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May 21, 2001

Hon. Jonathan Robin  
Deputy Commissioner, Audit and Enforcement  
New York City Department of Finance  
345 Adams Street, 10th Floor  
Brooklyn, NY 11201

*Re: Proposed SAP on Penalties*

Dear Deputy Commissioner Robin:

We write to offer our comments on the draft Statement of Audit Procedures governing the imposition of penalties.

As a preliminary matter, we commend you and the Department of Finance for addressing this bothersome issue we presented to Commissioner Eristoff at one of his Taxpayer Advisory Council meetings. Your response demonstrates the convening and operation of the Council is a truly worthwhile endeavor; we are pleased to participate as a member and look forward to continuing to contribute to the improvement of the City tax system.

As you know, the specific concern the draft SAP addresses is the perception, widely held by tax practitioners and taxpayers, that New York City tax auditors routinely use the threat and the imposition of penalties to obtain taxpayer concessions on substantive issues. When taxpayers refuse to so concede, penalties seem to be imposed automatically, irrespective of the specific facts and circumstances or justifications for penalty imposition. While we realize that these perceptions may be oversimplifications, they nevertheless exist.

Penalties properly are in the nature of fines for improper conduct. They should be imposed only when improper conduct has

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occurred. The burden should be on the Department's auditors to provide reasons penalties should be imposed and not on taxpayers to establish why they should not be.

The draft SAP would apply to penalties imposed under the Unincorporated Business Tax, the General Corporation Tax, the Banking Corporation Tax, the Real Property Transfer Tax, the Commercial Rent and Occupancy Tax, the Utility Tax, and the Hotel Room Occupancy Tax.<sup>1</sup>

The draft SAP would change the process for auditors to impose "substantial understatement" and "negligence" penalties. In both situations, the auditors - when they are considering imposing penalties - are instructed to inform taxpayers of the need to present all necessary information relevant to avoiding prospective penalty impositions. Adopting this procedural step will be a significant enhancement to the current process.

In connection with substantial understatement penalties, the taxpayer would be expected to demonstrate the statutory criteria for penalty abatement have been satisfied. These criteria are substantial authority, adequate disclosure, and reasonable cause.

The draft SAP's major change involves negligence penalties. The draft SAP would require auditors considering imposing negligence penalties to inform the taxpayer, in writing, of the reasons for the auditors' tentative conclusion that the taxpayer either has been negligent or has intentionally disregarded the law. We recommend inserting the word "specific" before the word "circumstances" in this part of the SAP to insure that a general statement the taxpayer had been negligent would not suffice; we also assume the letter will not become a "form" letter, but instead will convey the auditor's analysis of the taxpayer's specific case. Taxpayers may then respond, explaining why the auditors' tentative conclusion is erroneous. Additionally, it would be helpful if the SAP would set forth some examples of what would constitute reasonable cause in some commonly encountered situations, for purposes of both the substantial understatement penalty and the negligence penalty. For example, the New York State Audit Guidelines set forth some examples of when reasonable cause exists to abate late filing and

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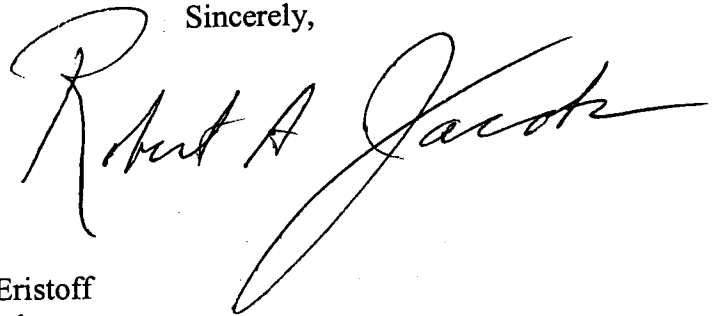
<sup>1</sup> It would be nice if New York State would institute the same type of guidelines with respect to the imposition of the New York State and City personal income tax so that when New York City auditors are working on behalf of New York State conducting a personal income tax audit, the same rules would apply.

substantial understatement penalties in the context of a personal income tax audit.

The requirement of an initial letter from the auditor clearly setting forth the proposed grounds for the penalty imposition is a significant improvement. Furthermore, we believe that the requirement of an initial, tentative penalty statement by the auditors (in cases of possible negligence penalty imposition) is truly a major step. In summary, we congratulate you and the Department for responding to taxpayer and tax practitioner concerns.

We look forward to working with you and the Commissioner on this and similar projects to better our City tax system.

Sincerely,

A handwritten signature in black ink, reading "Robert A. Jacobs". The signature is written in a cursive style with a large, looping initial "R".

RAJ:msv

cc: Honorable Andrew S. Eristoff  
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