

State of South Carolina
Department of Revenue



NIKKI R. HALEY
Governor

RICK REAMES III, ESQUIRE
Director

300A OUTLET POINTE BOULEVARD
POST OFFICE BOX 125
COLUMBIA, SOUTH CAROLINA 29214
Telephone: (803) 898-5040
Facsimile : (803) 896-0023
Director@dor.sc.gov

February 24, 2016

Mr. W. Anthony McDonald
Richland County Administrator
Post Office Box 192
Columbia, SC 29202

Dear Mr. McDonald:

This letter is in response to your letter dated December 31, 2015, and to the Department's meetings with Richland County officials held on January 19, 2016 and February 11, 2016. The purpose of this letter is to summarize our discussions and to further inform Richland County Council about the Department's concerns over the Richland County Transportation Penny Program. The enclosed report provides additional details, a more technical analysis of the issues and corrective action plans. Please note that all facts cited in this letter or in the enclosed report are found in publicly available records provided by the County or are otherwise available to the general public. No confidential tax information is discussed herein.

The Department's review of the Penny Tax program has uncovered millions of dollars of potential fraud, waste and abuse. These problems result from (1) expenditures not permitted by the state tax statutes authorizing transportation taxes and (2) numerous conflicts of interest found in the program.

As you know, concerns about public corruption were forwarded to law enforcement which is actively conducting its own investigation. Regardless of whether law enforcement agencies bring charges in this matter or whether other individuals or companies are charged with failing to pay state taxes, the Department's obligation is to ensure compliance with the state's tax statutes.

- **Failure to Perform Required Audits**
The County apparently has failed to conduct audits as required by its own ordinance. Had the required audits been conducted, perhaps the County could have identified and addressed many of the problems outlined in this letter.
- **Administrative Expenses Prohibited by Law**
Many of the administrative expenses paid as part of the Penny Tax program are prohibited by the state tax statutes that authorize and govern transportation sales taxes. The Department is providing the County with information on tax capitalization of expenses that will provide parameters for payment of administrative costs. This information will allow the County to determine which administrative expenses may be paid with Penny Tax revenue and which types must be paid with general fund revenue.

To be clear, the Department has concerns with payment of many administrative expenses which would be addressed by the implementation of the tax capitalization approach. Concerns with some specific administrative expenses are discussed in more detail below.

- **Small Local Business Enterprise Expenditures Prohibited by Law**

During just the first two years of a scheduled 22-year tax, Richland County has paid hundreds of thousands of Penny Tax dollars to fund a “Small Local Business Enterprise” program which has nothing to do with capital transportation tax projects. It appears many of these expenses will continue throughout the life of the Penny Tax program.

While a Small Local Business Enterprise program may be laudable, it is simply not allowed under the state laws governing this type of tax. If Council wants to encourage small and local business participation in County projects it should do so with general fund dollars – not with dollars approved by voter referendum for an earmarked purpose.

- **Excessive Public Relations Expenditures**

Richland County has allowed contracts with two firms totaling \$3M (before reimbursements which are numerous) in public relations expenses over the next five years. The two firms include the below described lobbying firm and an additional firm, both of which received \$1.5M contracts.

Despite contracting for \$3M with these two firms, additional payments totaling nearly \$900,000 appear to have been paid to other public relations firms for presumably more public relations services. As expressed in our December 3, 2015 letter, the Department remains concerned about the amounts of these contracts compared to work actually performed, as well as the fact that Richland County has its own public information office.

- **Insufficient Procurement Procedures**

After failing to follow procurement law in its initial award of management contracts – which resulted in a protest by the highest ranked bidder – Richland County Council passed an ordinance that exempted Penny Tax projects from established procurement law and procedures, including the right of an aggrieved bidder to protest. This exemption effectively allowed Council to award tens of millions of dollars in contracts without sufficient objective bidding and scoring – and has resulted in numerous conflicts of interest in the program as discussed below.

- **Conflicts of Interests Involving Public Relations Expenditures**

The Department understands that each of the firms receiving the above described \$1.5M public relations contracts was involved in efforts to pass the Penny Tax. These firms are now being paid with the Penny Tax revenue they helped secure.

- **Lobbying, Public Relations, and COMET Bus System Conflicts**

Additional conflicts of interest exist with one of the firms contracted to provide public relations services and whose clients have secured contracts worth millions of Penny Tax dollars.

The owner of the lobbying firm owns a 1/3 interest in one of the lead Project Development Team (“PDT”) members. This lead PDT member is scheduled to receive millions of Penny Tax dollars.

Despite this 1/3 ownership of a lead PDT member, this lobbyist’s firm also received the above described \$1.5M contract to perform public relations services for the PDT as well as a separate and additional public relations contract for the bus system.

In effect, it appears that the lobbyist or his firm is paid with Penny Tax dollars in at least three different ways, and possibly more, despite having a client or clients also paid with Penny Tax dollars.

- **COMET Bus System Conflicts Involving Legal Services**

The COMET Board controls \$300M in Penny Tax revenue. The chairman of that Board – a local attorney who also served as a City of Columbia Councilman at the time – received a nearly \$400,000 contract paid with Penny Tax dollars to provide legal services related to real estate and right-of-way acquisition. Despite that his stated practice areas had nothing to do with real estate and right-of-way acquisition, the chairman was awarded the contract and a vague mentor-mentee arrangement – funded by Penny Tax dollars – to learn the legal services he was contracted to perform.

- **More Mentor-Mentee Expenses**

A local realtor was paid with Penny Tax dollars to provide right-of-way services for Penny Tax projects. Like the COMET board chairman, this realtor also received mentor-mentee payments to learn how to perform the right-of-way services she was contracted to provide. Mentee payments to learn a trade are in no way related to capital transportation projects.

In summary, while Richland County indicated in its December 31, 2015 letter that it felt “strongly that Richland has done nothing in error,” the Department maintains that the Penny Tax program as it exists today fails to comply with state law and is full of wasteful expenditures and conflicts of interest created by inadequate procurement safeguards. As a result, millions of dollars of Penny Tax revenue is being spent improperly.

As is discussed in more detail in the report, the Department is providing Richland County Council with 30 days to begin action to resolve these issues and bring the program into compliance. The actions to resolve the problem must include reimbursement for impermissible expenses and prospective corrective action on tainted contracts and payments. In the event that Richland County does not take official action to address all of these concerns, the Department is prepared to enforce the state’s tax laws.

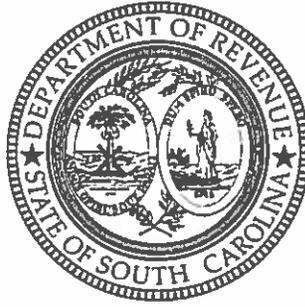
Thank you for your attention to this matter. The Department looks forward to working with the County to help restore public trust to the Penny Tax program.

Yours very truly,



Rick Reames III
Director

RRIII/afw
Enclosures



Report on Sales and Use Tax for Transportation Facilities in Richland County

Background

The SC Department of Revenue (the “Department”) exists “to administer and enforce the revenue laws of” South Carolina. S.C. Code Section 12-4-10. The General Assembly vested the Department with broad authority to facilitate tax administration, regulation, and enforcement. S.C. Code Section 12-4-310 *et seq.* The General Assembly further provided the Department authority to carry out investigations and examinations involving state taxes. S.C. Code Section 12-54-100.

In November of 2012, voters in Richland County passed a sales and use tax for transportation facilities. This tax is a state tax that is collected and administered by the Department and is ultimately remitted by the Department to the County for a restricted use – to build transportation facilities. In the statutes governing sales and use taxes and in the specific statute providing for the transportation sales and use tax, the General Assembly expressly provided that the Department is the proper party to administer and enforce the tax. The General Assembly further delegated authority to the Department to promulgate regulations to implement the transportation tax. S.C. Code Section 4-37-30 and S.C. Code Section 12-36-2660. The Department has begun the process of issuing regulations to provide additional guidance on the collection, administration, and enforcement of the transportation sales and use tax.

In April of 2015, the Department audited Richland County to determine compliance with the provisions of the state’s tax statutes, and in particular Code Section 4-37-30(A) (the sales and use tax provision). The County raised no objections to the audit. We appreciate the County’s full cooperation and its willingness to work with the Department to resolve all matters identified in the audit, as stated in the County’s December 9, 2015 letter. The audit revealed a number of concerns relating to Richland County’s compliance with the law which are discussed in detail below.

Procurement of PDT Contracts

In November 2013, Richland County Council (“Council”) issued a request for proposal (“RFP”) to procure professional services for a project development team (“PDT”) to help administer the Penny Tax program. At the time, Richland County law required that RFP submissions be reviewed and ranked by an independent selection committee (“Committee”). See Richland County Code, Section 2-600. The Richland County law required the Council to negotiate with the firm ranked highest by the Committee and if these negotiations failed, the Council would

then negotiate with qualifying firms in order of descending rank. Richland County law also provides for protest procedures. See Richland County Code 2-621.1.

The Committee performed its responsibility and ranked Team CESC the highest (90.6 ranking) with Team Baker as the second selection (73.8). Team ICA (66.8), Team MB Kahn (53) and Team Enviro (46.4) were scored third, fourth and fifth, respectively. The three firms ultimately chosen as the PDT were not scored first or second by the Committee. One of the firms – Brownstone – appears not even to have submitted a response to the RFP. Instead of beginning negotiations with the first or second highest scoring firms as required by Richland County's own ordinance, on January 7, 2014, after two rounds of voting, the Council selected the third ranked team, Team ICA. Team CESC protested and Council subsequently withdrew the PDT contract award from Team ICA.

On May 6, 2014, Council amended the Richland County law granting itself the authority to exempt Penny Tax expenditures, and only Penny Tax expenditures, from the standard procurement rules. See Richland County Code, Section 2-591. While the amended RFP process does require an evaluation committee to determine and submit a short list of qualified firms to the Council for consideration, the process appears to be substantially abbreviated and does not include the rigorous scoring of the original procurement procedure. Further, the law specifically exempts contracts granted (or not granted) using this procedure from the protest provisions of the Richland County law. See Richland County Code, Section 2-591, subsection (f).

Under this second procedure, Council, on the first round of voting, awarded Team ICA/Brownstone/MB Kahn the PDT contract. The effect of the May 6, 2014 amendment and subsequent contract award is that Council awarded a \$31 million contract for project management without independent scoring by an impartial scoring committee. Without independent scoring, sufficient oversight regarding conflict of interest, efficiency of costs, or experience and qualification of service providers cannot properly exist. In fact, Team ICA/Brownstone/MB Kahn's level of experience related to building actual transportation facilities is questionable in comparison to the experience of other applicants. The elimination of any procedure to protest the awarding of the contract to another party essentially eliminates any scrutiny of how the winner of the contract was chosen. This is particularly true since the Council has refused to grant the Transportation Penny Advisory Committee any oversight role with respect to the Penny Tax. The Council also appears to have failed to conduct an annual independent audit of Penny Tax funds despite the transportation sales and use tax ordinance requiring such audits and similar audits for any company participating in the Penny Tax program. See Richland County Ordinance No. 039-12HR, Section 1, paragraph 2 and Section 3, subsection (b), paragraph 3. A review of recent financial statements of Richland County also does not reveal that such an audit was performed or made available to the public as required by the ordinance. As mentioned, the Department's review of the Penny Tax program began in April 2015. Since that time, the County has not produced to the Department a copy of any audits. Furthermore, there do not appear to be any independent audits of the financial records and transactions of the agencies or organizations receiving an appropriation of the Penny Tax as required by the ordinance.

While Richland County's letter from December 9, 2015 points out that the County may circumvent the normal procurement process contained in Richland County Code 2-600 by approving any contract by ordinance, Richland County did not do that. Instead, Richland County chose to pass the ordinance allowing Penny Tax fund contracts to be subject to the lesser scrutiny of Richland County Code Section 2-591 with no protest rights. Furthermore, if Richland County were to use the ordinance method to approve a contract, the protest procedures contained in Richland County Code 2-621.1 would still be applicable as well as the possible referral of the protest to the county's independent procurement review panel as provided in Richland County Code 2-621.4.

For your convenience the relevant sections of the Richland County ordinances are included.

Concerns Regarding the Awarding of Contracts under the Penny Tax Program

Concerns also exist about some of the relationships between the PDT, the COMET bus system and parties who have been granted contracts associated with Penny Tax funds. For example, the Comet Board is scheduled to receive at least \$300 million of Penny Tax dollars over the life of the Penny Tax program to run the Midlands' bus system. The company which received the contract to operate the bus system is represented by a lobbyist who owns a one-third equity interest in one of the three lead firms that comprise the PDT granted the contract to oversee the Penny Tax program. That same lobbyist's company received a contract to perform public relations services for the Comet bus system and/or the client company running the bus system. Finally, the PDT (again, of which this lobbyist owns a one-third interest in one of the three lead PDT firms) awarded a \$1.5 million contract to the lobbyist's company for \$1.5 million for public relations work potentially associated with the Penny Tax program. Thus, this person and his firms are potentially being paid three times from Penny Tax funds: (1) through the contract involving the COMET bus system, (2) through his one-third ownership in one of the three lead firms awarded the PDT contract, and (3) through the \$1.5 million dollar public relations contract awarded through the PDT. The Department further understands that the lobbyist and/or his company were paid to assist in the passage of the Penny Tax itself.

Additionally, the chair of the Comet Board was hired as a member of the PDT and received a nearly \$400,000 contract to perform "right-of-way" closings. At the same time, the chair received \$200 an hour to be "mentored" on how to perform "right-of-way" closings. In total, he received over \$38,000 as a "mentee." Similarly, a local real estate broker was hired to provide immediate service regarding "right-of-way" matters for one of the firms hired by the PDT to work on Penny Tax projects. This broker also received "mentee" payments to be trained in the various activities of the "right-of-way acquisition" process.

Failure of Oversight and Substantiation

The use of Penny Tax funds to establish and staff the County's Small Local Business Enterprise ("SLBE") Program is inconsistent with the statute's specification that Penny Tax revenue be limited to transportation-related projects. Even though, as stated in Richland County's letter dated December 31, 2015, all contracts awarded to date through the SLBE "have been solely

related to the Penny Tax,” the SLBE Program was established as a countywide program intended to support all facets of county operations – not just Penny Tax projects. Expenditures – including more than \$200,000 for legal services related to “SLBE Program Administration” to a Maryland law firm; approximately \$219,000 in estimated personnel costs; \$122,000 for a software management system; and \$13,000 for website development – are to support the entire SLBE program not specific Penny Tax projects and therefore should not be paid for using Penny Tax revenue earmarked specifically for transportation-related projects.

The use of Penny Tax revenue to pay for public relations services and “mentoring” also seems inappropriate and inconsistent with the statute’s requirement that funds be used specifically for transportation facilities. The public relations contract paid for from Penny Tax funds appears to be excessive in relation to similar services offered by substantially similar firms. With respect to much of this work, there also appears to be a lack of any kind of documentation that would verify what services were provided and the amount of hours spent on these projects. While Richland County’s December 31, 2015 letter sets forth what the public relations firms were supposed to do for their \$1.5 million dollar contracts, it did not present documentation as to what services were actually performed for these fees or how much each service cost.

In addition, some entities included as part of the PDT have compliance issues according to Secretary of State records. Richland County allowed these entities to be paid with Penny Tax dollars despite noncompliance.

Concerns about Allowance of Administrative Expenses

Richland County’s Penny Tax ordinance, Ordinance No. 039-12HR, exceeds the scope of the state statute because the ordinance seeks to allow broad payment of expenses that the underlying statute does not permit. Neither S.C. Code Section 4-37-30 (the state statute authorizing the tax) nor any part of Chapter 37, Title 4 (“Transportation Facilities Law”) makes any mention of administrative expenses being allowed for transportation projects.¹ The law does mention administrative expenses or costs for administering the tax in other contexts. Specifically, the Department may claim its expenses for administering the tax and the county must pay the expenses of conducting the referendum.

Nothing allows a county to use the money for unlimited or unrelated administrative expenses. The statute specifically states that the ordinance to impose the Penny Tax provides that Penny Tax funds are to be used for projects such as “highways, roads, streets, bridges, mass transit systems, greenbelts, and other **transportation-related projects facilities**, including, but not limited, to, drainage facilities, relating to highways, roads, streets, bridges, and other transportation related projects;...” Code Section 4-37-30(A)(1)(a) [emphasis added]. The law also requires that the ordinance state the “estimated *capital cost* of the project or projects to be funded in whole or part from the proceeds of the tax....” Code Section 4-37-30(A)(1)(c) [emphasis added]. Specifically, under the terms of the transportation facilities law, the

¹ There is one reference to expenses in 12-37-30(A)(3) that provides that “If the referendum on the question relating to the issuance of general obligation bonds is approved, the county may issue bonds in an amount sufficient to fund the expenses of the project or project.” However, since it does not indicate what the term expenses means, it appears it refers to capital expenses.

expenditures must be used for facilities (tangible assets) and not general county operating expenses, and the expenses incurred must be related to the facilities themselves.

While some administrative costs may be appropriate expenditures under the transportation facilities law, the use of the term “capital costs” in the statute gives some guidance on what administrative costs may be properly allowable under the law. The term “capital cost” is not defined in the law. However, “capital costs” are generally considered one-time costs incurred for the creation or improvement of tangible property, either real or personal, such as buildings, infrastructure and equipment. Often such costs are referred to as “capital expenses” or “capital expenditures.”

The concept of “capitalized costs” for tax purposes is described in detail in Internal Revenue Code (IRC) §§ 263, 263A, and the accompanying regulations. South Carolina tax law conforms to these provisions.

In short, these sections require that a taxpayer capitalize all direct costs and an allocable portion of indirect costs and mixed costs associated with the purchase, creation, or improvements of property into what is called the basis of that property. Any costs that are traceable to the construction, purchase or improvement of property, such as a building or road, must be capitalized into the basis of that asset. These costs generally include the cost of labor to create the property, pensions for employees working to create the property, accounting and legal services, and other items associated with the creation, construction or purchase of the property. For example, the labor costs incurred in building an office building and the legal fees associated with acquiring the land on which the building was constructed would be capitalized into the basis of the office building. However, costs for an attorney to learn how to do a real estate closing would generally not be considered a “capital cost” to be included in the basis of the property. Since the statute does not define “capital costs,” these Internal Revenue Code principles can be used to provide guidance as to which costs are properly allowable under the transportation facilities law. Included in this memo is more information directly from the Internal Revenue Service on these Internal Revenue Code provisions which may be helpful in determining what “capital costs” are allowable.

In its December 31, 2015 letter, Richland County attempts to rely primarily on federal Workforce Investment Act (WIA) regulations concerning administrative expenses (20 C.F.R. 667.220) to justify the expenditures of Penny Tax funds on the SLBE program and public information. Unfortunately, there is no basis in the transportation facility law for using this standard in light of the specific language in the law that requires the funds be used to pay for facilities. Even if the workforce regulations, as opposed to tax provisions governing capitalization, are the proper standard for determining which costs may be paid using Penny Tax funds, Richland County’s administrative expenditures associated with public relations and the set-up and staffing of the SLBE program do not, *for the most part*, fall under any of the nine categories provided for in 20 C.F.R. 667.220.

Action Required

The Department has set forth its concerns and position concerning Richland County's use of transportation facility funds for improper purposes as outlined above. Pursuant to the Department's authority to collect, administer and enforce the state's tax laws, including the laws governing the Penny Tax funds, the Department is requesting that Richland County take the following actions within thirty (30) days of the date of this letter.

1. Repay from Richland County's general fund the amounts paid from Penny Tax funds for the set-up and staffing of the Small Local Business Enterprise Program, all of which is an operating expenditure of the County and does not specifically relate to transportation facilities.
2. Repay from Richland County's general fund that portion of public relations expenditures that were paid from Penny Tax funds that do not specifically relate to transportation facilities. To the extent the County determines that part of the public expenditures were related to specific transportation facilities and not general public relations concerns or advertising, the County should provide the Department with substantiation and the basis on which it believes such expenditures are associated with transportation specific projects.
3. As required by Richland County ordinance No. 039-12HR, Section 1, paragraph 2 and Section 3, subsection (b), paragraph 3, Richland County should immediately engage an independent accounting firm to conduct independent audits for all prior years in which Penny Tax funds were expended and require companies who received funds under the Penny Tax program to provide Richland County with independent financial audits concerning such funds as well.
4. Immediately take corrective action to assure that future expenditures of Penny Tax funds are made solely for capital costs associated with transportation facilities and provide the public with information as to how those capital costs are to be determined.