

TAX SECTION

New York State Bar Association

REPORT ON DEPARTMENT OF TAXATION AND FINANCE'S

UNIFORM PROCEDURE STUDY BILL

By Committee on New York state Tax Matters

January 14, 1988

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January 20, 1988

BY HAND

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Dear Saul:

I enclose a report on the Department of Taxation and Finance's Uniform Procedure Study Bill prepared by the Committee on New York State Tax Matters. The report was approved at a meeting of the Executive Committee held on January 12, 1988. It was drafted by James A. Locke. Helpful comments were provided by Herbert Edelstein, Paul Frankel, Arthur Rosen and Bernard Sherer.

The report points out that the Bill would eliminate a number of procedural traps and inequities for taxpayers and streamline the administration of the Tax Law by the Department. The report concludes that, as an overall matter, the Bill is well conceived and even-handed. While making some suggestions for improvement, the report enthusiastically supports its enactment.

The report goes on to note that the Bill does not apply to New York City taxes, which are not administered by the Department.

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The Committee strongly recommends that the procedural rules for New York City taxes be conformed with the provisions for comparable New York State tax rules and that New York City adopt a system of dispute resolution modeled on the Division of Tax Appeals' rules recently adopted for New York State taxes.

Sincerely,

Donald Schapiro

Enclosure

Copies of this letter and report to persons on the attached distribution list

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NEW YORK STATE BAR ASSOCIATION
TAX SECTION

REPORT ON DEPARTMENT OF TAXATION AND FINANCE'S
UNIFORM PROCEDURE STUDY BILL

By Committee on New York state Tax Matters*

The New York State Department of Taxation and Finance ("Department") has drafted a Uniform Procedure Study Bill as its 1988 Legislative Proposal No. 1 ("Bill") to unify, simplify and strengthen the procedural and administrative provisions of most of the taxes administered by the Commissioner of Taxation and Finance. This report is in response to the Department's request for our comments on the Bill.

In 1984 the Tax Section submitted a report ("1984 Report") to the Department on the need for procedural uniformity in the New York Tax Law. Members of the Committee had several meetings with personnel from the Department and staff members from various committees of the Legislature in 1984 and 1985 to discuss issues raised in that report.

The principal recommendations made by the Committee in the 1984 Report have been incorporated by the Department in the Bill. We believe that the Bill, if enacted, will make significant progress in bringing order and simplification to the procedural and administrative provisions of the New York Tax Law

* This report was drafted by James A. Locke. Helpful comments were provided by Herbert Edelstein, Paul Frankel, Arthur Rosen and Bernard Sherer.

("Tax Law"). The Bill will eliminate a number of procedural traps and inequities for taxpayers and streamline the administration of the Tax Law by the Department. We believe that the Department is to be commended for both the well-conceived structure of the Bill and its even-handedness. While we have some suggestions to improve the Bill, we enthusiastically support its enactment.

The Bill does not apply to New York City taxes, other than those administered by the Department (e.g., sales and use and personal income taxes). New York City has many local taxes closely modeled after similar New York State taxes. In order to avoid procedural traps for taxpayers, the Committee strongly recommends that the procedural rules for New York City taxes be conformed with the provisions for the comparable New York State tax. We further recommend that New York City adopt a system based upon the Division of Tax Appeals recently adopted for New York State taxes.

I. OVERVIEW

Unlike the Internal Revenue Code, the Tax Law does not currently contain any unified or even consistent procedural and administrative provisions. The various articles of the Tax Law were added at different times and each contains its own procedural and administrative rules. As a result, any uniformity in procedures is more a historical accident than an intentional objective. As was pointed out in the 1984 Report, the current rules are unnecessarily complex and confusing in a manner which

serves no logical objective. In addition, the subtle differences in procedural rules among the various articles have created procedural traps for taxpayers and administrative complexity for the Department.

The Bill substantially corrects most of these problems. The various procedural rules are reorganized into a new procedural article (Article 35) which would apply to most taxes. To the extent practical, the procedural provisions of the personal income and franchise taxes serve as the model for uniform procedural rules. Generally, these rules are closely modeled after the procedural provisions of the Internal Revenue Code and they are thus familiar to taxpayers and practitioners. Moreover, the new organization of the procedural rules should facilitate uniform changes in these rules as new legislation is adopted in future years.

The Bill also makes certain changes in existing procedural rules to more closely conform to the corresponding provisions of the Internal Revenue Code, as amended by the Tax Reform Act of 1986. For example, the interest rates for overpayments and underpayments of New York taxes will be identical to the corresponding interest rates for overpayments and underpayments of federal taxes. Finally, certain fundamentally unfair provisions of current law (e.g., the requirement that a taxpayer pay certain contested taxes prior to seeking an Article 78 review of a Tax Tribunal decision) have been eliminated. These changes were recommended in the 1984 Report.

The Bill correctly recognizes that the major differences in the types of New York taxes make complete uniformity unrealistic. However, by collecting the various provisions into a single procedural article, the Bill will provide significant assistance to taxpayers and practitioners in complying with and protecting their rights under the Tax Law.

II. COMMENTS

A. General Scope of Bill

Article 35 will apply to most, but not all, New York taxes. It will not apply to the estate tax except for the additional taxes imposed by Sections 954-a and 958-a of the Tax Law (tax on certain premature dispositions of property by heirs). While the Committee continues to believe that the procedural rules for the estate tax should be similar to those of the other major New York taxes, such a change would require major structural changes to the underlying tax scheme and is not appropriate for inclusion in the Bill. The Committee continues to support the recommendations previously made on this subject. See New York State Bar Association Tax Section Report, "Recommendation for Simplification of New York Estate Tax Exemptions and Procedures" (September 1967) at p. 38-39; New York State Bar Association Tax Section, "Report On Procedural Uniformity in the New York Tax Law" (July 1984) at p. 7-8.

Only those provisions of Article 35 that relate to conciliation conferences, division of tax appeals and judicial review will apply to the mortgage recording tax (Article 11), the

stock transfer tax (Article 12), the real estate transfer tax (Article 31) and the taxes in the Racing, Pari-Mutuel Waging and Breeding Law. This limitation on the scope of Article 35 may be proper in view of the unique nature of these taxes.

Nevertheless, the Committee believes that there must be better coordination between the substantive provisions of these taxes and those sections of Article 35 which are applicable to such taxes. For example, Section 279-a of the Tax Law (stock transfer tax) must be amended to coordinate with the provisions of the Bill which would be applied to such tax.

B. General Procedures

1. Notice of Deficiency and Assessment Procedure

Sections 1610 and 1611 of the Bill adopt a generally uniform rule for notices of deficiency and assessments based upon the similar provisions of the personal income and franchise taxes which are derived from the corresponding provisions of the Internal Revenue Code. This change was recommended in the 1984 Report.

(a) Elimination of Notice of Determination Provisions

For certain taxes, such as the sales and use and the real property gains taxes, the "notice of determination" procedure is currently used. Other taxes use the "notice of deficiency" procedure which is similar to the federal system. Unlike the taxes for which the notice of deficiency procedure is used, there is no requirement that a tax for which the notice of

determination procedure is used be "assessed" before it is subject to collection action. As a result, the Department is not prohibited from attempting to collect disputed taxes while the matter is being contested in the Division of Tax Appeals, We understand that unless the jeopardy assessment provisions are applicable/ the Department has an administrative policy to not collect taxes subject to the "notice of determination" procedure until any proceedings in the Division of Tax Appeals have been completed. Article 35 would provide a uniform rule by applying the "notice of deficiency" procedures to all taxes governed by Article 35 thus giving taxpayers the statutory protection they currently enjoy only as a matter of administrative discretion. Absent a jeopardy assessment, the Bill would prohibit the Department from attempting to collect disputed taxes until the taxpayer's appeal rights in the Divisions of Tax Appeals have been exhausted. This change thus conforms the "practice" with the law and was recommended in the 1984 Report.

(b) Elimination of Differing Time Limits for Contesting Notices of Deficiency

The Bill eliminates the confusion under existing law whereby a taxpayer has different time periods for contesting a tax in the Division of Tax Appeals. Under current law, the time limits vary from 30 to 90 days for notices sent to U.S. addresses and 30 to 150 days for those sent to non-U.S. addresses. The Bill adopts a uniform rule of 90 days unless the notice of deficiency is sent to a non-U.S. address, in which case a uniform 150-day rule applies.

2. Interest

Sections 1613 and 1616 of the Bill substantially adopt the franchise and personal income tax provisions of current law for calculating the amount of interest payable on an underpayment or overpayment of tax. Section 1624 of the Bill adopts the federal rules of Section 6621 of the Internal Revenue Code for determining the applicable rate of interest, with the rate of interest payable on an underpayment set a rate of 1% higher than the rate for an overpayment. Interest is to be compounded daily.

Generally, we believe that the adoption of a uniform method for the determination of the rate of interest for all taxes is a substantial simplification. Instead of the many rates of interest which are applicable under current law, the corresponding federal rate of interest on underpayments and overpayments will generally apply to the New York taxes subject to Article 35. However, we have substantial questions concerning the wisdom of the two-tier interest rate structure for federal taxes. It is unclear to us whether the simplicity of uniformity between the New York and federal systems overcomes the objections to the federal rule. Thus, we do not take a position on this issue but suggest that the Department give further thought to this issue.

The franchise and personal income tax rules which serve as the basis for the new rules of applying interest are a good format. Although the federal interest rules, with daily compounding of interest, are not simple, the use of a single

method for New York and federal purposes will simplify compliance for both taxpayers and the Department. This change was recommended in the 1984 Report.

3. Limitation on Period for Assessment

(a) General Rules

The rules for the limitation on the period for assessments contained in the franchise and personal income taxes are generally adopted in Section 1612 of the Bill. Special rules, which appear justified, apply for certain of the miscellaneous taxes.

(b) Real Estate Gains Tax

The Bill needs to be clarified concerning when the limitation on the period for assessment of the real estate gains tax expires. Section 1601(f) of the Bill apparently provides that the tentative assessment of gains tax due which is filed by the transferor is not a "return" for purposes of Article 35. Since there is no other "return" due for such tax, the Bill would apparently eliminate the limitation period for such tax. As indicated by the special rule in Section 1612(c)(1)(H) of the Bill, this was not the intent of the draftsmen. Thus, the Bill should be clarified to eliminate this ambiguity.

(c) Report of Federal Changes

The Bill adopts the provisions of existing law with respect to the limitation period when a taxpayer is required to report federal income tax changes for purposes of the franchise

and personal income taxes. If a taxpayer files a report of the federal change, the Department may assess additional New York tax related solely to such changes for a period of two years after the filing of the change report, regardless of the otherwise applicable limitation period. If a taxpayer fails to file the change report (even if the change would allow the taxpayer to seek a refund of tax), the assessment period for the taxpayer's entire liability for franchise or personal income taxes for the year in question never expires. See Tax Law §§ 683(c)(a)(C) and 1083(c)(1)(C); Bill § 1612(c)(1)(C). Thus, a taxpayer who inadvertently fails to file a report of a federal change may be surprised to discover that many years later, the Department may assess additional taxes unrelated to the federal changes. While it may be argued that the existing provision encourages taxpayers to file reports of federal changes, most taxpayers (and practitioners) are unaware of the harsh result of this obscure rule. The Committee believes that there are fairer methods to obtain taxpayer compliance, including specific penalties for failure to file change reports. See e.g., Tax Law §§ 681(e)(1) and 1081(e). Therefore, we recommend that the law be amended so that the limitation period for assessment is suspended only for the portion of the tax relating to the federal changes if a federal change report is not filed.

4. Limitation on Period for Refunds

Section 1615 of the Bill applies the current income and franchise tax limitations to most taxes. Generally a refund claim can be filed within three years from the filing of a return or two years from payment. The two-year period (from the later of the transfer date or the payment date) for the real estate gains tax under existing law is retained and other exceptions are applicable for certain miscellaneous taxes.

The major benefit from this change is to eliminate the trap for taxpayers seeking refunds of sales and use tax. Under current law, a refund claim must be filed within three years of when the sales and use tax is payable. This means that a taxpayer who pays sales or use taxes more than three years after the due date of such taxes can never seek a refund of such taxes. This is a trap for an unsuspecting taxpayer who pays amounts claimed due in a notice of determination to stop the imposition of interest believing that he has two years in which to seek a refund.

5. Hailing Rules

Section 1620 of the Bill adopts the mailing and other miscellaneous rules for timely complying with deadlines contained in the franchise and personal income taxes. While the Committee believes that these uniform rules are desirable, there will be problems if uniform regulations are not also adopted. Currently, there are regulations under the sales and use, personal income and motor fuel tax laws which provide rules for the timely filing

of documents dated with a private postal meter. No such regulations have been issued under the franchise tax. Thus, the use of a private postal meter can lead to a filing which is timely under one tax, but which would be untimely under another tax. Compounding this confusion, the regulation for the use of private postal meters for filing of petitions under Section 3000.16(a)(1) of the Tax Tribunal Regulations is inconsistent with the sales tax regulations (Sec. 535.1(b)(2)) and the personal income tax regulations (Sec. 146.4(a)(2))* Clearly, this inconsistency should be resolved when the Bill is adopted by uniform regulations for all taxes based upon the rule in the sales and use and personal income tax regulations which allows the use of private postal meters.

6. Judicial Review

Under current law, several taxes, including the sales and use and the real estate gains taxes, require either the payment of such taxes or the filing of a bond as a condition of seeking judicial review of a decision of the Tax Tribunal. Section 1619 of the Bill generally adopts the judicial review rules currently contained in the personal income and franchise tax laws which allows an Article 78 proceeding without the prior payment of disputed taxes. This adds substantial fairness to the

* Under Section 3000.16(a)(1) of the Regulations, the date of filing of a petition stamped with a private postal meter is the date the petition is received. Section 535.1(b)(2) of the regulations provides that a sales tax petition is deemed filed based upon the date of the private postal meter if the petition is later received in due course.

procedure for seeing judicial review. As under existing law, the Department may institute collection procedures after the Tax Tribunal's decision is final so that this change should not adversely affect the collection of taxes. This change was recommended in the 1984 Report.

C. Civil Penalties and Additions to Tax

The Bill collects the penalty provisions from the various taxes governed by Article 35 and orders them in a logical fashion. The penalties are generally based upon the provisions of the franchise and personal income tax laws. In addition, many specialized penalties of existing law are retained. Since the penalties are generally similar to the comparable federal penalties, these provisions have also been updated to reflect changes made by the Tax Reform Act of 1986. These changes include increasing the "substantial understatement" penalty to 25%.

1. Failure to File/Failure to Pay

Section 1646 of the Bill generally adopts the current franchise and personal income tax rules for the failure to file - failure to pay penalties. Special penalties are retained for certain taxes including the sales and use, withholding, motor fuel and cigarette taxes. Certain changes to conform these penalties to changes made by the Tax Reform Act of 1986 in the similar federal penalties are also incorporated. Section 1646(a)(3) creates a new penalty for failure to pay the tax due after a notice of deficiency is issued where the taxpayer

has also previously failed to file a return. That appears to be reasonable.

2. Negligence

Section 1647 imposes a penalty for negligence which is derived from the current income and franchise tax laws. It also incorporates a definition of "negligence" and "disregard" derived from Section 6653 of the Internal Revenue Code.

3. Fraud

Section 1648 adopts a civil fraud penalty (and related additional interest penalty) which is based upon the fraud penalty of Section 6653(b) of the Internal Revenue Code, as amended by the Tax Reform Act of 1986.

4. Substantial Understatement Penalty

Section 1650 imposes a substantial understatement penalty of 25% which is derived from Section 6661 of the Internal Revenue Code. While similar penalties are currently applicable for the income, franchise and sales and use taxes, the Bill would expand this penalty to other taxes. The application of the substantial understatement penalty to the real estate gains tax is unclear. As previously discussed, there apparently is no gains tax filing which meets the definition of a "return" in Section 1601(f) of the Bill. Thus, it would appear there could never be a "substantial understatement" of the gains tax since the "understatement" is based upon the amount required to be shown on a "return". Nevertheless, it is clear that it was intended that this penalty apply to the gains tax. See Bill § 1650(c) (last

sentence). Thus, either the definition of a "return" or an "understatement" should be modified to clarify that the penalty applies to the gains tax.

5. Other Penalties

The Bill incorporates a variety of special penalties from current law which have limited application into the penalty portion of Article 35.

D. Collection Provisions

The current collection provisions of the taxes subject to Article 35 are consolidated in Part IV of Article 35. The provisions are generally based upon the collection provisions in the personal income tax law. Several new provisions are added which are based upon federal collection provisions.

The Bill also has changes in the rules for filing of state tax liens. For example, New York tax liens would be filed in a manner similar to federal tax liens.

The Committee recommends that these provisions of the Bill be reviewed by the Banking, Corporation and Business Law Section.

E. Effective Date

The Bill would be generally effective on January 1, 1989 except that the change in the limitation periods for refunds would apply to taxable years beginning on or after January 1, 1989 and the new interest rate rules would be effective for calendar quarters beginning on or after March 1, 1989.

The Committee believes that these effective date provision needs further clarification for both taxpayers and the Department. A section by section analysis of Article 35 would be appropriate to provide clear guidance for the transition from current law for each section.

F. Miscellaneous Comments

1. The Bill should amend the existing procedural sections of the various tax articles to fully coordinate with Article 35 and add cross references to such Article.

2. The Bill needs to be updated to reflect several minor changes in the Tax Law made by the Tax Reform and Reduction Action of 1987, the Business Tax Reform and Rate Reduction Act of 1987 and the Tax Reform Technical Corrections Act of 1987.

January 14, 1988

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