State of Nevada
Governor's Finance Office
Division of Internal Audits

Audit Report

Department of Taxation
County Distributions

Report No. 18-07
June 14, 2018

EXECUTIVE SUMMARY
Department of Taxation
Local School Support Tax and
Basic City County Relief Tax Distributions

Objective: Ensure the Department Distributes LSST and BCCRT in Accordance with State Laws

Collaborating with the Attorney General's Office (AG) to interpret local school support tax (LSST) and basic city county relief tax (BCCRT) statutes will help clarify taxation language and ensure distribution methods to school districts and counties are clearly documented. Statutes require the Department of Taxation (department) to determine, for each county, the amount of LSST and BCCRT collected in the county from in-state businesses. Statutes' use of the phrase "collected in the county" is interpreted differently for LSST and BCCRT. For LSST, "collected in the county" is interpreted as the taxes collected by businesses located in the county. For BCCRT, "collected in the county" is interpreted as the tax collected in the county where the sale is made, meaning where the taxpayer takes delivery.

Statutes state LSST should be parallel in all respects to sales and use taxes and BCCRT should be substantially identical to LSST. The current distribution of LSST makes it different from sales and use taxes, and the current distribution of BCCRT is not substantially identical to the LSST distribution provisions. A change in interpretation of the statutes will impact the amount of LSST and BCCRT; however, our sample may not represent the overall impact on distribution to the counties.

INTRODUCTION

At the direction of the Executive Branch Audit Committee, the Division of Internal Audits conducted an audit of the Department of Taxation (department).

Our audit focused on distribution of Local School Support Tax (LSST) and Basic City/County Relief Tax (BCCRT). The audit's scope and methodology, background, and acknowledgements are included in Appendix A.

Our audit objective was to develop recommendations to:

- ✓ Ensure the department distributes LSST and BCCRT in accordance with state laws.

Department of Taxation
Response and Implementation Plan

We provided draft copies of this report to the department for their review and comments. Their comments have been considered in the preparation of this report and are included in Appendix B. In its response, the department accepted our recommendation. Appendix C includes a timetable to implement our recommendation.

NRS 353A.090 requires within six months after the final report is issued to the Executive Branch Audit Committee, the Administrator of the Division of Internal Audits shall evaluate the steps the department has taken to implement the recommendation and shall determine whether the steps are achieving the desired results. The administrator shall report the six month follow-up results to the committee and department officials.

The following report contains our findings, conclusions, and recommendation.

Ensure The Department Distributes LSST and BCCRT In Accordance With State Laws

The Department of Taxation (department) may not be distributing Local School Support Tax (LSST) or Basic City/County Relief Tax (BCCRT) in accordance with state laws. The department should collaborate with the Attorney General's Office (AG) to interpret LSST and BCCRT statutes. Collaborating with the AG to interpret LSST and BCCRT statutes will clarify taxation language and ensure distribution methods to school districts and counties are clearly documented.

Collaborate with AG to Interpret Statutes

The department should collaborate with the AG to interpret LSST and BCCRT statutes. Documented interpretation of LSST and BCCRT statutes will help clarify taxation language and ensure distribution methods to school districts and counties are clearly documented.

The LSST and BCCRT are part of the state sales and use taxes. Distributions are made monthly after businesses have filed their sales and use taxes report.[1] Both LSST and BCCRT statutes require a percentage to be distributed to the state general fund as compensation for collecting the tax.[2] The remaining amount is distributed to other funds and accounts based on whether the business filing is considered out-of-state or in-state. The statutes are very specific as to what fund the monies get distributed to for out-of-state businesses; however, statutes for in-state business distributions can be interpreted in multiple ways.

Distributions Dependent on How Statute is Interpreted

NRS 374 is the Local School Support Tax Law. NRS 374.785(c)(e) requires the department to determine, for each county, the amount of money equal to the fees, taxes, interest, and penalties collected in the county from in-state businesses, less the amount transferred to the general fund. This amount is to be transferred to the Intergovernmental Fund and credited to each county school district fund.

[1] Sales and use tax reports are used by businesses to report sales in the various counties and determine the amount of tax owed based on the sales tax rate in each county.

[2] Statute requires .75 percent of LSST and 1.75 percent of BCCRT collected to be distributed to the state general fund as compensation to the state for the cost of collecting the tax.

The terms, “collected in the county,” can be interpreted in two ways. It can denote the amount of money collected in the county where the business that made the sale is located, or the county where the taxpayer takes delivery.

The department interprets NRS 374 (LSST) to denote the school district in the county where the business is located will receive the funds. Distributing to the school district in the county where the business is located may be based, in part, on the idea that businesses in each county, in general, hire local workers whose children go to the schools in that county; therefore, the tax dollars collected by the businesses should also go to the school district in that county. However, this statute could also be interpreted to mean the amount collected in the county where the taxpayer takes delivery, because the local taxpayer wants the tax dollars to go to the school district in their county.

NRS 377 is the City-County Relief Tax (CCRT) Law. The CCRT includes the BCCRT and Supplemental City-County Relief Tax (SCCRT). The SCCRT is distributed based on a population formula in statute. The BCCRT distribution for in-state businesses can be interpreted in multiple ways.

NRS 377.055(1)(2) requires the department to determine, for each county, the amount of money equal to the sum of any fees, taxes, interest, and penalties which derive from the BCCRT collected in that county from in-state businesses, less the amount transferred to the state general fund. This amount is to be deposited into the Local Government Tax Distribution Account for credit to the respective subaccounts of each county.

The department interprets NRS 377 (BCCRT) to mean the county where the taxpayer takes delivery will receive the funds. This is inconsistent with the department’s interpretation of “collected in the county” for NRS 374 (LSST). Other references in the statutes specify LSST distribution should parallel sales and use tax.

Statute States LSST Will Parallel
Sales and Use Taxes

NRS 374.015(8) states, “(T)he convenience of the public and of retail merchants will best be served by imposing the LSST upon exactly the same transactions, requiring the same reports, and making such tax parallel in all respects to the sales and use taxes.” Sales and use taxes, excluding LSST, are distributed to the county where the taxpayer takes delivery, except for the taxes with distribution calculations enumerated in detail in statute. (See Appendix A Exhibit VI.) Distributing LSST to the school district in the county where the business is located evidences LSST is not parallel in all respects to the sales and use taxes.

Proposed Legislation Points to Distributing
Sales and Use Taxes to County Where Taxpayer Takes Delivery

Previously proposed legislation points to distributing sales and uses taxes, including LSST and BCCRT, to the county where the taxpayer takes delivery:

- In April 1995, AB 450 was presented to the Assembly Committee on Taxation to clarify retailers are to calculate the sales and use taxes due on each sale based upon the rate in effect in the county where the goods are delivered and used.
- During legislative discussion, the bill sponsor explained sales tax was applied at the site where the taxpayer takes delivery. For example, the sponsor noted if a taxpayer took delivery for an item in Reno that is where the tax would go.

Included in the original bill were changes to NRS 374 and NRS 377 to clarify what "collected in a county" meant and to establish penalties for businesses that did not calculate the sales and use tax at the applicable county rate. The bill proposed adding language to the effect that the department would need to determine the amount, for each county, equal to the fees, taxes, interest, and penalties derived from the tax collected *on sales pertaining to the county*. They further defined *"pertaining to the county"* to mean the county where the taxpayer takes delivery, even if the tax is actually collected in another county. Only the penalties were added in the final bill; the intended clarification was not included. However, the original version of the bill shows the intent for distributing sales and use tax to the county where the taxpayer takes delivery.

Pre-1998 Annual Reports Point to Distributing
Sales and Use Taxes to County Where Taxpayer Takes Delivery

The Department of Taxation Annual Reports published prior to fiscal year (FY) 1998 indicate LSST and BCCRT were both distributed the same as other sales and use taxes for in-state collections. At that time, the annual report stated 99 percent of in-state collections for LSST and BCCRT were distributed back to the county of origin.[3] This indicates all sales and use taxes, except for the state portion of one percent, were distributed to the county where the taxpayer took delivery.

A change in LSST distribution methodology appears to have occurred in 1998. The annual report published for FY 1998 states LSST for in-state collections is

[3] At the time, 1 percent of LSST and BCCRT was distributed to the state general fund as payment for collecting the tax.

distributed to the county where the business is located, and BCCRT for in-state collections is distributed to the county where the sale was made (where the taxpayer took delivery). LSST is the only tax included in sales and use taxes that is not distributed to the county where the taxpayer took delivery when statute does not enumerate a distribution formula.

Statute States LSST and BCCRT Provisions Should be Substantially Identical

NRS 377.040 states the provisions of the CCRT should be substantially identical to those of the LSST law. The department's interpretation of NRS 374 and NRS 377 regarding the distribution of taxes from in-state businesses results in different provisions for the LSST and BCCRT.

<u>Proposed Legislation Confirms Provisions Should be Substantially Identical</u>

Proposed legislation noted changing language in the LSST law would, by implication, require changes in the BCCRT. During a hearing for AB 450, an exhibit was submitted to the committee which outlined the proposed changes. The exhibit clarifies for the LSST, and by implication the BCCRT, property sold for delivery in a county is sold for consumption in the county to where it is delivered. This indicates LSST and BCCRT should be distributed using the same methodology because changes affecting LSST also affect BCCRT.

Department Guidance Inconsistent

The January 2010 Nevada Tax Notes issue contained an article, "Overview of How Sales & Use Tax Revenues are Distributed," which states both LSST and BCCRT are to be distributed back to the county where the business is located.[4] However, the annual report for the same year and subsequent years state LSST is distributed to where the business is located and BCCRT is distributed to where the sale is made (where the taxpayer takes delivery). The difference in which distribution policy is followed impacts the amount of sales and use tax revenue received by counties and school districts for local funding purposes.

Change in Interpretation Impacts Distribution

Changing distribution interpretation based on where the business is located or where the taxpayer takes delivery impacts the amount of LSST each school district or BCCRT each county receives. We reviewed 23 sales and use tax returns, which represented almost 25 percent of the sales and use taxes

[4] The department publishes Nevada Tax Notes. It is the official newsletter of the department for use by members of the public.

collected on December 31, 2016. The department represented this is one of the largest collection days of the year since monthly, quarterly, and annual filers must file at the end of December. This is also a particularly large collection day due to the holidays.

The following exhibits show potential impacts on LSST and BCCRT distributions based on the sample of 23 sales and use tax returns. These impacts indicate there can be a difference in the amount of LSST and BCCRT as a result of a change in interpretation. However, we were not able to determine the overall impact on the amount of distributions of LSST and BCCRT to each county.

LSST Comparison

Exhibit I shows the potential impact on LSST distributions to school districts in the counties when LSST is distributed based on where the taxpayer takes delivery instead of where the business is located.

Exhibit I

LSST Distributions Potential Impact[a]

County	Business Location	Where Taxpayer Takes Delivery	Difference	Percent Change
Churchill	$ 142,416	$ 158,913	$ 16,497	12%
Clark	3,970,471	3,893,853	76,618	-2%
Douglas	204,284	268,490	64,206	31%
Elko	474,715	393,333	81,382	-17%
Esmeralda	343	3,339	2,996	875%
Eureka	29,915	123,941	94,026	314%
Humboldt	384,399	210,176	174,223	-45%
Lander	13,219	122,738	109,519	828%
Lincoln	6,022	4,930	1,092	-18%
Lyon	162,961	152,409	10,552	-6%
Mineral	12,491	22,460	9,969	80%
Nye	290,557	254,370	36,187	-12%
Carson City	318,815	305,963	12,852	-4%
Pershing	10,614	34,628	24,014	226%
Storey	1,356	2,186	830	61%
Washoe	1,197,017	1,236,251	39,234	3%
White Pine	24,840	56,455	31,615	127%
Total	$ 7,244,435	$ 7,244,435		

Table Note:
[a] This table shows potential impacts based on 25 percent of collections for a single day. These numbers should not be used to determine the end impact of a change in interpretation.

Currently, the department distributes LSST to the school district in the county where the business is located. If the department instead distributed LSST to the school district in the county where the taxpayer takes delivery, ten counties would receive more LSST and seven counties would receive less.

BCCRT Comparison

Exhibit II shows the potential impact on BCCRT distributions to counties when BCCRT is distributed based on where the business is located instead of where the taxpayer takes delivery.

Exhibit II

BCCRT Distributions Potential Impact[a]

County	Where Taxpayer Takes Delivery	Business Location	Difference	Percent Change
Churchill	$ 30,252	$ 27,112	$ 3,140	-10%
Clark	741,273	755,859	14,586	2%
Douglas	51,112	38,889	12,223	-24%
Elko	74,879	90,372	15,493	21%
Esmeralda	636	65	571	-90%
Eureka	23,595	5,695	17,900	-76%
Humboldt	40,011	73,178	33,167	83%
Lander	23,366	2,517	20,849	-89%
Lincoln	939	1,146	207	22%
Lyon	29,014	31,023	2,009	7%
Mineral	4,276	2,378	1,898	-44%
Nye	48,425	55,313	6,888	14%
Carson City	58,246	60,693	2,447	4%
Pershing	6,592	2,021	4,571	-69%
Storey	416	258	158	-38%
Washoe	235,345	227,876	7,469	-3%
White Pine	10,747	4,729	6,018	-56%
Total	$ 1,379,124	$ 1,379,124		

Table Note:

[a] This table shows potential impacts based on 25 percent of collections for a single day. These numbers should not be used to determine the end impact of a change in interpretation.

The department currently distributes BCCRT to the county where the taxpayer takes delivery. If the department instead distributed BCCRT to the county where the business is located, seven counties would receive more BCCRT and ten counties would receive less.

LSST and BCCRT
Same Distribution Methodology Comparison

Exhibit III shows the potential impact of distributing LSST and BCCRT using the same methodology.

Exhibit III

Potential Impact of Distributing LSST and BCCRT Using Same Methodology[a]

County	Where Taxpayer Takes Delivery	Business Location	Difference	Percent Change
Churchill	$ 189,165	$ 169,528	$ 19,637	-10%
Clark	4,635,126	4,726,330	91,204	2%
Douglas	319,602	243,173	76,429	-24%
Elko	468,212	565,087	96,875	21%
Esmeralda	3,975	408	3,567	-90%
Eureka	147,536	35,610	111,926	-76%
Humboldt	250,187	457,577	207,390	83%
Lander	146,104	15,736	130,368	-89%
Lincoln	5,869	7,168	1,299	22%
Lyon	181,423	193,984	12,561	7%
Mineral	26,736	14,869	11,867	-44%
Nye	302,795	345,870	43,075	14%
Carson City	364,209	379,508	15,299	4%
Pershing	41,220	12,635	28,585	-69%
Storey	2,602	1,614	988	-38%
Washoe	1,471,596	1,424,893	46,703	-3%
White Pine	67,202	29,569	37,633	-56%
Total	$ 8,623,559	$ 8,623,559		

Table Note:
[a] **This table shows potential impacts based on 25 percent of collections for a single day. These numbers should not be used to determine the end impact of a change in interpretation.**

If the department distributed both LSST and BCCRT to the county where the taxpayer takes delivery, seven counties would receive more and ten counties would receive less than if distributed to where the business is located.

Conclusion

Collaborating with the AG to interpret LSST and BCCRT statutes will clarify taxation language and ensure distribution methods to school districts and counties are clearly documented.

Recommendation

1. Collaborate with the Attorney General's Office (AG) to interpret LSST and BCCRT statutes.

Appendix A

Scope and Methodology, Background, Acknowledgements

Scope and Methodology

We began the audit in February 2018. In the course of our work we interviewed Department of Taxation (department) staff and discussed processes inherent to their responsibilities. We reviewed department records, NRS, NAC, and other state guidelines. We concluded field work and testing in April 2018.

We conducted our audit in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

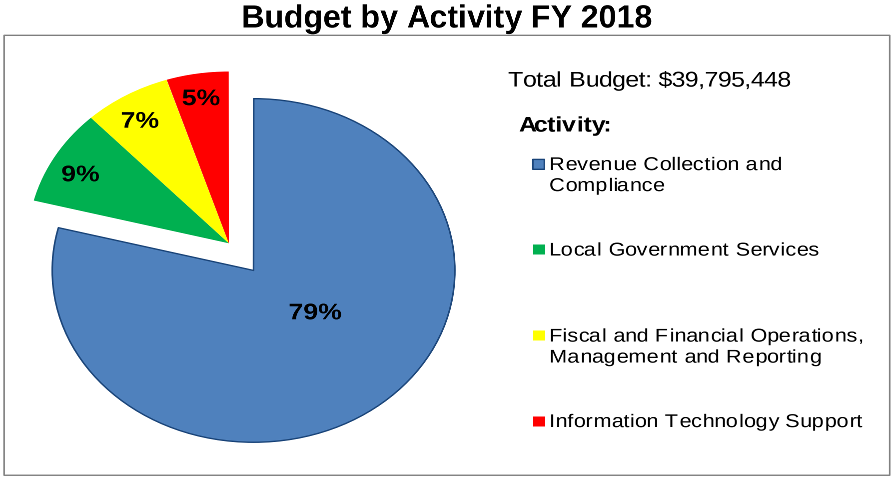
Background

The department's mission is to provide fair, efficient, and effective administration of tax programs for the state of Nevada in accordance with applicable statutes, regulations, and policies. In addition, the department serves taxpayers as well as state and local government entities.

The department is funded by the state general fund, transfers, and other revenues. The department's budget for fiscal year (FY) 2018 was approximately $39.8 million. Exhibit IV summarizes the department's budget by activity for FY 2018.

Exhibit IV

Department of Taxation
Budget by Activity FY 2018



The department is comprised of six major divisions/sections: Executive Division; Administrative Services Division; Information Technology Division; Local Government Services Division; Marijuana Enforcement Division; and the Compliance Division which consists of the Revenue/Collection and Audit Sections.

The Revenue/Collection Section is responsible for the oversight and collection of sales and use taxes. In-state and out-of-state businesses file sales and use tax returns with the department monthly, quarterly, or annually depending on the amount of taxable sales. Businesses report the sale in the county where delivery takes place. The businesses list the amount of sales made in each county, deducts any exempt sales to determine the taxable sales, and multiplies by the applicable county tax rate to determine the tax due. Exhibit V shows the tax rates for each county as listed on the sales and use tax returns at December 31, 2016.

Exhibit V

County Tax Rates
December 31, 2016

County	Tax Rate
Churchill	7.600%
Clark	8.150%
Douglas	7.100%
Elko	7.100%
Esmeralda	6.850%
Eureka	6.850%
Humboldt	6.850%
Lander	7.100%
Lincoln	7.100%
Lyon	7.100%
Mineral	6.850%
Nye	7.600%
Carson City	7.600%
Pershing	7.100%
Storey	7.600%
Washoe	7.725%
White Pine	7.725%

County sales and use tax rates are set at either the minimum statewide tax rate (6.85 percent), or a combination of the minimum statewide tax rate, option taxes, and special and local tax acts approved by that county. Exhibit VI breaks down the minimum statewide tax rate and where the tax is distributed.

Exhibit VI

Minimum Statewide Sales and Use Tax Rate Breakdown

Tax Type	**Tax Rate**	**Distribution**
Sales Tax	2.00%	To General Fund.
Local School Support Tax	2.60%	In-State Business Returns: Tax is distributed to the school district in the county where the business is located. Out-of-State Business Returns: Tax is distributed to the State Distributive School Account.
Basic City-County Relief Tax	0.50%	In-State Business Returns: Tax is distributed to the county where the sale was made (where delivery took place). Out-of-State Business Returns: Tax is distributed to counties and cities based on a population formula in statute.
Supplemental City-County Relief Tax	1.75%	Tax is distributed to all qualifying local governments according to statutory formula.
Minimum Statewide Tax Rate	**6.85%**	

Minimum statewide sales and use taxes are distributed to the general fund, school districts, the State Distributive School Account, and counties. When sales are made in a county with option taxes or special and local tax acts, the portion of the tax collected for the option tax and special and local tax acts goes directly to that county.

Acknowledgments

We express appreciation to the department director and staff for their cooperation and assistance throughout the audit.

Contributors to this report included:

Warren Lowman
Executive Branch Audit Manager

Catherine Brekken, CPA
Executive Branch Auditor

Appendix B

Department of Taxation
Response and Implementation Plan

BRIAN SANDOVAL
Governor
JAMES DEVOLLD
Chair, Nevada Tax Commission
WILLIAM D. ANDERSON
Executive Director

STATE OF NEVADA
DEPARTMENT OF TAXATION
Web Site: https://tax.nv.gov
1550 College Parkway, Suite 115
Carson City, Nevada 89706-7937
Phone: (775) 684-2000 Fax: (775) 684-2020

RENO OFFICE
4600 Kietzke Lane
Building L, Suite 235
Reno, Nevada 89502
Phone: (775) 687-9999
Fax: (775) 688-1303

LAS VEGAS OFFICE
Grant Sawyer Office Building, Suite1300
555 E. Washington Avenue
Las Vegas, Nevada 89101
Phone: (702) 486-2300 Fax: (702) 486-2373

HENDERSON OFFICE
2550 Paseo Verde Parkway, Suite 180
Henderson, Nevada 89074
Phone: (702) 486-2300
Fax: (702) 486-3377

MEMORANDUM

Date: May 24, 2018

To: Catherine Brekken, CPA
Governor's Finance Office

From: William D. Anderson, Executive Director

Subject: Audit Response

The audit report indicates that the Department may not be distributing the Local School Support Tax (LSST) or the Basic City/County Relief Tax (BCCRT) in accordance with state laws. The report indicates that statutes pertaining to these two taxes are ambiguous and the term "collected in the county" can be interpreted in two ways: the amount of money collected in the county 1) where the business is located or 2) the county where the taxpayer takes delivery. Since these statutes can be interpreted in two ways, the Department believes that its interpretation is not facially unreasonable and its interpretation should continue to be followed until it receives clear direction from the legislature to change the historical practice.

Since conception of the LSST and BCCRT in 1967 and 1969 respectively, the Department has always distributed the LSST to the county where the business is located and the BCCRT to the county where the sale was made (or TPP was delivered). While certain references in the Department's Annual Reports (until 1997-98), contain statements that both the LSST and BCCRT were distributed to the "county of origin," other statements in those same Annual Reports make clear that the LSST is distributed to the school district where the business is located and the BCCRT is distributed where the sale is made. The Nevada Tax Notes from 2010 also correctly note that the LSST is distributed where the business is located and the BCCRT is distributed where the sale is made.

The legislative history does not suggest that the Department's historical practice is inconsistent with the statutes. While legislative history from 1967 and 1969 appear to be lost (as noted in the discussion for AB 104 in Senate Committee on Taxation minutes from June 15, 1991), legislative history for AB 104 in 1991 (known as the Fair Share bill) and AB 450 in 1995, indicate that the LSST has always been credited to the county where the business is located, and that the BCCRT has always been credited to the county where the delivery is made. In addition, in the May 10, 1995 Assembly Taxation Committee Minutes, Assembly Member Lambert questions whether AB 450 will change how the LSST will be distributed and whether AB 450 will now require it to be distributed to where the property is delivered. Assembly Member Hettrick, author of AB 450, replies that the bill does not change the distribution of the LSST and has absolutely no effect on fair share, tax distribution, schools, or any other sales tax distribution. Other than these legislative committee minutes, the Department was unable to locate any other legislative discussion on the distribution of the LSST and BCCRT or find a bill where the distribution was changed.

Other public documents also discuss the historical distribution of the LSST and BCCRT. In February 1995, the University of Nevada, Reno published a report titled "Fiscal Impact Model for Douglas County, Nevada. On page 22 of this report it states that

> ". . . the BCCRT is distributed to the county where the purchase is made, not where the sale is made. In other words, if a Douglas County contractor buys lumber in Carson City and takes delivery in Douglas County, the sales tax should be paid to Douglas County."
>
> "In contrast to BCCRT, the LSST is distributed to the county where the sale is made regardless of where the purchaser lives. Thus, a sale similar to that described above would generate LSST for Carson City and BCCRT for Douglas County if it was properly allocated."

Additionally, in 2014, the Tax Foundation published a document titled "Simplifying Nevada's Taxes: A Framework for the Future." On page 38 of this publication under the section "School Districts via the Local School Support Tax" it states that collections from in-state businesses are distributed directly to the school districts in which they are collected. Further review of the publication would indicate that this means the LSST is distributed to the school district where the business is located because on page 26, the Department's Annual Report Fiscal 2012-2013 is referenced and the referenced Annual Report on page 12 indicates the LSST is distributed to the school district in which the business is located.

Based on all of the above, the Department concludes that distribution of the LSST to the county where the business is located, and distribution of the BCCRT to the county where the sale is made is a reasonable interpretation and application of the statutes.[1] The Department cannot find any legislation that has changed the distribution method for the LSST and BCCRT subsequent to their establishment and contends that it has no authority to change the distribution method absent specific legislation to do so. Thus, the Department believes it is correctly distributing both these taxes. With that said, we stand ready to work with the Attorney General's office to get its interpretation of the statutes regarding the distributions upon recommendation of the Internal Audit Division.

[1] In regards to the requirement that the LSST be treated substantially identical with sales and use tax, the Department interprets that as requiring the LSST be applicable to the same transactions to which sales and use tax is applicable—not that the "distribution" of the two taxes be identical, which would be inconsistent with original enactment in 1967.

Appendix C

Timetable for Implementing Audit Recommendation

In consultation with the Department of Taxation (department), the Division of Internal Audits categorized the recommendation contained within this report into one of two separate implementation time frames (i.e., *Category 1* – less than six months; *Category 2* – more than six months). The department should begin taking steps to implement the recommendation as soon as possible. The department's target completion dates are incorporated from Appendix B.

Category 1: Recommendation with an anticipated implementation period of less than six months.

Recommendation	Time Frame
1. Collaborate with AG to Interpret Statutes. (page 8)	Dec 2018

The Division of Internal Audits shall evaluate the action taken by the department concerning the report recommendation within six months from the issuance of this report. The Division of Internal Audits must report the results of its evaluation to the Executive Branch Audit Committee and the department.