

November 29, 2000

The Honorable Arthur J. Roth
NYS Department of Taxation and Finance
Office of Tax Operations
W.A. Harriman Campus, Building 9
Albany, New York 12227

The Honorable Andrew J. Eristoff
New York City Department of Finance
1 Centre Street
New York, New York 10007

Re: Conformity of Federal, State and City Offers in Compromise Statutes

Dear Commissioner Roth and Commissioner Eristoff:

I am writing on behalf of the Tax Section¹ to urge your support for legislation conforming New York State statutory rules for offers in compromise of taxes ("Offers" or "Offers in Compromise") to federal statutory rules and also adding consistent rules for New York City taxes.

The Tax Section has worked extensively with the New York State Department of Taxation and Finance to improve the implementation of the current New York State Offer in Compromise program. Our recommendations for regulations and guidelines under Section 171(fifteenth) of the New York State Tax Law were contained in our October 2, 1997 report entitled "Report on Proposed Regulations for New York State Offers in Compromise".

¹ This letter was drafted by Sherry Kraus, a member-at-large of the Tax Section's Executive Committee.

In addition, in a letter to members of the New York State legislature dated May 17, 2000, we supported provisions of an amended version of a bill (Assembly Bill 8518-A, Senate Bill 5671-A) from the 1999 Session that would have made limited changes in the Offer in Compromise provisions of the State Tax Law and provided for an Offer in Compromise program for taxes administered by the New York City Department of Finance. This legislation was not enacted. In that letter we indicated that although those proposed changes would be a step in the direction of improving the State and City Offer programs, we expected to present recommendations later this year for further statutory changes to improve the effectiveness of the Offer in Compromise programs. This letter sets forth those recommendations.

At the time of our report in 1997, the New York State Offer in Compromise program was widely perceived by taxpayers and tax practitioners as a difficult and often futile process. In contrast, the federal Offer in Compromise program has proved to be an increasingly effective procedure for resolving federal liabilities not likely to be collectible in full. While there exist some differences between the federal and New York State enabling statutes allowing for compromise of tax debts, our 1997 report concluded that the fundamental objectives of the two programs are the same and that a well designed New York State Offer in Compromise program could work as well as its federal counterpart in resolving liabilities not likely to be collectible in full.

In our 1997 report, we made a number of suggestions for improving the New York Offer program. Because the federal Offer program is now working well in achieving its goal of collecting "what is potentially collectible at the earliest possible time and at the least cost to the government" (Internal Revenue Service Manual, 57(10)1.1), we suggested modeling the New York program on the federal program as much as possible.

Since that report, the New York State Offer in Compromise program has been modified to more closely conform to the federal Offer program. However, full conformity of the state program to the federal program is impossible unless there are statutory changes to the underlying state enabling legislation. We believe that the statutory changes needed to

conform the state Offer program to the federal Offer program will make the state Offer program a better and more effective procedure for resolving tax liabilities not likely to be collectible in full. The statutory changes would allow needed modifications to the state Offer program, including the flexibility to accept Offers that more realistically reflect collection potential. It is our view that statutory conformity of the Offer programs would (1) increase revenue collections to the state, (2) reduce administrative costs associated with the present, more cumbersome, evaluation procedure now required under the state Offer statute, (3) provide a better and more effective procedure for resolving tax liabilities that are not likely to be collectible in full and (4) restore present tax debtors to future compliance with the tax laws.

Comparison of Federal and State Offer in Compromise Statutes.

The authority underlying the Internal Revenue Service's ability to compromise federal taxes, interest and penalties derives from Section 7122 of the Internal Revenue Code, which provides in part as follows:

(a) The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

* * *

(c) STANDARDS FOR EVALUATION OF OFFERS. --

(1) IN GENERAL. -- The Secretary shall prescribe guidelines for officers and employees of the Internal Revenue Service to determine whether an offer-in-compromise is adequate and should be accepted to resolve a dispute.

This statute contains a broad delegation of authority to Treasury and, indirectly, to the Internal Revenue Service to structure the federal Offer in Compromise program.

The authority of the New York State Commissioner of Taxation and Finance to compromise taxes which have become finally and irrevocably fixed, along with interest and penalties thereunder, derives from Section 171 (fifteenth) of the New York State Tax Law (hereafter "subdivision fifteenth"). The Commissioner has the authority to compromise any tax, warrant or judgment if

. . . the tax debtor has been discharged in bankruptcy, or is shown by proofs submitted to be insolvent, but the amount payable in compromise shall in no event be less than the amount, if any, recoverable through legal proceedings, and provided that where the amount owing for taxes, penalties and interest or the warrant or judgment is more than twenty-five thousand dollars, such compromise shall be effective only when approved by a justice of the supreme court.

New York State's enabling statute for an Offer in Compromise differs from the federal statute in the following ways:

(1) As a threshold requirement for consideration of an Offer in New York State, the tax debtor must demonstrate that he has been discharged in bankruptcy or is insolvent.

(2) A tax debt under subdivision fifteenth can be compromised only if there is found to be "doubt as to collectibility". No other ground, including "doubt as to liability", is acceptable.

(3) The Offer amount must be at least as much as the state can recover in legal proceedings.

(4) If the total taxes, interest and penalties sought to be compromised are more than \$25,000, the Offer must be approved by a Justice of the Supreme Court.

Comments:

(1) Insolvency as Requirement for State Offer.

The federal Offer program does not require that the tax debtor demonstrate that he is "insolvent" or has been discharged in bankruptcy as a prerequisite to consideration of an Offer. However, in an Offer based on "doubt as to collectibility", the tax debtor must make a minimum offer which equals or exceeds his net equity in assets. In this way, the tax debtor must pay down all equity and assets to the point of "insolvency" if the federal Offer is accepted.

New York, in contrast, requires that the tax debtor demonstrate a balance sheet insolvency *prior* to making the Offer. This eliminates from the Offer program all tax debtors who are not technically insolvent even though they may have no likelihood of ever paying the liability in full. As noted in our 1997 report, we believe the inclusion of the insolvency prerequisite for consideration of a New York State Offer introduces a needlessly restrictive condition that does not advance the overall goals of the New York Offer program. The requirement denies "Offer in Compromise" relief to many "solvent" taxpayers who will never be able to pay their liability in full, while at the same time depriving the state of revenue from the pay down of equity of solvent taxpayers.

The requirement that the tax debtor demonstrate insolvency or bankruptcy also adds complexity to the New York Offer program. As discussed in our 1997 report, the statute is unclear as to (a) which assets should be counted in determining "insolvency" and (b) the appropriate method for valuing those assets. Because the assets taken into account for a "discharge in bankruptcy" can differ from the assets taken into account in determining "insolvency" under New York law, there is also the potential for differing determinations for similarly situated tax debtors seeking to avail themselves of Offer relief depending upon whether the tax debtor has been "discharged in bankruptcy" or is attempting to demonstrate "insolvency".

The insolvency requirement also increases the burden and complexity of the Offer analysis for the state since the assets counted and

valuation methods used in determining whether the tax debtor is insolvent may, in many cases, not be the same as the assets counted and valuation methods used in determining the "minimum Offer" amount. As a result, the potential for confusion, lack of uniformity and improper determination of the "minimum Offer" amount is significantly increased both for the state in evaluating the amount needed to be offered and for the taxpayer in determining the minimum amount that should be offered.

In our view, the requirement that a tax debtor must demonstrate a discharge in bankruptcy or insolvency before New York State will consider an Offer should be eliminated. As in the case of a federal Offer in Compromise, solvent New York tax debtors who have no likelihood of fully paying their tax debts should not be barred from paying down the net equity in their assets to satisfy their New York tax debts.²

(2) Grounds for Relief Under the Offer Program.

At present, Offers considered by New York State under subdivision fifteenth are limited to those based only on "doubt as to collectibility". The Commissioner is not permitted to compromise a tax debt based on "doubt as to liability" or any other ground. While subdivision eighteenth of Section 171 does allow for compromise of taxes on the ground of "doubt as to liability" as well as "doubt as to collectibility", this authority is limited to the narrow category of disputed taxes that have not yet become final and irrevocably fixed. (The vast majority of tax liabilities for which Offer in Compromise relief is needed fall within the purview of subdivision fifteenth.)

Under the federal Offer in Compromise program, a tax debt can be compromised on the alternative grounds of (1) "doubt as to liability", (2) "doubt as to collectibility" or (3) "effective tax administration". We believe that the New York Offer statute should be amended to similarly

² For a more complete discussion of this point, see pages 38 and 39 of our 1997 report.

expand the grounds on which an Offer may be granted. Under New York law, just as under federal law, there are relatively short periods in which a taxpayer can seek an administrative review or a judicial appeal of a contested assessment. Many taxpayers who may have meritorious defenses to liability do not, for a variety of reasons, make timely appeal of the proposed assessments. Once the tax has become final, there is no further opportunity for administrative review of the liability except through the refund process. Because a refund review requires full payment of the tax, taxpayers who are unable to pay the tax will have no further procedural avenue for challenging the liability. While New York does, at times, cancel unwarranted assessments through the use of the "courtesy conference", this procedure is available only at the discretion of the Department of Taxation and Finance and is generally requested only by taxpayers who have tax advisers with substantial experience in dealing with New York State tax matters. A broadening of the state statute to permit the Department the flexibility to extend Offer in Compromise relief to cases where there is "doubt as to liability" would afford New York tax debtors an important additional procedural avenue for substantive review of the liability similar to that now available at the federal level.

Since 1998, the Internal Revenue Service's Offer in Compromise authority has been expanded to allow compromise of tax liabilities on the basis of equity, hardship and public policy. Such compromises are granted to "promote effective tax administration". This new ground for a federal Offer in Compromise applies only where the taxpayer does not meet the requirements of "doubt as to collectibility" or "doubt as to liability". An Offer in Compromise for "effective tax administration" is granted only in exceptional circumstances where collection of the full liability would create an economic hardship to the tax debtor or would be detrimental to voluntary compliance. The following example from the Internal Revenue Service guidelines demonstrates the type of case where a compromise based on "effective tax administration" would be considered:

The taxpayer has assets sufficient to satisfy the tax liability (which is undisputed). The taxpayer provides full time care and assistance to her dependent child, who has a serious long term illness. It is expected that the taxpayer will need to use the equity in her assets to provide for adequate

basic living expenses and medical care for her child. The taxpayer's overall compliance history does not weigh against compromise.

The above facts would be potential grounds for acceptance of an "effective tax administration" Offer based on economic hardship. The acceptable Offer amount would be determined based on the facts and circumstances of the taxpayer's situation and the financial information analysis. If, for example, the taxpayer (i) had a \$100,000 tax liability, (ii) had assets and income of \$125,000, and, (iii) would need \$75,000 to avoid economic hardship, the remaining \$50,000 would be considered an acceptable Offer amount.

(3) Minimum Offer Amount.

For New York Offers considered under subdivision fifteenth, the Department must, by statute, set the minimum Offer amount at not less than "the amount, if any, recoverable through legal proceedings". In contrast, the applicable Internal Revenue Service guideline requires that "the amount offered reasonably reflects collection potential" (IRM 57(10)1.1). The minimum Offer amount is not set by statute at the federal level.

Paradoxically, while the Internal Revenue Service has broader powers of collection than New York in levying on a tax debtor's assets, income and wages, New York has less flexibility than the Internal Revenue Service in fine tuning the amount acceptable in an Offer to reflect more realistic long term collection potential. In contrast to the New York Offer program, the Internal Revenue Service is not required by statute to assume a full exercise of its levy and garnishment powers in setting the minimum Offer amount.

Probably the most significant example of the need for flexibility in determining "minimum Offer amount" is in the evaluation of future income collections. Under the federal statute, the Internal Revenue Service has the freedom to develop valuation methods that realistically reflect (a) the agency's experience in collections from the tax debtor's present and future income and (b) the taxpayer's income requirements to meet basic living expenses. In contrast, under the New York Offer statute, the Department is

required to assume a full statutory income execution (presently, up to 10% on earned income) in determining minimum Offer amount. In some cases the New York amount will be higher and in some cases lower than the valuation method used in a federal Offer. However, by having the standard for valuation of income set by statute in determining the minimum Offer acceptable, there is insufficient flexibility left to the Department to develop alternative valuations that more realistically reflect collection potential.

We favor a change in the New York State Offer in Compromise statute to remove the valuation standard for determining minimum Offer amount. The determination of "minimum Offer amount" should be left to the Department based on its experience with collection potential.

(4) Judicial Approval of Offers .

The New York Offer statute requires judicial approval for any Offer that compromises a tax liability (inclusive of interest and penalties) of more than \$25,000. Under present law, collection of New York State taxes can extend over a period as long as twenty years if a tax warrant is filed. This is twice the federal tax collection period of ten years. The significantly longer collection period in New York State increases the potential for large uncollectible tax liabilities. Even a small unpaid liability will grow significantly over a twenty-year period by accrual of interest and penalties. Accordingly, a disproportionately large number of tax debts will fall within the category of Offers requiring judicial approval under the present relatively low threshold of \$25,000 -- which has not been changed since enactment of the Offer in Compromise statute in 1986.

It is our understanding that most of the Offers now being processed by the Department of Taxation and Finance require the step of judicial approval. Under the present state Offer in Compromise regulations and administrative practice, the processing of any Offer recommended for acceptance must undergo at least three levels of internal review: (1) the Head of Tax Compliance, (2) the Office of the Commissioner and (3) the Office of Counsel.

In last year's Assembly Bill 8518-A and Senate Bill 5671-A, a change to subdivision fifteenth was proposed which would have increased the threshold for requiring judicial approval of Offers in Compromise. The proposed amendment (Section 22) would have increased the threshold for needed judicial approval to Offers where the tax liability sought to be compromised (not inclusive of interest and penalties) was in excess of \$100,000. In our letter dated May 17, 2000, we expressed our support for that change. The federal Offer in Compromise program has no similar requirement for judicial approval.

Because of (a) the factually based nature of an Offer in Compromise, (b) the comprehensive evaluation process now in place for state acceptance of an Offer and (c) the multiple levels of administrative review now given an Offer recommended for acceptance, we question the need for any form of judicial approval as part of the New York State Offer in Compromise process. The "de novo" judicial review now required by Offer statute allows a Supreme Court Justice to reject the adequacy of an Offer notwithstanding the highly factual nature of the underlying evaluation process. In most cases, Offers are merely given "pro forma" review by the court.

Our 1997 report expressed our recommendation for creating an administrative review and appeal procedure within the Department to insure a fair and uniform application of the state Offer program and to foster a sense of fairness to the taxpayer in administration of the program. The present statutorily mandated judicial approval process, however, does not serve well in this role and, in our view, adds no significant benefit to the Offer program.

We recommend elimination of the present requirement of judicial approval for state Offers in Compromise since the present approval process (1) does not serve as an effective review and appeal procedure to insure a uniform and fair application of the New York Offer in Compromise program, (2) impedes the effective administration of the program, (3) adds unnecessarily to the time required to process an Offer and (4) unduly burdens the court system. If, however, judicial review is viewed by the legislature as a necessary oversight to the state Offer program, we recommend increasing the

threshold for judicial approval to Offers where the tax liability (not including interest or penalties) is in excess of \$100,000, as proposed in last year's bills.

(5) Conformity of New York City Offer in Compromise Program.

We favor amendments to the New York City Charter and Administrative Code to grant the City Commissioner of Finance the same authority to settle and adjust tax claims as would be possessed by the State Commissioner of Taxation and Finance, including power the City does not now have for settlements based on doubt as to collectibility.

As discussed above, our letter of May 17 supported proposed amendments to grant such authority in Section 23 of last year's Assembly Bill 8518-A and Senate Bill 5671-A. We believe that the combined effect of the State and City statutory amendments we support would be to permit greater efficiency in dealing with uncollectible liabilities of taxpayers who are delinquent in their obligations to both the state and the city.

Conclusion.

We support changes to the New York State Tax Law and to the New York City Charter and Administrative Code to conform the New York State and New York City Offer in Compromise statutes to the federal Offer in Compromise statute. We believe such changes will permit adoption of better and more effective procedures for resolving state and city tax liabilities not likely to be collectible in full. An improved Offer program at the state level, and a similar program at the city level, will (1) increase revenue collections, (2) reduce administrative costs associated with older, uncollectible liabilities and (3) restore tax debtors to future compliance with the tax laws.

Enactment of statutory provisions conforming to those underlying the federal Offer program will also allow for greater use by the state and city of the federal Offer in Compromise guidelines to provide needed guidance for administrative review of an Offer and for taxpayers submitting Offers. The Internal Revenue Service has spent many years revising and fine tuning its Offer in Compromise program and has published detailed guidelines

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to promote uniformity in the application of its Offer program and to give needed guidance to taxpayers in the submission of an Offer. Because taxpayer representatives have generally had more experience in submitting federal Offers in Compromise, greater conformity with the federal program will also expedite the preparation of state and city Offers in Compromise.

Accordingly, we urge that you support the prompt introduction and enactment of legislation to conform state Offer in Compromise statutes to the federal Offer in Compromise statute and to provide similar statutes for city taxes. This recommendation does not in any way represent a withdrawal of our support for the more limited changes endorsed as an interim measure in our May 17 letter, if they are reintroduced next year.

Yours very truly,

Robert H. Scarborough

cc: Barbara G. Billet, Esq.
Ellen E. Hoffman, Esq.