation of this research should also be placed in the tax exemption file.
- Continue to evaluate the timeframe in which applications for general tax exemptions are evaluated.

We recommend that the Land Use Department:

- Instruct the Assessment staff member, when a property is approved for the "use test" and the property has not yet been converted into the exempt activity for which the exemption was claimed, to return to the property to ensure the property was converted to the exempt use.

- Instruct the Assessment Technician performing the “use test” to include documentation on how he/she verified that the property was being used for the particular exempt activity.

#### Management Response – Law Department

Management did not provide a response.

#### Management Response – Land Use Department

Management did not provide a response.

#### **Comment # 4: Consider evaluating organizations potentially holding property for investment purposes.**

A December, 2008 article in the Wilmington News Journal noted “In several fire companies, officials have put their surplus money into real estate, which then becomes exempt from property taxes because of the companies’ nonprofit status. In 1994, the Talleyville Fire Company bought the two-acre lot next to its fire station for \$80,000. Now, the U.S. Postal Service pays the company \$120,000 a year to lease the site for a post office ... If that property were owned by an individual or corporation, it would generate about \$12,000 in annual taxes for Brandywine School District and \$3,700 for New Castle County ...” The article then gave two other examples of New Castle County fire stations which may be holding properties for investment purposes.

We originally had not included any volunteer fire companies in our testing because we were informed that these companies receive an “automatic” tax exemption per Article 6, Section 14.06.102 of the County Code (i.e., the property automatically becomes exempt when the deed is recorded). That Section states: “Notwithstanding anything in this Chapter to the contrary, fire and rescue stations owned by volunteer fire companies, including the halls and grounds appurtenant thereto, shall be exempt from all real property taxes.” The phrase “notwithstanding anything in this Chapter to the contrary” led us to examine the other Sections in Division 14.06.100, and Section 14.06.101 contains the phrase (mentioned earlier in this report) “property not held by way of investment.” The examples given by the News Journal (if true) are examples of property held by volunteer fire companies which could be held by way of investment.

In its legal memoranda on property tax exemption applications, the Law Department generally states: “... to qualify for exemption under Delaware law, it must also demonstrate that the properties are not held by way of investment ... The determinative test of whether a property is held by way of investment is whether there is an intent to use the property primarily for the purpose of securing a profit for its owner ...”

In October, 2010, the Law Department made us aware of a 1990 Delaware Supreme Court case in which the Court stated, in looking at whether a property was held by way of investment, “the determinative factor is that of purpose. Of necessity, such a

determination is intensively factual and requires the Court to consider all relevant circumstances ...” In this case, the Court found that a property held by a non-profit organization was not held by way of investment and looked at the following four factors:

- Whether the entity is an entity organized for the purpose of making a profit: The fire companies, as was the situation with the organization in the Delaware Supreme Court case, are organized as non-profits.
- Whether the rental is to help defray the costs of maintaining and operating the properties which, viewed collectively, are operated and maintained for a tax exempt purpose: In the case of the fire companies, the courts would need to analyze the financial condition of each fire company to help make this determination. We believe it is most likely that the courts would find in favor of the fire companies on this factor.
- Whether the conditions under which the organization holds title to the property legally preclude the organization from operating the property for the purpose of securing a profit: We don't believe any of the fire companies mentioned in the News Journal article are legally precluded from operating the property for the purpose of securing a profit; however, the courts would need to analyze this.
- Whether the organization is in fact securing a profit from the rental (whether the rental revenues are exceeded by organization's costs of operating the properties): In the case of the fire companies, the courts would need to analyze the financial condition of each fire company to help make this determination. We do not express any opinion on how the courts would find on this factor.

We believe the Law Department should use the above factors in analyzing all potential situations (not just the fire companies) where it is possible that an organization could be holding a property by way of investment.

### Recommendations

We recommend that the Departments of Land Use and Law do the following:

- Consider evaluating whether any properties held by volunteer fire companies are being used for income-producing or other potential investment purposes and, if so, apply the four factors from the 1990 Delaware Supreme Court case to each situation and then decide whether it is cost-beneficial to pursue the possible rescinding of the tax exemption (or a portion of it). The decision on whether to perform such evaluation should be made in light of the volunteer fire companies' recent presentation to County Council on their funding shortfalls.
- Consider evaluating all other “automatic” tax exemptions (e.g., governmental entities, religious organizations, schools) to determine if the possibility exists that the types of organizations having the exemptions could be holding property for investment purposes and, if so, perform additional research to determine whether such organizations are indeed holding any property for investment. (Please note that Section 8102 of the Delaware State Code, titled “Property Owned by Governmental, Religious, Educational or Charitable agency”, appears to exclude schools from the “held by way of investment” limitation.) If a percentage of a property is potentially being held for investment purposes, we do believe that such percentage will be a low

one and thus the property could very well fail the Delaware Supreme Court test of a property being "held by way of investment"; however, management could possibly use this information to seek a payment in lieu of taxes from such entities (see comment # 9).

- Evaluate whether these organizations should be receiving an automatic tax exemption as soon as the deed is recorded, or whether some analysis should be performed before granting the exemption.
- Implement a control to help detect when the use of a property changes from non-investment to “potential” investment purposes. Such control could be asking the property owner each year to certify that the property is still being used for non-investment purposes.

#### Management Response – Law Department

Management did not provide a response.

#### Management Response – Land Use Department (provided by General Manager of Land Use Department)

Beginning January 1, 2011, Assessments will begin a review of all existing General Exemption holders to ascertain non-investment status.

### **Audit Objective # 2: Evaluate compliance with relevant sections of the State and New Castle County Codes relating to tax exemptions, as well as compliance with Land Use policies and procedures.**

#### **Comment # 5: Consider approaching State Legislature about amending the State Code to allow New Castle County to appeal decisions of the Board of Assessment Review.**

Chapter 14, Article 6, Division 14.06.000, Section 14.06.1111 of the New Castle County Code states: “Any person who feels aggrieved by a decision of the County ... may file an appeal with the Board of Assessment Review no later than 30 days after the date of the County’s decision by filing a notice of appeal ...” However, we were informed by the Law Department that the County itself generally does not have the right to appeal decisions of the Board of Assessment Review based upon a judicial decision in a 1993 case. The ability for the County to have a right to appeal would require the General Assembly to enact a revision to State Law.

Our testing of property tax exemptions revealed an instance where New Castle County probably would have liked to appeal a decision of this Board.

New Castle County denied a charitable tax exemption to one organization primarily because “... membership is not open to all persons, but is instead limited to citizens who pledge allegiance to the American Flag, who are of good character, not under the age of

21, and who believe in God.” This reasoning is based upon the Delaware Supreme Court case (Trustees of New Castle Common v. Megginson) which states: ”In order to qualify as a charity, an organization must work for the benefit of an indefinite number of persons ...” The organization filed an appeal with the Board of Assessment Review and the Board unanimously granted the appeal “... based upon the fact that the works performed by the (name deleted) were beneficial to the community at large and of a charitable nature and based upon precedent set by the Board in granting exempt status to organizations engaged in charitable functions.” We spoke about this case to the County Attorney, who disagreed with the Board of Assessment Review’s decision. It should be noted that the written opinion issued by the Board of Assessment Review did not address the issue that the organization must work “for the benefit of an indefinite number of persons.”

We spoke to the Chairman of the Board of Assessment Review and he could not provide us with specific criteria that the Board uses in deciding whether or not to grant a charitable tax exemption. He did say that there have been very few appeals on charitable tax exemption applications.

The amount of tax revenue in the particular situation noted above is not large; however, we believe the decision of the Board of Assessment Review sets a bad precedent and that the County should have the right to appeal decisions of this Board.

#### Recommendation

We recommend that the County Executive Office consider approaching the State Legislature about amending the State Code to provide the County with the authority to appeal a decision of the Board of Assessment Review.

#### Management Response – County Executive Office

Management of the prior Administration did not provide a response.

#### **Comment # 6: Re-evaluate the section of County Code which grants a tax exemption for new or renovated commercial or building projects in the City of Wilmington.**

In 1978, at a time when many governmental entities across the country were taking steps to help major cities, the County Council passed an ordinance allowing a tax exemption for “new or renovated commercial or manufacturing projects”, i.e., “any structure located within the corporate limits of the City of Wilmington ... which is newly constructed and the costs of site acquisition and construction exceed fifty thousand dollars (\$50,000.00). The term shall not include any residential structure.” The ordinance allows for an exemption based upon the greater of (1) “The property’s highest assessed value in the year immediately preceding any new construction or renovation; or (2) The fair market value assessment based on the new construction or renovation, less the percentage of exemption permitted under this Section.” The percentage of exemption is 100% for the

first fiscal year in which the new structure is subject to new taxation; the percentage is then reduced by 10% in each of the next 9 fiscal years until it is 0%.

The County Executive at the time did not sign the ordinance (although, per County Code, it still became law since she did not veto it), stating in a memorandum: “While it is clearly important for government at all levels in Delaware to improve the climate for economic development, I am not convinced that the approach used in Ordinance No. 78-158 is the most equitable or effective response to this problem. I am also very much concerned about the potential revenue losses which could result from any new exemption ...”

At a public budget hearing for the Fiscal Year 2009 budget, the subject of this tax exemption arose and the County Auditor told those in attendance that he was looking at this exemption on the Property Tax Exemptions audit and would be recommending in his audit report that Council re-evaluate the need for this exemption. The County Auditor later talked to a Senior County Councilperson who said that prior County Councils have discussed whether or not to maintain this exemption. Please note that a County Councilperson in attendance at the budget hearing introduced an ordinance in July 2008 to revise the Code Section addressing this tax exemption. The ordinance was withdrawn in September 2008.

We asked the Assessment Division to provide us with a report of the amount of revenue the County has lost during the last eight fiscal years because of this exemption. The report estimated that the County has lost approximately \$448,000 in these eight years. The report also estimated that the schools have lost approximately \$4 million in school taxes.

#### Recommendation

Because the County is dealing with difficult financial times, we will ask a County Councilperson to consider introducing the above-mentioned ordinance (or a new version of it) again, or at least initiating a discussion on the topic. No response to this comment is necessary.

#### **Comment # 7: Approach State Legislature about incorporating a deadline in the State Code for the filing of property tax exemption applications.**

The County denied a tax exemption application from the University of Delaware (for four tax parcels) because the University did not meet the application deadline imposed by the County. The University appealed to the Board of Assessment Review, who denied the appeal. The University then appealed the Board’s decision to the Delaware Superior Court (affirmed by the Delaware Supreme Court), and the Superior Court ruled in favor of the University.

The University changed the use of certain properties it owned from non-exempt use to exempt use prior to July 1, 2004. The University applied to the County for tax

exemptions in July of 2004. Exemption was granted for the properties but was made effective to July 1, 2005 because the University failed to submit the applications prior to its deadline of 12/31/03 (as provided for in County Code). The Delaware Superior Court ruled that New Castle County did not have the authority to impose an application deadline in a manner that has the right to negate the tax exemption rights conferred by Delaware State Code: “Property belonging to ... any college or school and used for educational or school purposes ... shall not be liable to taxation and assessment for public purposes by any county or other political subdivision of this State ...” County Code Section 14.06.1103 requires that applications for the exemption of educational property be filed with the Assessment Division by 12/31 of the fiscal year immediately preceding the fiscal year for which the exemption is sought. The Court said that the County did not have the power to restrict a tax exemption by the imposition of an application deadline when the State created the tax exemption without any deadline in the Statute.

At the beginning of our audit, the Law Department told us about this situation and informed us that the County would seek to have the State Code changed to allow the County to impose an application deadline.

#### Recommendation

We recommend that the County Executive Office consider approaching the State Legislature about amending the State Code to allow the County to impose an application deadline.

#### Management Response – County Executive Office

Management of the prior Administration did not provide a response.

#### **Comment # 8: Enhance written policies and procedures for the initiation, review & approval, and processing of tax exemption applications.**

Written policies and procedures relating to the processing of tax exemptions include a manual (“Property Tax Exemption Guidelines”) with the eligibility requirements for each type of tax exemption, and a listing of the various types of exempt codes and the general categories they fall under. However, not all of this documentation is current (e.g., the requirements have changed for the senior and disability exemptions) and there are certain areas where there are no written policies and procedures, e.g.,

- The procedures within the Assessment Division for processing each type of exemption application.
- The procedures for assessors performing the “land use test” (i.e., the review of the property to ensure it is being used for the exemption type the organization applied for).
- The procedures for periodic review of properties which could have outdated tax exemptions.

Although we believe the Assessment Division is performing its role in properly reviewing, authorizing, and recording property tax exemptions, we believe that the lack

of comprehensive, documented policies and procedures increases the risk that tax exemption activity may not be managed in the best interests of New Castle County. Reliance upon the memories of long-term employees is a risk because eventually those employees are going to leave the County's employ.

### Recommendation

We recommend that the Assessment Division establish a formal Policies & Procedures Manual which includes the current policies and procedures as well as the following:

- The procedures within the Assessment Division for processing each type of exemption application.
- The procedures for assessors performing the "land use test" (i.e., the review of the property to ensure it is being used for the exemption type the organization applied for).
- The procedures for periodic review of properties which could have outdated tax exemptions.
- Definitions of the various exemption categories which are on the Land Use System.
- Any other items the Assessment Division deems applicable (e.g., some of the items recommended in this report, such as a step that requires a signed letter from a physician in the case of disability exemptions).

### Management Response (provided by General Manager of Land Use Department)

Beginning January 1, 2011, Assessment will review (with the concurrence of the Law Department) all policies and procedures for the General Exemption approval process. This review will result in a new, complete and concise policies and procedures manual.

**Audit Objective # 3: Evaluate the progress of any recommendations relating to property tax exemptions that were made by the Task Force for the Financial Future of New Castle County Government (e.g., the policies and procedures established to ensure compliance with the legislation passed in 2007 regarding senior and disability tax exemptions).**

**Comment # 9: Determine the feasibility of implementing a "payment in lieu of taxes" (PILOTS) program.**

Two of the recommendations by the Task Force for the Financial Future of New Castle County were as follows:

- **"Sunset and replace overly generous tax and sewer exemption programs.** Replace with programs targeted toward those in need. Implementing a need-based program more appropriately targets limited resources to residents that are truly suffering from financial hardship." This recommendation was partially addressed by

two ordinances, regarding the senior and disability tax exemptions, passed by County Council in October, 2007.

- **“Implement a Payment-In-Lieu-of-Taxes (PILOTS) program for commercial properties currently exempt from paying property taxes.** Pursue State legislation to eliminate the property tax exemption for cable television assets given the changes in the structure of that market. There is currently \$51 million of tax-exempt commercial property.” Except for a resolution directing the Director of the Office of Management and Budget, the Secretary of Finance, the Secretary of Education, and the Controller General to provide the Governor and the General Assembly with recommendations for a fair and equitable reassessment of all real property for the purpose of ad valorem taxation by county governments and school districts, no other legislation has been introduced in the State or the County regarding this issue.

In late 2008, the County engaged Public Financial Management, Inc. (PFM) to build on previous staff and executive efforts to develop options for new sources of recurring revenue. PFM issued a report in February 2009 which included a comment on PILOTS programs. The comment stated that such programs are “payments made by state governments or by organizations that do not pay real property tax to partially compensate localities for lost property tax due to state-mandated property tax exemptions. PILOT programs of various types are common nationwide, and are a significant source of revenue for many localities.” PFM’s report included general information on types of PILOT programs and more detailed information on two specific types and their potential fiscal implications for New Castle County. PFM stated that “Given the number, size, and variety of New Castle County’s non-profit entities, a successfully implemented PILOT program could potentially generate new revenue in the same range, between \$1.7 million and \$3.4 million.”

### Recommendation

Article 6, Section 14.06.1003 of the County Code states: “Nothing in this article shall restrict the County from entering into an agreement with an exempt property owner for payment of service charges in lieu of taxes.” Given the statement from the Task Force that there is approximately \$51 million in tax-exempt commercial properties, and given the PFM report which provides detailed information on two types of PILOTS programs, we recommend that:

- the County Executive Office determine the feasibility of implementing a PILOTS program in New Castle County, and
- If a PILOTS program is deemed feasible, the County Executive Office develop a plan for implementing such a program.

### Management Response – County Executive Office

Management of the prior Administration did not provide a response.