New York State Bar Association
Tax Section

Report On Proposed Changes To New York State Statute Of Limitations On Collection Of Unpaid Tax Liabilities

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Report No. 1203

New York State Bar Association
Tax Section

Report On Proposed Changes To New York State Statute Of Limitations On Collection Of Unpaid Tax Liabilities

I. Introduction.

This Report recommends changes to the New York State statute of limitations for collecting unpaid tax liabilities.[1] As described in more detail below, the New York State tax collection rules differ from the federal tax collection rules in three important respects: (i) New York State has a much longer statute of limitations; (ii) however, New York State is more limited in the types and amounts of taxpayer assets and income from which it can collect; and finally (iii) New York State offers more limited opportunities for taxpayers to compromise or negotiate the payment of their taxes. The effect of these rules is to impose very significant burdens on New York taxpayers who have limited financial resources. The long statute of limitations also imposes administrative burdens upon the New York State Department of Taxation and Finance (the "Department"), and causes the Department to expend resources on taxes that may be very difficult to collect rather than on more productive sources of revenue.

Under New York State law, once a New York State tax warrant for taxes owed has been filed, the State has the same rights as a private judgment creditor to enforce the warrant and may collect against a tax debtor on the state tax debt for twenty years from the date of filing. If there is any written acknowledgement or payment on the debt (whether voluntary or involuntary) by the tax debtor within the twenty-year period, the life of the judgment continues for a new twenty-year period. This has the potential for making the statute of limitations for collection of state tax debt effectively unlimited. Since New York State tax liabilities potentially carry significant combined interest/penalty rates, small tax liabilities can easily grow to very large liabilities by virtue of these long collection periods.

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[1] The principal drafter of this Report was Sherry Kraus, Co-Chair of the Individuals Committee, with substantial contributions from Kenneth Bersani, Brian Boland, Yvonne Cort, Eugene Fisher, Maria Jones, Elizabeth Kessenides, William Neild, Erika Nijenhuis, Robert Plautz, Art Rosen, Karen Tenenbaum, and Jack Trachtenberg. Helpful comments were received from Kim Blanchard, Jerri Cirino and Michael Schler. Appreciation is expressed to Kenneth Bersani, David Carlson, Erika Nijenhuis, Carlton Smith and Sharon Stern Gerstman for their assistance in drafting of proposed statutory amendments.

We have discussed with the New York State Department of Taxation and Finance in very general terms the possibility of shortening the statute of limitations for tax debts. We appreciate the assistance that the Department has provided to us in that regard. The Department has not reviewed this Report, and all discussion and recommendations in the Report are those of the Tax Section and not of the Department.

This report has been approved by the Executive Committee of the New York State Bar Association.

In contrast, the Internal Revenue Service ("IRS") has only ten years to collect on a federal tax debt. In a small number of cases, the federal collection period is extended by twenty years by converting the tax debt into a federal judgment.

This Report analyzes the impact of New York's long collection statute, particularly in light of the more limited state programs available for resolution of liabilities unlikely to be collected in full than are available at the federal level. The Report also reviews differences between federal and state laws in tax collection rights against a tax debtor's assets and income.

The Report concludes that the longer, potentially unlimited, New York statute of limitations period on collection results in unduly harsh consequences to taxpayers, undermines taxpayer compliance and is counterproductive to the State's efforts at collection of tax liabilities. The Report recommends amendment of the New York State Tax Law and the New York State Civil Practice Law and Rules to conform the statute of limitations for collection of New York State tax debts to that of the comparable federal provision.

More specifically, the Report recommends that the statute of limitations for collecting tax liabilities be shortened to ten years, but that the statute of limitations for filing a warrant to reduce tax liabilities to judgments be lengthened to ten years. The Report also examines whether a shortened collection period should be accompanied by an enhancement of the rights of New York State to enforce its collection of tax debt and revision of New York State's programs for resolving tax liabilities unlikely to be collected. The Report makes a number of suggestions for possible changes in these areas, but makes no specific recommendations, because we believe that it will be important to consult with the Department in order to craft changes that would enhance the Department's rights to collect taxes that are both due and collectible but also provide appropriate tax debtor protections. The Report does, however, reiterate our long-standing support for revising New York State's program for "offers in compromise" as one component of such a package of changes. As described below, we believe that any broadening of the State's powers to collect taxes must be coupled with expanded taxpayer relief programs, in order to ensure that any changes to the law do not leave taxpayers facing an even more intractable collections system than they do today.

Part II of the Report provides background information on the federal and New York state rules and processes for assessments and collections, federal and state law restraints on collections, and federal and state taxpayer relief programs. Part III of the Report describes the reasons for providing relief to taxpayers with unpaid tax debts, the collection experience of the IRS and the Department, the limited scope of the State's taxpayer relief programs, and the burden on tax debtors and the Department resulting from a system in which the government seeks to collect on very old assessments. Part IV of the Report contains our recommendations for amendments to the Tax Law and the Civil Practice Law and Rules in order to conform the statute of limitations for collection of New York State tax debt to the provisions for tax collections on federal tax debt. Part V of the Report discusses the possible expansion of New York's powers of collection and state taxpayer relief programs. An attached Appendix contains the text of proposed statutory changes.

II. <u>Background.</u>

A. Federal Tax Assessments and Collections.

Assessments.

In order to collect a tax, the IRS must first assess the tax. Assessments are made by the IRS pursuant to several different procedures, including (1) summary assessments (self-reported tax on a filed return, mathematical errors) (Internal Revenue Code §6201 *et seq.*)[2]; (2) deficiency assessments (additional tax due) (IRC §6213); (3) nondeficiency tax assessments (*e.g*., employment taxes) *(id.*) and (4) jeopardy and termination assessments (allowing for immediate assessment and collection of the tax) (*id.*). The general rule is that taxes must be assessed within three years after the return is filed. IRC §6501(b) (1).

The IRS cannot make deficiency assessments of additional tax unless a notice of deficiency has been issued. IRC §6213(a). Within 90 days after the notice of deficiency is mailed (or within 150 days after mailing if the notice is addressed to a person outside the U.S.), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. IRC §6213. If the taxpayer does not file a Tax Court petition within the 90-day period, the IRS may assess the deficiency and the tax may be collected. IRC §6213. If the taxpayer files a Tax Court petition within the 90-day period, there can be no assessment until the decision of the Tax Court becomes final. IRC §§7481, 7483.

However, if the taxpayer does not agree with the results of a proposed deficiency assessment, the taxpayer has the right to file an appeal to the Appeals office of the IRS, which is under the jurisdiction of the National Director of Appeals. Treas. Reg. §601.109(d). By providing for an independent appeals review within the IRS, many disputed liabilities are resolved administratively without the need for the taxpayer going to court. The taxpayer is informed of the right to appeal in a "30-day letter" issued by the IRS (which also sets forth the proposed additions to tax). If the taxpayer fails to file for an appeal within the 30-day period, the taxpayer will then be issued a notice of deficiency and have 90 days to file a petition with the Tax Court.

IRS administrative appeals are available for a broad spectrum of IRS assessment and collection actions. For example, a taxpayer may request an Appeals conference not only to review a proposed tax deficiency assessment as described above, but also to review (1) a proposed assessment of employment taxes (which is not subject to the deficiency assessment

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[2] Hereafter, all further references to the Internal Revenue Code will be to "IRC §", references to New York State Tax Law will be to "Tax Law §"; references to New York State Civil Practice Law and Rules will be to "C.P.L.R. §"; references to Treasury regulations promulgated under the Internal Revenue Code will be to "Treas. Reg. §"; references to the Rules and Regulations of the State of New York will be to "NYCRR §"; and references to the Internal Revenue Manual will be to "IRM".

procedures and may be assessed by the IRS without the issuance of a notice of deficiency[3]); (2) to seek relief from federal tax lien and levy actions under the Collection Due Process appeal procedure (IRC §6320(b)); (3) to forestall levies or seizure of assets, or to appeal the denial or termination of an installment payment agreement under the Collection Appeals Program (IRC §7123(a); IRM 8.7.2.2.1 (1-1-06); and (4) to appeal the denial of an Offer in Compromise (IRC §7122(e)(1)).

Collections.

As a general rule, the IRS has ten years from the date of assessment to collect a tax.[4] IRC §6502(a). After assessment, the IRS sends a "notice and demand" for payment to the taxpayer for the assessed taxes, accrued interest and penalties. IRC §6303(a). If the taxpayer ignores the notice and demand, the amount billed becomes a lien in favor of the United States on all of the taxpayer's property and rights to property, whether real or personal. IRC §6321. The lien may be further perfected against the right of third parties by the filing of a Notice of Federal Tax Lien under IRC §6323, but the filing of this notice does not in itself extend the ten-year collection statute. The lien continues until the liability is satisfied or the collection statute of limitations expires. IRC §6322.

The federal lien can be enforced either by administrative action by the IRS by levying on the taxpayer's property or by a judicial proceeding brought by the Department of Justice under IRC §7403 to enforce the lien or foreclose the lien on property of the taxpayer. The Department of Justice can also bring suit in federal district court simply to reduce a tax debt to judgment (discussed below).

Through an administrative levy, the IRS can seize bank accounts, personal and real property, social security payments, most pension assets and wages. IRC §6331(a), (b), (c) and (e). The only requirement before pursuing forced collection by levy is that the IRS must first issue to the taxpayer a notice of intent to levy 30 days in advance. IRC §6331(d). That notice also affords the taxpayer an opportunity to request a hearing at the IRS Appeals level to propose a collection alternative, such as an installment payment agreement, an offer in compromise, or being placed in "currently not collectible" status. IRC §6330. If the taxpayer does not request an Appeals hearing, the IRS can proceed to levy or garnish, and can do so repeatedly over the remainder of the ten-year collection period.

The federal government may extend the ten-year period of collection of a tax by bringing suit in federal district court to enforce its tax lien or to reduce a tax debt to federal judgment. As long as legal action is commenced before the expiration of the initial ten-year collection period, such a judgment will extend the IRS's ability to collect on the tax debt by

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[3] Employment taxes (*i.e.,* withheld income taxes, FICA, and federal unemployment taxes) are imposed by IRC Subtitle C, Chapters 21 through 25, and are thereby not subject to the IRC § 6213 deficiency assessment procedures.

[4] The period for collection may be extended by taxpayer waiver only in connection with an installment payment agreement. IRC §6502(a)(2). IRS policy is that the statute of limitations will only be extended for five years beyond the normal ten year statute of limitations expiration date. IRM 5.142.1(7-12-05). The collection period is automatically extended when the taxpayer submits an Offer in Compromise (IRC §6331(k)(3)), a Collection Due Process Appeal (IRC §6330(e)(1)), or when the taxpayer files for bankruptcy. IRC §6503(h).

twenty years and be renewable for another twenty years with court approval. 28 U.S.C. §§3002(3)(B) and (8); 28 U.S.C. §3201(c). If the government brings such an action, the judgment is not merged into the lien provided under IRC §6321. United States v. Hodes, 355 F.2d 746 (2d Cir.1966). Further, IRC § 6502(a) provides that if a timely proceeding in court is commenced within the ten-year collection period provided therein, "the period during which such tax may be collected by levy (under IRC §6331(a)) shall be extended and shall not expire until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable."

Suits to obtain an extension of time beyond the normal ten-year collection period are rare.[5] To reduce a tax debt to a judgment, the IRS must proceed through the Department of Justice to commence an action in federal district court to obtain the judgment. Reducing the tax to judgment is usually done only when the IRS is aware of substantial valuable property at the end of the ten-year collection period that would justify the expenditure of costs and effort to bring suit. Unless the tax liability is large or the IRS is aware that the taxpayer has assets from which collection can be obtained after the expiration of the ten-year period, the IRS generally does not seek to reduce the tax claim to judgment merely to extend the collection period.[6] The tax liability is totally extinguished after the expiration of the collection statute of limitations period.

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[5] In fiscal year 2008, the federal government filed only 896 civil tax suits in all federal district courts. 2008 Annual Report of the Director of the United States Courts, Table C-2 (Sept. 30, 2008), available at the United States Court website at www.uscourts.gov/judbus2008/appendices/C02Sep08.pdf. During that same fiscal year, the IRS filed 768,168 notices of federal tax lien, served 2,631,038 notices of levy on third parties and conducted 610 seizures. IRS Data Book 2008, Table 16, available at the IRS website at www.irs.gov/pub/irs-soi/08databk.pdf.

[6] The federal guidelines for determining whether to recommend a suit to reduce a tax claim to judgment are found in the Law Enforcement Manual, LEM 5.5 (IRM §5.17.4.7.2 (11-06-2007)). These guidelines are confidential. However, it is commonly known that the Department of Justice will not accept a case to reduce an assessment to judgment unless the IRS is able to establish that there is substantial "current collection potential". Recommendations to reduce an assessment to judgment are prepared by the Collection Division and forwarded to the Chief Counsel's office for review to make sure the assessment is proper and the file shows collection potential. If it does, the Chief Counsel's office issues a prosecution recommendation to the Department of Justice, where the Department makes its own independent review of collection potential. The only exception to this "collection potential" rule involves actions brought by taxpayers in District Court for review of the IRS's imposition of the IRC §6672 Trust Fund Recovery penalty as a "responsible person" for payment of employment taxes. The government routinely files a counterclaim in such cases, regardless of collection potential, to ensure that the liability will be reduced to judgment if the taxpayer fails in the action. This is intended as a deterrent to taxpayers bringing an action to challenge the assessment. There is no similar risk to taxpayers in bringing an appeal before the United States Tax Court where the government cannot counterclaim and convert an adverse outcome to the taxpayer into a judgment. At present, IRC § 6672 cases may not be heard before the United States Tax Court. *See also*, 637 T.M., *Federal Tax Collection Procedure—Liens, Levies, Suits and Third Party Liability* at A-53.

B. ***New York State Assessments and Collections.***

Assessments.

The procedures for assessment of State taxes are similar to those described above for federal tax assessments. "Assessment" occurs, depending on the circumstances, on the date a return is filed (Tax Law §682(a)), the date payment is due (*id.*), 90 days from the mailing of a notice of deficiency (Tax Law §681(b)), the date a decision of the Division of Tax Appeals is not subject to further administrative or judicial review (Tax Law §2016), or the date of mailing of a notice of additional tax due, unless an amended return is filed within 30 days of mailing. (Tax Law §681(e)). In general, assessments must be made within three years of the date the return was filed. Tax Law §§683(a), 1083(a).

- *Deficiency Assessments*

.As under federal law, deficiency assessments to impose liability for additional tax must follow certain procedural requirements and may not be summarily made. Tax Law §§681,1081, 1138. These procedural requirements must be satisfied to afford the taxpayer an opportunity for review prior to assessment and collection. Before assessment and collection of a deficiency, the taxpayer is entitled to a notice of the proposed assessment. Tax Law §§681(a), 1081(a). The notice of deficiency ("notice of determination" for sales/use tax) requirement largely parallels the federal deficiency procedure. The taxpayer has 90 days (150 days if the notice is sent outside the United States) from the date the notice of deficiency is mailed to file a petition with the Division of Tax Appeals for redetermination of the deficiency. Tax Law §§689(b), 1089(b), 2008. The Division of Tax Appeals is an autonomous unit of the Department of Taxation and Finance that is completely independent of the Commissioner and intended to provide adjudicative functions to resolve tax disputes.[7] If no petition is filed within this period, the notice of deficiency becomes an assessment at the expiration of the 90-day or 150-day period of all tax, interest and penalties stated in the notice. Tax Law §§681(b), 682(a), 1081(b), 1082(a). No further act is required by the Department to perfect the assessment. If, however, the taxpayer files a petition within the 90- or 150-day period for redetermination of all or part of the proposed deficiency, no assessment may be made for any deficiency covered by the petition until the decision of the Division of Tax Appeals is not subject to further administrative or judicial review. Tax Law §2016.

- *Other Assessments.*

Just as under federal law, not all state tax assessments are subject to the deficiency assessment procedures described above. Self-assessments, where the tax for which liability is admitted, such as that shown on a return or amounts paid as a tax or in respect of a tax (other than withholding or estimated taxes), may be summarily assessed. Tax Law §§682(a), 1082(a). Similarly, where there is a mathematical error on the return, any recalculated tax

[7] The Division of Tax Appeals is a forum for litigating tax issues, broadly similar to the federal Tax Court. Unlike Tax Court, the Division of Tax Appeals cases are heard by administrative law judges, with decisions appealable to the Tax Appeals Tribunal.

resulting from correction of the error may be summarily assessed. Tax Law §§682(a), 1082(a).

Deficiencies resulting from federal changes[8] are also summarily assessed if conceded. Tax Law §§682(a), 1082(a)(2). If such changes are not conceded, the usual deficiency procedures apply, except that (1) the Department may assess within two years of the taxpayer's filing a report of change (if longer than the usual period of limitations), and (2) where the taxpayer does not report the federal change, the Department must give 30 days notice to challenge it. Tax Law §§683(c)(3), 1083(c)(3). If the taxpayer challenges the notice of additional tax due within the 30-day period, the normal deficiency assessment procedures must be followed. In commencing the normal assessment procedures, the notice of additional tax due is not deemed the equivalent of a notice of deficiency. Tax Law §§681(e)(2), 1081(e)(2).

If the Department determines that the assessment or collection of a tax may be jeopardized by delay, it may assess and take steps to collect the tax without regard to the usual restrictions on deficiency assessments and collections. Tax Law §§694(a), 692(b), (c), 1094(a), 1092(b), (c).

- *Appeal Rights.*

By legislation effective September 1, 1987, the Department was reorganized to establish a more independent administrative system for resolving tax controversies between the Department and the taxpayer. Tax Law §170(3-a). As part of this restructuring, the Bureau of Conciliation and Mediation Services was created as a separate operating bureau within the Department. *Id.*

However, unlike IRS Appeals officers, who have broad powers of settlement, the conciliation conferees may encourage and facilitate settlement of the case, but, if the Department does not agree with a proposed resolution, the conferee has only the power to waive or modify penalties, interest and additions to tax. Tax Law §170(3-a)(c). Thus, even if the conferee were persuaded by the taxpayer that the proposed assessment is not supportable, the conferee does not have the power to cancel the underlying tax over the objection of the Department.

A conferee's informal settlement abilities are distinct from his or her authority to accept an offer in compromise from a taxpayer who has requested a conference. The conferee does not have the authority to evaluate and accept such offers, but must forward such offers either to the counsel for the Department (if based on doubt as to liability) or to the Director of the Tax Compliance Division (if based on doubt as to collectibility). 20 NYCRR §4000.4.

A taxpayer who receives a statutory notice of deficiency has the right to request a conciliation conference. Tax Law §170(3-a)(a); 20 NYCRR §4000.3(a). Filing a request tolls

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[8] Taxpayers are required to report any change in their federal return that has the effect of changing N.Y. tax liability. Tax Law §§659, 211(3).

the statute of limitations for filing a petition for a hearing in the Division of Tax Appeals. Tax Law §170(3-a)(b).

A conciliation conference order is binding on the Division of Taxation, absent fraud, malfeasance or misrepresentation of a material fact. Tax Law §170(3-a)(e); 20 NYCRR §4000.5(c)(4). A conciliation order is equally binding on a taxpayer unless he or she requests a hearing before the Division of Tax Appeals within 90 days of the issuance of the order. Tax Law §170(3-a)(e); 20 NYCRR §4000.5(c)(4).

Collections.

The statutory provisions governing New York's limitation period for collection of tax debt differ depending on the type of tax assessed.

Collections on Personal Income Taxes under Article 22.

After an income tax is assessed, a notice of demand for payment is issued granting 21 days (10 days for large amounts) to pay. If not paid, the Department has six years from the date of assessment to file a warrant, which establishes public notice of the assessment and grants to the Department collection rights equivalent to those enjoyed by a private judgment creditor. New York State Tax Law §692(c). If the Department does not file its warrant for income taxes within the required six-year period under Tax Law §692, it will be barred from collecting on the tax assessment.[9] The Department issues the warrant as a routine matter shortly after all appeal rights to challenge the assessment have expired.[10]

In contrast to the federal law provisions which allow for the administrative filing of a tax lien to secure the IRS's creditor status, the State has no mechanism for securing its interest as a creditor on a tax debt except through the filing of a tax warrant under Tax Law §692. However, unlike the effect of the filing by the IRS of a federal tax lien, the New York State tax warrant is not treated merely as a lien, securing the State's interest as a creditor, but rather as a money judgment under Tax Law §692(e). This means that the State has the same rights as a private judgment creditor to enforce its "judgment" under Article 52 of the Civil Practice

[9] The six-year period for filing the tax warrant may have its origins in the former six-year statute of limitations applicable to collections of federal tax debt. However, the period for filing a warrant under New York law was not extended after the 1990 change in federal law extending the period for collections from six years to ten years. IRC §6502(a).

[10] The only alternative to collection of tax by warrant is suit for civil judgment (*see, e.g.,* Tax Law §§692(h), 1092(h) and 1141(a)). However, New York State is subject to the C.P.L.R. statute of limitations requiring suit to be started within 6 years from the time a cause of action "accrues" (C.P.L.R. §§5203(a), 213). Inasmuch as the Department may not sue for tax unless and until it is assessed, the Department has stated its view that a cause of action for a tax liability accrues upon assessment. Hence, the six year periods of Tax Law §682(a) and C.P.L.R. §213 are, for all practical purposes, coterminous. October 23, 2001 Counsel's Memorandum. (Opinions of Counsel do not have legal force or effect and do not set precedent. However, all operating bureaus and divisions of the Division of Taxation, including the Bureau of Conciliation and Mediation Services, must follow such opinions where the factual situations are the same. 20 NYCRR § 2375.4. Opinions of Counsel are no longer being issued and Regulation section 2375.4 has been repealed.)

Law and Rules. By reason of the warrant's status as a "judgment," the filing of the warrant extends the collection statute of limitations period for the State by at least twenty years.[11] If, for example, a warrant was issued and docketed two years after the collection statute began, the collection statute would be extended another twenty years – *i.e.,* to be twenty-two years in total. During that twenty-two year period, the Department would be able to assert all collection remedies available to private creditors under New York law to collect the tax.

There are two ways the twenty-year period to enforce a warrant (judgment) can be extended. The twenty-year period runs anew from the date of the last payment (voluntary or involuntary) or from a written acknowledgment[12] of the debt by the debtor, made before the twenty-year period expires. C.P.L.R. §211(b). If the State manages to collect during that twenty-year period a single dollar of the tax owed through a levy on a bank account, seizure of an asset or voluntary payment by the tax debtor, the statute of limitations period on collection will be extended for another twenty years from the date of the levy or payment.[13] Thus, for example, with as little collection effort as a levy on a bank account at least every twenty years, the Department can and regularly does effectively make the collection statute of limitations period against individuals unlimited.[14]

Second, the twenty year period of the warrant can be extended by a suit instituted by the Attorney General's office on behalf of the State on the old unpaid judgment so long as this is done within twenty years from its filing. C.P.L.R. §211(b). This new judgment has its own new twenty-year enforcement period.

To secure its priority as a creditor with respect to real property owned by the tax debtor, the State must file its tax warrant in the County Clerk's office of the county in which the

[11] The warrant, being treated as a money judgment, is governed by C.P.L.R. §211(b), which states that "[a] money judgment is [conclusively] presumed to be paid and satisfied after the expiration of twenty years from the time when the party recovering it was first entitled to enforce it."

[12] There is no case law that defines an "acknowledgment" under C.P.L.R. §211(b). Case law under Gen. Obligations Law § 17-101, which includes a similar "acknowledgment" requirement, appears to support the position that "[the] acknowledgment must ... contain nothing inconsistent with an intention on the part of the debtor to pay [the debt] "). *See*, Morris Demolition Co., Inc. v. Board of Education of the City of New York, 40 N.Y.2d 516, 387 N.Y.S.2d 409 (1976); *see also,* Yezhak v. Datek Securities, 2 A.D.3d 594, 769 N.Y.S.2d 581 (2003) (The acknowledgment must "import an intention to pay...."). Nevertheless, it has been reported that, in at least one instance, the Department took the position that an "acknowledgment" was triggered under C.P.L.R. §211(b) when a taxpayer merely wrote the Department inquiring about an outstanding assessment and, in the same writing, explicitly denied the legality of the assessment and denied being served with notice of the assessment. While we are aware of only one isolated instance of the Department taking this position and do not believe that this position would be sustained by a court, the anecdote demonstrates what taxpayers can encounter in this area.

[13] The statute provides that if any written acknowledgement of or payment is made on the "judgment", "the judgment is conclusively presumed to be paid and satisfied as against any person after the expiration of twenty years after the last acknowledgement or payment made by him." C.P.L.R. §211(b). In addition, "[p]roperty acquired by an enforcement order or by levy upon an execution is a payment, unless the person to be charged shows that it did not include property claimed by him". *Id.*

[14] There is a wide variation in the collection limitation statutes of other states. Many, such as Illinois and New Jersey, have twenty year statutes. California has a ten year statute. Texas and Florida have a ten year statute and do not allow the state to enforce tax judgments against a tax debtor's income by garnishment.

taxpayer resides, and within which the real property is located if it is not located within the taxpayer's county of residence. To secure its interest more broadly to include the personal property owned by the tax debtor, it must (and routinely does) file a tax warrant with the Secretary of State in Albany in accordance with Tax Law §692(d). The filing with the Secretary of State creates a lien for the Department on a taxpayer's personal property coextensive with the life of the judgment – ordinarily twenty years.

Section 174-a of the Tax Law effectively limits the life of a judgment lien filed against real property (as opposed to personal property) to a period of ten years. Notwithstanding the twenty-year life of a warrant, a judgment filed in a county where the tax debtor has real property constitutes a lien on that real property for only ten years. C.P.L.R. §5203; Tax Law §174-a. A lien on real property is necessary to give the State the right to have a debtor's property sold to satisfy the judgment and to establish the priority of the State as a creditor relative to other creditors who have similarly filed liens against the debtor. C.P.L.R. §5236(a). Generally, the priority of a lien – the right to be paid before others – depends on the date a lien attaches – that is, the date a judgment is filed with the county clerk. If the Department does not timely enforce its lien from a filed warrant within that ten-year period, its rights in the real property of the tax debtor come only after payment to other creditors whose liens did not lapse.

The ten-year lien of a filed judgment against real property, as opposed to the judgment (warrant) itself, may be extended in two ways. First, an action may be instituted on the old judgment, within ten years (instead of within twenty years) from the filing of the old judgment to effectively refile the lien. C.P.L.R. §5014. A new ten-year lien period arises when a new judgment is secured. Second, in certain circumstances, a motion can be made for a court to extend the ten-year lien for sufficient time to allow the creditor to complete a sale of the property when sale proceedings were started before the ten-year lien period expired. C.P.L.R. §5203(b).

However, actions by the State to extend its ten-year lien against a tax debtor's real property are not customarily brought. The Department has stated its policy that if a warrant cannot be collected within ten years from entry, it would require "unusual circumstances" to justify a request to the Attorney General to sue in order to obtain an extension. *See,* October 23, 2001 Counsel's Memorandum.

Even if the real property lien arising from the filing of a warrant is allowed to lapse after the passage of ten years, the warrant may still be enforced by the Department administratively by levy on a taxpayer's personal or real property. C.P.L.R. §§5232, 5235. However, if the filed warrant on the taxpayer's real property has lapsed, the Department's ability to collect a warrant against real property is diminished because it no longer has priority over good faith purchasers for value or subsequent creditors with perfected liens on the same property.

Collections on Sales Taxes (Article 28) and Corporation Taxes (Article 27).

The procedures for collecting sales and corporation taxes are similar to those for collecting personal income tax under Article 22. *See,* Tax Law §279-b, §692(c)-(d), §1141(b). Article 28 of the Tax Law sets forth the procedures for the assessment and collection of sales and use taxes. Because the taxpayer has failed to collect and pay over sales tax, the process begins with a "Notice of Determination and Demand" rather than a "Notice of Deficiency." Tax Law §1147(b).

For sales tax collections, Tax Law §1141(b) (entitled "Proceedings to Recover Tax") provides for the filing of a warrant and grants the Department "the same remedies to enforce the amount due thereunder as if the state had recovered judgment therefore." This conforms the procedures for collection of sales and use taxes to those applicable to the collection of income taxes with one notable difference – Tax Law §1141(b) makes no mention of a requirement that the State file its sales tax warrant within the *six-year period* after assessment as is required under Tax Law §692(c) for personal income taxes.

However, Tax Law §1147(b) (entitled "Notices and limitations of time") introduces an ambiguity into the collection limitation period applicable for sales and use taxes. This section states that "[t]he provisions of the civil practice law and rules or any other law relative to limitations of time for the enforcement of a civil remedy shall not apply to any proceeding or action taken by the state or the tax commission to levy, appraise, assess, determine or enforce the collection of any tax or penalty provided by this article." Strictly interpreted, there would be no statute of limitations for the collection of sales or use taxes. Notwithstanding these seemingly conflicting provisions, it is our understanding that the Department applies the same procedures for the collections of sales and use taxes as for the collection of income taxes, with the exception that it does not regard itself as required to file a sales tax warrant within six years of assessment.

There has not been any judicial interpretation of the contradictory provisions within Article 28 for the collection of sales tax. This is unfortunate since sales tax liabilities often represent some of the largest assessments against New York tax debtors. That is attributable, in part, to the very high penalty/interest rates imposed (currently 14.5% per annum).[15] In contrast, a private judgment creditor will accrue interest on the judgment at only 9% per annum. Since it is rare for a private judgment creditor to extend the ten-year lien against real property, the accrued liabilities owed to a private creditor do not have the same potential for mounting to the extent of tax debt owed to the State.

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[15] The higher rate is intended to discourage noncompliance in the collection and payment of a "trust fund" tax due to the state (even though it also applies to self-generated use tax liabilities). Noncompliance in the payment of sales taxes or employment taxes has far more serious ramifications than the nonpayment of personal income taxes by a taxpayer. The size and scope of the liability is generally much larger than for income taxes. Also, the retention of moneys collected from customers (or employees) for payment over to the State is more akin to "conversion" (theft) of moneys due to the State than simply a default on payment of a personal tax debt. Legal deterrents to trust fund tax delinquencies are similarly reflected in the bankruptcy laws wherein tax debtors cannot discharge liabilities for "trust fund" taxes and "trust fund recovery penalties."

C. Federal and State Law Restraints on Collection.

New York tax debtors are protected from excessive tax collection practices by the State in a number of ways. These limitations derive from both federal and state law. Federal law limits the amounts that states may allow creditors to collect on debts. State law may be more restrictive in allowing collection of debts, but may not exceed that allowed under federal law.

The federal "Consumer Protection Act" established national limits for wage garnishments and restricts any garnishment against "earned income" to 25% of disposable earnings. 15 U.S.C. §1673. This 25% is an aggregate sum, representing the maximum part of an individual's income which may be subject to garnishment from any and all creditors combined. Notably, this restriction specifically excludes actions to collect federal and state taxes from its limits. *Id.*

In addition, there are federal law restrictions under the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") prohibiting creditor collections against qualified retirement plans, such as a profit-sharing plans, money purchase pension plans, 401(k) plans or other similar employer-sponsored plans. In Patterson v. Shumate, 504 U.S. 753 (1992), the United States Supreme Court confirmed that the "anti-alienation" provisions of ERISA represent enforceable restrictions upon the rights of creditors to reach an individual's interest in a qualified retirement plan and that such plans cannot be used by creditors to satisfy judgments. However, individual retirement accounts (IRAs) do not enjoy the same unlimited protection under ERISA.

In New York, the New York Civil Practice Law and Rules establishes limits on creditor rights of collection in New York. While state law cannot restrict the rights of the IRS to collect federal tax debt (which are governed by federal law), the C.P.L.R. restrictions apply to the Department in its collection of state tax debts in the same manner as applicable to private creditors.

Article 52 of the C.P.L.R. sets forth the New York state law limitations on creditor enforcement of money judgments. All creditors, including the Department, are limited in income executions (wage garnishments) to the lesser of 10 percent of "earnings" or twenty-five percent of "disposable earnings" provided the taxpayer meets a certain income threshold.[16] C.P.L.R. §§5201(b) and 5205(d)(2). As under the federal law restrictions, this limitation is an aggregate sum, representing the maximum part of an individual's income which may be subject to garnishment from any and all creditors combined.

The C.P.L.R. defines "earnings" as "compensation paid or payable for personal services whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program." C.P.L.R. §5231(c)(i). "Earnings" are interpreted narrowly under the law and do not include self-employment income. As a result, the Department commonly levies without limitation on the

[16] Under C.P.L.R. §5231, only earnings in excess of thirty times the federal minimum hourly wage may be garnished. Since current federal minimum wage is $7.25/hour, creditors cannot reduce a debtor's disposable earnings to an amount below $217.50/week.

earnings or receivables of a self-employed individual even if such earnings are derived from personal services. "Disposable earnings" are defined as that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld. *Id.*

Section 5205 of the C.P.L.R. also protects New York debtors from creditor collections against self created trusts, including IRAs. Section 3212 of New York State Insurance Law protects certain life insurance proceeds and annuity contracts from the claims of creditors. For other exempt assets, see New York State Debtor Creditor Law §283. Under current federal and state debtor protection laws, the Department cannot reach social security payments, public assistance payments, veterans benefits, unemployment insurance, child support and workers compensation payments. If the Department levies a bank account containing exempt funds, there is a procedure available for the owner of the account to claim an exemption from levy for the exempt funds. *See* C.P.L.R. §5222-a.

D. Bankruptcy Protections to Tax Debtors.

The issues involving the dischargeability of taxes in bankruptcy are extremely complex and beyond the scope of this report. The following is a brief overview of the provisions affecting tax discharges in bankruptcy.

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The one major area where the Bankruptcy Code (all references in this section are to the Bankruptcy Code under Title 11 unless otherwise specified) provides some relief to taxpayers is to allow the discharge of older federal and state income tax liabilities that are based on actual return filings. The determination of whether an income tax may be dischargeable rests on the interplay between the priority provisions under section 507 and section 523(a)(1). All taxes enjoying priority under section 507(a)(8) are, by definition under section 523(a)(1)(A), non-dischargeable and will survive the bankruptcy. The income taxes enjoying priority are broken into three basic categories:

1) Those income taxes arising from a year for which a return was due within three years of the bankruptcy filing date plus extension, if any. For example, a bankruptcy filed on June 30, 2009 could discharge income tax debts from the 2005 tax year (or earlier tax year) since the return fell due on April 15, 2006 and the bankruptcy was not filed until after three years from the due date of the return.

2) Income taxes assessed within 240 days of the filing of the bankruptcy. This can occur where the tax is from an old year meeting the first test in paragraph 1 but that does not get assessed due to an audit or a protracted Tax Court proceeding. A recent assessment, within 240 days of the bankruptcy filing date, renders the tax for that assessment a priority liability and therefore not dischargeable.

3) Income taxes not assessed before the bankruptcy but still assessable after the bankruptcy is filed. This can occur, for example, where the taxpayer has run afoul of the 25% omission rule extending the normal three year rule under the Internal Revenue Code for issuing a statutory notice of deficiency. In such a case, the three year assessment rule is extended to six years. IRC §6501(e). The impact for

> bankruptcy purposes is that the Internal Revenue Service can assess in those circumstances and that assessment will enjoy priority rendering the tax non-dischargeable.

If the taxpayer does not run afoul of any of the three rules set forth above, the tax will not be entitled to priority and may, if other requirements are met, be dischargeable.

Other examples of priority taxes (and therefore non-dischargeable taxes) are taxes required to be collected or withheld and for which the debtor is liable in whatever capacity (trust fund payroll taxes and sales taxes) [section 507(a)(8)(C)]; certain employment taxes arising within three years, plus extensions, from which a return was last due (this covers recently incurred employer taxes such as FICA and Medicare) [section 507(a)(8)(D)]; and finally, penalties related to a claim of a kind specified in section 507(a)(8) and in compensation for actual pecuniary loss [section 507(a)(8)(G)] (this is to cover the trust fund recovery penalty under IRC §6672).

E. Taxpayer Relief Programs.

Taxpayers who have an outstanding tax liability do not always have the means to pay the liability in full or to discharge the full amount due in a single payment. In recognition that it is in the interests of both the tax authorities and the taxpayer to provide relief programs under which the taxpayer can reduce the amount due to an amount the taxpayer can actually afford to pay and/or the taxpayer can arrange to pay the liability over time, a number of taxpayer relief programs have been implemented over the years at both the federal and state level.

At the federal level, taxpayer relief programs include the Offer in Compromise ("OIC") program, and Installment Payment Agreements ("IPAs"). The federal IPA program is administered pursuant to guidelines intended to ensure that minimum living expenses are factored into IPAs and collection decisions. In addition, the federal tax system provides administrative appeal rights before collection action that allow taxpayers to contest the appropriateness of an IRS lien, levy or seizure before it occurs and a Taxpayer Advocate office to assist taxpayers in resolving problems with the IRS. IRC §7803(c)(2)(a).[17]

New York State similarly has OIC and IPA programs, and administrative appeal rights prior to assessment. However, these programs are much more limited than the federal programs. New York State has only recently established a Taxpayer Advocate office. On the other hand, New York State has offered tax amnesties and has recently created a voluntary disclosure and compliance program, which have not been offered at the federal level. In practice, the programs available at the state level offer much less potential relief to taxpayers

[17] The original Taxpayer Advocate program was created in 1996 under the Taxpayer Bill of Rights 2 (P.L. 104-168) to assure that individual taxpayers would have somewhere to turn when the system failed, someone who could step in and make sure that their problems were not lost or overlooked and someone who could assure that their rights were protected. In the 1998 IRS Restructuring Act, the Taxpayer Advocate office was elevated to enlarge the functions of the program and to submit reports directly to Congress. IRC §7803(c)(1).

than the federal programs. The differences between the state and federal programs are discussed in more detail in Sections III.E and III.F, below.

III. Analysis

A. Reasons for Tax Debtor Relief.

The conceptual basis underlying statutes of limitations was stated by the United States Supreme Court in Chase Securities Corp. v. Donaldson[18] to be as follows:

> "Statutes of limitations find their justification in necessity and convenience rather than logic. They represent expedients, rather than principles. They are practical and pragmatic devices to spare the courts from litigation of stale claims and the citizen from being put to his defense after memories have faded, witnesses have died or disappeared, and evidence has been lost. They are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable and unavoidable delay. They have come into the law not through the judicial process but through legislation. They represent a public policy about the privilege to litigate. Their shelter has never been regarded as what is called a "fundamental" right or what used to be called a "natural" right of the individual. He may, of course, have the protection of the policy while it exists, but the history of pleas of limitation shows them to be good only by legislative grace."

The grant of relief to tax debtors has always been a difficult topic. Relief always raises public policy issues, such as whether relief on tax debts will undermine tax compliance.

Part of the difficulty in effecting reform in this area is the general perception that tax debts should be strictly enforced and tax debtors are not deserving of relief. Comments included in the 1990 Congressional Record when the IRS collection statute was increased from six years to ten-years are representative of this perception. *See* 136 Cong. Rec. 30665 (1990). Senator Lieberman, co-sponsor of the Senate amendment to IRC §6502, stated as follows:

> "[I]t would give the agency [IRS] more time to go after *tax cheats* whose debt to the Government would otherwise become uncollectible."
>
> (emphasis added.)

Senator Glenn, the other co-sponsor of the amendment, made this observation about the change:

[18] 325 U.S. 304 (1945)

> "It gains revenue. At the same time, it gets the *tax deadbeats, scofflaws and chiselers* who already owe taxes and do not pay them."
>
> (emphasis added)

While such characterizations are certainly an accurate description of many tax debtors who flout compliance with tax filings and tax payments, such invective fails to take into account the vast majority of more typical tax debtors who, as the result of an unexpected tax deficiency adjustment, loss of a job, failure of a business, sickness or other personal/ financial crisis could not timely file or timely pay the taxes owed. The circumstances that give rise to an unpaid tax debt are as varied as those giving rise to any other form of debt. To brand all tax debtors as "cheats", "deadbeats", "scofflaws" and "chiselers", thereby implying that tax debtors are undeserving of any debt relief, does a tremendous disservice to the taxpayers who owe tax, but cannot pay for reasons unrelated to moral turpitude, character flaws or poor citizenship. Many tax debtors do not dispute the underlying tax liabilities, which may indeed be based on timely filed returns.

For tax practitioners who practice in the "Collections" area, large tax debts are commonly observed when a taxpayer is forced to cash out all or a part of a pension plan after a job layoff in order to pay living expenses. If the taxpayer is under 59½ years old (which is often the case), there is an additional ten percent penalty to pay, which increases the tax substantially even if the worker has had full tax withholding on his or her wages. Another commonly observed reason is when a taxpayer has not timely filed a return and either the IRS or the Department has filed a "substitute-for return" for the taxpayer under IRC §6020(b) based on reported income or gain. In most such cases, the estimated tax liability substantially overstates the tax owed.

Often the tax debt reflects liabilities that should have been, but were not, protested within the relatively short time frame for appeal under federal and state tax laws. The failure of the taxpayer to appeal the assessment may have nothing to do with lack of merit of the claim, but rather to the taxpayer's inability to respond to what may be perceived as a complex, intimidating and legally challenging process at a time when the taxpayer is least able to deal with the problem. In many cases, the need to file a protest falls at the very time when the taxpayer is experiencing personal, financial or emotional problems that may have caused the late filing or payment. Often, in such a case, the tax issues do not get addressed until the taxpayer is forced to do so – generally after the IRS or the State begins forced collection action on the assessment.

This can have particularly serious consequences if the assessment involves a "trust fund" tax, such as employment taxes or sales taxes. As discussed earlier, to discourage lack of compliance in the collection and payment of these taxes, higher interest and penalty provisions are imposed and there are fewer opportunities for relief.

The IRS has endeavored to develop policies that treat the collection of tax debt in a business-like way while, at the same time, not undermining compliance. This is reflected in many programs, including the Offer in Compromise program, wherein a tax debtor can

resolve a tax debt for an amount less than full payment if it is in the interest of the IRS to compromise the liability. There has never been a general tax amnesty offered at the federal level, reputedly out of concern that such would have an adverse effect on tax compliance.

B. Collection Experience of the IRS.

The experience of the IRS is that any significant delay in collection on the tax reduces the likelihood of full collection of the liability. As noted in the 2007 National Taxpayer Advocate Annual Report to Congress, IRS data demonstrates that collection efforts for any tax debt owed for more than three years is not cost effective.[19]

This experience has long been the basis for the "five-year rule" used by the IRS to evaluate the "collection potential" of a file in the federal Offer in Compromise ("OIC") program. As expressed in a previous, more extensive version of the OIC guidelines, any payment agreement that requires more than five years to complete "has a high probability of not being completed." See OIC Guidelines at IRM 57(10)(13).(10) (9-22-94). For this reason the IRS evaluation of a taxpayer's future income "collection potential" approximates the discounted present value of a five year installment payment agreement.[20] Collection against income projected to be earned after five years is not taken into account in evaluating "collection potential" for OIC purposes even if the statute of limitations on collection extends beyond five years.

Until 1990, the collection limitations statute for federal tax debt was six years. The 1990 amendment to IRC §6502 to extend the statute of limitations on collection to ten-years was initiated in the Senate by Senators Glenn and Lieberman. *See* P.L. 101-508. It was believed at the time that the IRS did not request the additional collection years and did not view the lengthening of the collections statute as enhancing the overall collection potential of a file, especially after taking into account the added costs of administering the collection file for more years. Many at the IRS believed that the main effect of the change would be to artificially inflate "accounts receivable" that would never be collected.

Notably, there is no committee report or other legislative history showing support by the IRS or Treasury for the change. The congressional record relating to the Senate amendment shows it was offered by Senators Glenn and Lieberman on the assumption that it would allow the IRS greater opportunity for collections and thereby increase revenue. Both sponsors stated that the projected revenue to be gained from the change over the following five years ranged in estimate from $250 million (Joint Committee on Taxation) to $600

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[19] *See*, National Taxpayer Advocate Annual Report to Congress for 2007 at p. 20, citing in footnote 50 the data from IRS, Automated Collection System Operating Model Team, Collectibility Curve (Aug. 5, 2002), available at the IRS website at ftp.irs.gov/advocate/article/o,,id=177301,00.html.

[20] Under current OIC guidelines, the valuation has been simplified to the use of a 60 month multiplier of the monthly payment that would be required under an Installment Payment Agreement (*i.e.*, five years) unless the payment is a cash offer, in which case the multiplier is set at 48 months, thereby more closely approximating the former five year discounted present value rule. IRM 5.8.5.6 (09-23-2008).

million (Governmental Accountability Office). Senator Lieberman referred to an "unofficial estimate" by the IRS that the change would raise $500 million over five years.[21]

C. Collection Experience of New York State.

According to the New York Office of Operations Analysis in the Collection and Civil Enforcements Division of the New York State Department of Taxation and Finance, there is no hard data on the percentage return realized by the State on collections for older tax debt files. In addition, the publicly available "Statistical Report of New York State Tax Collections," published annually by the Office of Tax Policy Analysis, does not break out the collection data in a manner that reveals the State's experience in productivity of collections for older collection files. Notwithstanding this lack of comparative data, it is our understanding that the Department recognizes that its experience in collections for older files is similar to that of the IRS's in at least two respects: (a) the older the file, the less likelihood it will be collected and (b) the long collection statute artificially inflates accounts receivable on debts that are not likely to be collectible.

The Department's experience in diminished collection potential for older files is also evident in other ways: for example, the State has a stated policy of not seeking to refile a tax warrant to extend the ten-year period of a lien against real property unless special circumstances justify the filing. *See* October 23, 2001 Counsel's Memorandum. Another example is reflected in the results of a collaborative effort in 1999 between the Tax Section and representatives of the Department's Offer in Compromise Unit whereby a past practice in the Offer program was modified to reduce the valuation of a wage garnishment from a maximum of twenty years to a maximum of ten years regardless of the number of years remaining for enforcement of the tax warrant.

While publicly available data on collection files is extremely limited, it is our understanding that the Department maintains different classifications of collection files depending on the age of the file. The "active inventory" consists primarily of collection files for tax debts within one to three years of assessment. This is consistent with the IRS experience for optimizing collections. The State's older collection files are placed in the "inactive inventory" category and are viewed as having a low likelihood of collection, thereby not warranting high cost collection efforts unless special circumstances exist. (Low cost collection efforts on older files, such as collections on tax liens when a tax debtor's real property is sold or refinanced, however, are generally regarded as very productive and cost effective for the state.) An older collection file may be moved from "inactive inventory" status to "active inventory" status if the States identifies a bank account, income or other asset of the tax debtor that had not been previously available for collection.[22] This can give rise to a tax collection against the tax debtor many years after assessment. The overall effect of the

[21] See 136 Cong. Rec. 30665 (1990). At the time of the change, there was a "pay as you go" limitation on new federal laws that required that the net effect be revenue neutral. The fact that this change could be scored as a "revenue raiser" without "raising taxes" was stated by Senator Glenn as an important feature of the change.
[22] Section 1701 of the Tax Law has provided the State with an important new tool in identifying assets of tax debtors. All financial institutions within New York are now required to file a quarterly report identifying accounts held by tax debtors listed in a State distributed data base against whom a tax warrant has been filed.

State's practices is that it maintains a large inventory of mostly uncollectible collection files, incurring a low per-file cost but potentially a significant aggregate cost, while actually seeking to collect large amounts from a relatively limited number of taxpayers on an essentially random basis.

D. Impact on Tax Debtors from Collections on Old Assessments.

Collections by the Department on very old files occur with considerable frequency. It is not unusual for the State to proceed with collection action many years or decades after the liability arose, generally by means that do not cost it much money (e.g., bank levies, wage garnishments). In a September 19, 2008 letter to the New York State Legislature submitted by The Legal Aid Society, Harlem Community Law Office, and The Cardozo School of Law Tax Clinic,[23] a plea was made for the legislature to shorten the statute of limitations for New York income tax collections to the ten-year period allowed for collection of federal taxes. The letter states:

> "Low income taxpayers with few assets are regularly being pursued by the Department for tax debts that were assessed over twenty years earlier. These unpaid debts, while once relatively small, have grown enormous through the accretion of interest and penalties."

Examples given in this letter include (1) a senior citizen against whom the Department was still seeking to collect a 1969 tax liability; (2) a self-employed auto mechanic in his 50's earning less than $10,000 a year against whom the Department was seeking to collect over $200,000 in gasoline sales taxes from a few quarters in 1982 when he co-owned a failing gas station (the Department had rejected his offer in compromise); (3) an elderly widow living mostly on Social Security against whom the Department was seeking to collect over $80,000 in joint income taxes from the early 1980's about which she knew nothing, and (4) a blind former newspaper-stand vendor against whom the Department was trying to collect tens of thousands of dollars of sales, tax, interest and penalties estimated to be due because she failed to file her last quarterly return when closing the stand in 1986.

Other examples provided by practitioners for preparation of this report include: (1) an eighty year old medically disabled veteran, who had income tax liabilities dating back to the 1960's. The taxpayer claimed that he heard essentially nothing from the Department for decades until 2005 when it seized his entire savings of $50,000 from a bank account. During that time period, the liability had grown from approximately $15,000 in tax to over $200,000 after accrual of penalties and interest. The Department is still trying to collect against him. Since his only income now is social security and veterans benefits, he is now essentially judgment proof. There is no evidence of any notices or mailing records to the taxpayer in the 40 years between assessment and collection; and (2) two brothers who owned an auto repair shop together back in the early 1980's. Both are now middle-class, blue collar workers "trying to scrape by a living." The Department alleged they owed sales taxes going back to

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[23] A copy of the letter is attached to this report as Appendix II.

the early 1980's. The liabilities were estimated and inaccurate. The brothers were assessed as "responsible officers." The liability had grown to over $5 million with penalties and interest. The Department had garnished wages of one brother for about a decade. It seized bank accounts from the other brother. Finally, the brothers challenged the "assessments" and they were cancelled in their entirety because the State could not prove it had a valid assessment.

As evident from the above examples, the delay in Department enforcement (and the fact that the Department does not always provide periodic reminders to taxpayers that the tax is due and owing) often means that the taxpayer forgets about the liability or falsely concludes that the tax is no longer due or enforceable. For old liabilities, the taxpayer will rarely have retained any documentation regarding the tax period. When collection enforcement proceeds many years or decades after the assessment, records that could have been used by the taxpayer to defend against the liability may no longer be available or have been discarded by reason of the passage of time.

Taxpayer procedural challenges to a late-asserted collection on the tax are extremely limited and rarely successful. The case of Matter of Castellana v. New York State Dept. of Tax. & Fin., 239 A.D.2d 749 (Third Dept. 1997) is typical. In that case, the taxpayers neglected to report changes to their 1959, 1960 and 1961 federal income taxes to the Department. In 1969, the Department assessed against the taxpayers additional New York income taxes based on the federal changes. In 1970, the Department filed tax warrants in Kings County. In later years, the Department also filed warrants in other counties. Between 1971 and 1991, the Department engaged in nine income executions under the C.P.L.R. Between 1972 and 1995, it also obtained a number of partial payments. When the Department levied on one of the taxpayers' bank accounts in 1994, however, the taxpayers brought suit to annul the seizure, arguing laches and the expiration of the statute of limitations. The Third Department Appellate Division, upheld the Department's 1994 levy as timely with respect to the 1969 assessments. Here, there was a 25-year gap between the assessments and the levy at issue and a 35-year gap between the tax year at issue and the levy at issue.

Successful taxpayer challenges to a levy are generally available only to those who can afford the most sophisticated of tax advisors. Because such challenges generally involve judicial proceedings, they can be very costly to the taxpayer without any assurance of success. Most taxpayers feel powerless to challenge a State levy, especially if a bank account has been taken and there are no longer any cash resources available to pay the costs of a challenge to the collection action. An example of a successful challenge was provided by a tax practitioner for inclusion in this report: The case involved a firefighter, dying of a heart condition, who owned a pizza parlor in the late 1970's. He was assessed for unpaid sales tax as a "responsible person." However, the State didn't contact him about the alleged liability until the late 1990's. The Department began garnishing his wages. The taxpayer brought a legal challenge and got the liabilities cancelled because the State could not prove it had a valid assessment.[24]

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[24] Without records, the legal challenge may go before the Division of Tax Appeals in a proceeding which requires the Department to provide proof that it has a valid assessment against the taxpayer and, therefore, jurisdiction to proceed with collection activity. If the case is so old that the Department no longer has these

E. Lack of New York Alternatives to Resolve Overwhelming Tax Debt.

Although there are greater restrictions on the State's ability to collect against assets and income of a tax debtor for the payment of state taxes, as compared to the IRS in federal tax collections,[25] the opportunities for taxpayers to obtain relief from overwhelming tax liabilities are also more limited at the state level than at the federal level. As a result, a taxpayer may give up hope of being able to resolve its tax debt in a legal and affordable way. The insoluble state tax debt often forces taxpayers to find ways to evade collection. Many taxpayers enter the underground economy by working off the books to avoid garnishment or levy. Many make themselves collection-proof by not owning assets or not carrying bank accounts. Many simply leave New York, severing all financial ties, as a means of avoiding the debt. While many other taxpayers resign themselves to paying off their tax debt over an extended, perhaps lifelong, period of time, it is the experience of the tax practitioners who contributed to this report that evasive tactics of the kind described above are sufficiently common as to be highly troubling as a matter of principle, since a tax system should be designed to promote compliance rather than be perceived as so unfair and so onerous that taxpayers opt out of the system.

There are many differences in the programs, policies and approaches for dealing with taxpayer debt at the federal and state levels. Here are some aspects of the state laws and procedures that hamper successful resolution of tax debt:

- Administrative Appeals. As discussed above, the opportunity for a taxpayer to resolve disputes in assessment and collection are significantly greater at the federal level than at the state level. The Appeals office of the IRS provides for an independent review within the IRS of a broad spectrum of IRS assessment and collection actions. A taxpayer may request an Appeals conference (1) to review a proposed tax deficiency assessment, (2) to review a proposed assessment of employment taxes, (3) to seek relief from federal tax lien and levy actions under the Collection Due Process appeal procedure (IRC §6320(b)); (4) to forestall levies or seizure of assets, or to appeal the denial or termination of an installment payment agreement under the Collection Appeals Program (IRC §7123(a); IRM 8.7.2.2.1 (1-1-06); and (5) to appeal the denial

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records (or if the records never existed in the first place), it will likely fail to meet its burden of proof and the case may be dismissed. However, an administrative proceeding of this sort may not be effective if there is pending collection action against the taxpayer (*e.g.,* a pending seizure of assets) because the Division of Tax Appeals does not have the authority to restrain a pending levy or garnishment. Taxpayers may choose, therefore, to file an action in New York State Supreme Court where they can request a temporary restraining order ("TRO") and preliminary injunction staying the execution of the levy, garnishment, etc. However, TROs are difficult to obtain against the State. Additionally, state court actions are much more complex and costly due to the Department's likely response of filing motions to dismiss such actions on procedural grounds. This added layer of litigation discourages many taxpayers from seeking judicial relief, leaving them with little recourse even in the event of an unlawful or unwarranted seizure.

[25] The differences between the assets and income available for State and federal tax collections are described in Section II.C, above.

of an Offer in Compromise (IRC §7122(e)(1)). IRS Appeals officers have considerable discretion and broad powers of settlement.

In contrast, conciliation conferees in the State Bureau of Conciliation and Mediation Services may encourage and facilitate settlement of a disputed assessment between the taxpayer and the Department, but do not have the level of discretion or authority to resolve a dispute in the manner available to an IRS Appeals officer. If the Department does not agree with the conferee's proposed resolution, the conferee has only the power to waive or modify penalties, interest and additions to tax. Tax Law §170(3-a)(c). The conferee does not have the power to cancel the underlying tax over the objection of the Department. Also, in contrast to an Appeals officer at the IRS, the conferee has no authority to evaluate and accept a negotiated settlement of the liability based on "hazards of litigation" or otherwise, since all offers in compromise must be forwarded either to the counsel for the Department (if based on doubt as to liability) or to the Director of the Tax Compliance Division (if based on doubt as to collectibility). 20 NYCRR §4000.4. Unlike the appeals structure at the IRS, the State Bureau of Conciliation and Mediation Services serves no function in the review of Department collection actions such as warrants, wage garnishments and asset seizures or in the review of denied Offers in Compromise.

- Offers in Compromise.[26] The New York State Offer in Compromise Program, as currently being administered under Tax Law §171-Fifteenth, often does not provide adequate relief for resolving overwhelming tax debts. This is the result of both administrative policy at the Department and underlying statutory differences between the New York Offer program and the more effective federal Offer in Compromise program. Shortcomings in the New York Offer program include:

  - *Doubt as to liability*. Tax debt cannot be compromised on the basis of "doubt as to liability" as under the federal OIC program. (This is a statutory restriction.) If a taxpayer fails to challenge his/her liability for an assessment within the relatively short time frame to assert such a challenge, there is no procedural avenue for review of the correctness of that assessment other than through a refund claim – which requires payment of the liability, inclusive of interest and penalty. For large liabilities, the refund claim procedure is rarely a practical option for securing a review. At the federal level, the "doubt as to liability" option for obtaining federal OIC relief has played an important role,

[26] The Tax Section has made a number of recommendations in the past for changes to the New York State OIC program. Attached to this report are our "Letter Re: Conformity of Federal, State and City Offers in Compromise Statutes" (Report No. 983, Nov. 29, 2000), and our earlier "Report on Proposed Regulations for New York State Offers in Compromise" (Report No. 913, Oct. 2, 1997). Sections III.B.3, III.B.4 and III.B.5 of the 1997 report are no longer relevant; Sections III.B.2(b) and III.B.6 remain relevant with modifications discussed in this report.

particularly in review of the Trust Fund Recovery Penalty imposed under IRC §6672 for those who are unable to afford an appeal to federal district court. Under the present New York State OIC statutory provisions, the only basis for granting relief in an Offer in Compromise is on the ground of "doubt as to collectibility."

- *Number of offers*. Unlike the federal OIC program where a taxpayer is not limited in the number of offers that can be made with respect to a liability, New York will not reconsider another offer on the same liability after an offer has been declined unless the taxpayer can show "a material change in circumstances" or a "meaningful increase in the offer." Given the many decades for collection on the liability, this is an inexplicable restriction in the program.[27]

- *Minimum offer*. The program requires taxpayers to make a minimum offer (this is also true of the federal program). The calculation of the appropriate "minimum offer" amount that will be accepted under the New York Offer program makes no allowance for the taxpayer's need to pay basic living expenses. This is mandated by the New York Offer in Compromise statute which requires that the minimum Offer amount must be "the amount, if any, recoverable through legal proceedings." In contrast, the federal OIC guidelines require an allowance for the costs of basic living expenses[28] in determining the collection potential of the file for future years. Unlike New York, the IRS will not proceed with forced collections against the taxpayer if the taxpayer can demonstrate that such actions would render the taxpayer unable to pay his or her basic living expenses.

- *Assets and income considered.* Tax Law §171-Fifteenth provides that the minimum offer may not be less than the amount that the State may legally collect. As administered by the Department, however, the minimum "offer" amount required in its OIC program often takes into account assets and income that are not subject to legal collection by the State, *e.g.,* pension assets. This policy has the effect of requiring taxpayers to make a higher offer than is required under the statute. The tax debtor is often attempting to resolve both federal and state tax debts, and must take such assets into account in making a federal offer. Current law does not permit the Department to take into account the fact that the taxpayer is also trying to resolve federal tax debts. As a result, the Department's policy of requiring that a minimum offer take

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[27] If, as is often the case, the taxpayer presents the initial offer *pro se*, the offer may not meet the statutory criteria for acceptance. However, a subsequent offer will not be reconsidered by the Offer Unit without demonstrating a "material change" or "meaningful increase" in the offer.

[28] National and regional guidelines are periodically updated in the Internal Revenue Manual and set limits on the amounts allowed.

into account assets that are not subject to legal collection by the State and that are needed by the taxpayer to resolve its federal tax debt often puts a New York Offer in Compromise out of reach, leaving the tax debtor with an insoluble New York State tax debt.

- *Guidelines*. The Department has never issued detailed guidelines for evaluating the adequacy of an offer. New York Publication 220, which is less than two pages long, provides little more than a summary of the Offer in Compromise program and a description of the forms to be submitted.[29] The regulations, at three pages, provide only somewhat more detail. *See* 20 NYCRR §5005.1. Detailed guidelines are important to ensure that the New York OIC program conforms to statutory requirements, is administered in a fair and uniform way and is readily accessible to taxpayers and tax practitioners. In contrast, the IRS has issued detailed guidelines to assist the taxpayer and the tax practitioner in determining the adequacy of an offer. *See,* IRM 57(10).

- *Appeals*. The Department has no formal procedure for a taxpayer to appeal the denial of an Offer in Compromise. At the federal level, a denial may be appealed to IRS Appeals for an independent evaluation.

Specifically noted in the September 2008 Legal Aid Society letter referred to earlier is that few low-income taxpayers are aware of the New York State Offer in Compromise program. And even for those who find out about the program, "the Department often refus[es] to accept offers for debts that will clearly never be paid." This point resonates with the experience of many of the tax practitioners who contributed to this report who have found working with the State Offer in Compromise program difficult.

Legislation has recently been proposed that would bring the New York State Offer in Compromise program statutory rules into closer harmony with the federal OIC rules.[30] We are very pleased to see the proposed legislation, and believe that it represents a substantial step in the right direction. However, the legislation has not yet been enacted. Moreover, even

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[29] The adequacy of an "Offer" is described in very general terms in Publication 220 as follows: "The department, after an evaluation, determines an amount that it realistically expects could be collected within a reasonable period of time from the taxpayer's assets. The amount acceptable in compromise cannot be less than what could be expected to be collected from the taxpayer over that period through legal proceedings, such as levies, income executions and seizures." Once a warrant is filed, the period for legal collections would extend over the full 20-year life of the collection statute, thus making the calculation of an adequate offer out of reach financially to most taxpayers. At one time, the value of an income execution was based on the maximum garnishment (i.e., 10%) times 240 months (i.e., twenty years). After collaboration with the Tax Section in 1999, the Department altered that position and agreed to limit the valuation of income to only ten years of garnishments. However, this policy has never been set forth in any public guidelines or in the regulations and could be changed at any time.

[30] 2009-2010 New York State Executive Budget, part L, submitted by the Governor on January 19, 2010. The proposed Budget and a Memorandum in Support are available through www.budget.state.ny.us. The proposed legislation appears to closely follow the recommendations that we made in our prior report and letter on the New York State Offer in Compromise program, cited in note 26, *supra*.

if it is enacted, the effect on New York State taxpayers will depend on the manner in which the Department administers the new provisions.

- Installment Payment Agreements under Tax Law §3010. The Department does not, in its installment payment agreements, make an allowance for the tax debtor to cover basic living expenses. The Department will proceed under its rights as a judgment creditor by levying against a tax debtor's assets or income within the allowable limits of the law even if such action would render the taxpayer unable to pay basic living expenses. The only protections to the tax debtor from excessive collections that would render him/her destitute are those imposed by federal and state law on all judgment creditors as discussed above. In contrast, the IRS makes an allowance for the taxpayer to reserve enough assets and income to cover basic living expenses in determining an appropriate level of payment on the tax debt under an Installment Payment Agreement.

- No Long-standing Taxpayer Advocate Program. In contrast to provisions under federal law, New York has only recently (Oct. 1, 2009) established a taxpayer rights advocate program to assist and intervene on behalf of taxpayers in disputes with the Department over tax liabilities or tax collections. At the federal level, the Taxpayer Advocate office has proved to be an important resource for taxpayer protection against inappropriate or unlawful IRS actions and a respected voice in evaluation of IRS programs and recommendations for reforms. The state taxpayer rights advocate program is too new to make any judgments as to how effective it will be. However, unlike the federal program, the state program exists entirely at the discretion of the Department and the state taxpayer rights advocate therefore will have only such powers as are administratively granted to him or her.

F. State Taxpayer Relief Programs.

The State has offered some taxpayer relief programs that have not been offered at the IRS for federal tax debt.

- Tax Amnesty. The State has offered four tax amnesty programs since 1985. The amnesties have basically been penalty abatement programs and have required full payment of all underlying tax and statutory interest within a relatively short time frame. None of the tax amnesties have extended to the potentially large employment tax liabilities imposed on "responsible officers" under Tax Law §685(g).[31] The amnesties have been initiated at the legislative level and appear to be primarily intended to raise revenue rather than to implement any tax policy of promoting compliance. The Department is reputed not to favor these amnesties even though the amnesties have the beneficial effect of closing out accounts that might otherwise have languished

[31] The explanation by the Department for this is that the entire liability is viewed as a "tax".

for years in uncollectible status. The federal government has never offered a general tax amnesty.

- Voluntary Disclosure and Compliance Program.[32] The Department has also developed and offered a recent program to promote compliance by offering abatement of civil and criminal penalties and immunity from criminal prosecution if a taxpayer comes forward and files unfiled tax returns with full payment of the tax and statutory interest. A condition of qualification for the "Voluntary Disclosure and Compliance Program" is that the taxpayer must initiate the filing and may not have been targeted for audit or received anything from the Department indicating that the liability is due. The intent is to bring into the State tax revenue that would possibly never be identified as owed. As a result, this program offers no relief to tax debtors who already have assessments against them.

G. Effect of Overwhelming and Insoluble Tax Debts on Tax Collection and Tax Compliance.

The common objective of most taxpayer relief programs at both the federal and state levels is to introduce best business practices in the collection of tax debts and to promote future tax compliance by providing tax debtors with a fresh start. As stated in the guidelines governing the federal Offer in Compromise program:

> "The Service, like any other business, will encounter situations where an account receivable cannot be collected in full or there is a dispute as to what is owed. It is an accepted business practice to resolve these collection and liability issues through a compromise. Additionally, the compromise process is available to provide delinquent taxpayers with a fresh start toward future compliance with the tax laws."
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> Internal Revenue Manual, IRM 57(10), Offers in Compromise

New York's long collection statute, when coupled with its more limited opportunities to grant taxpayer relief from overwhelming tax liabilities that can accrue over long collection periods, undermines effective tax collection for the State. It does so, in part, because the long collection statute removes incentive for the State to proceed promptly in its collections, thereby reducing the likelihood of a full collection of the liability in the immediate years after assessment. As a result, the long collection statute may have a counterproductive effect on tax collections in New York.

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[32] The IRS has also offered some voluntary disclosure and compliance programs, but only in narrowly targeted instances and only for a limited period of time. One recent example is the immunity from criminal prosecution offered by the IRS under a voluntary disclosure program to U.S. taxpayers who report previously unreported offshore accounts. U.S. customers of UBS (Switzerland) whose information was provided to the IRS by UBS are not eligible to take part in this program.

The long collection period also places administrative burdens on the State since the Department is required to carry an ever mounting inventory of old collection files that have little likelihood of being collected. The Department must also incur costs and devote scarce resources to administering old tax debt files that are not cost effective.

The problem for the Department in maintaining old collection files was mentioned in the October 23, 2001 Counsel's Memoranda cited earlier:

> "We do not see how inability to enforce particular assessments invalidates those assessments, justifying cancellation. We note that it might be useful to keep a tax liability history of unpaid assessed tax for a period of time for purposes of considering requests for installment payments, compromises and such.
>
> * * *
>
> Having given this legal answer, we note as a practical matter that there is no reason why a record of clearly unenforceable assessments has to be kept indefinitely as part of the Department's contemporaneous computerized tax records. It may be possible to purge the Department's electronic records of these assessments, keeping them on separate computer tape or paper records. In fact it might be possible, absent contrary directions or requirements of the Division of the Budget or the Comptroller, to discard entirely any record of these assessments.
>
> * * *
>
> We suggest you investigate whether there is any need, for accounting or auditing purposes, to permanently keep records of unenforceable and uncollectible assessments."

The long collection statute also undermines taxpayer compliance for tax debtors who face overwhelming and insoluble tax debt resulting from years of accrued interest and penalties. If the debt is too large and the collection measures too harsh, otherwise law-abiding taxpayers who would never have considered taking evasive steps or being noncompliant will be forced, through desperation, to find ways to avoid collection. With no effective means to resolve the tax debt, tax debtors quickly learn the limitations on New York's power to collect taxes and find ways to become collection-proof. As stated earlier, this might mean working "off the books", not owning assets, not maintaining bank accounts or changing banks frequently. The tax debtor may choose simply to move out of the State, severing all financial ties, as a means of avoiding the debt. While extraterritorial collections for New York have improved over the years, there is still enormous revenue loss by reason of tax debtor flight from the State. Any of these reactions by tax debtors results in losses to the State – not only in the potential for collection on the file, but also any future revenue from that person's earnings, investment and future tax compliance.

IV. Recommendations

We recommend that the New York State Tax Law and the New York State Civil Practice Law and Rules be amended to shorten the statute of limitations for collection of all New York State tax debts to conform to the provisions for tax collections on federal tax debt.

More specifically, for the collection of income taxes under Article 22:

i. Amend Tax Law §692(c) and (h) to provide for warrants to be issued up to ten years after assessment so as to match the federal ten-year collection statute.
ii. Amend C.P.L.R. §§211(b) and 212 to provide that, except as noted below in iii, if a money judgment arises from a filed tax warrant, the liability reflected in the warrant is conclusively presumed paid upon the expiration of the period in Tax Law §692(c) for issuing a warrant, and no subsequent acknowledgements or payments extend that period.
iii. Amend Tax Law §692(h) to extend the period during which the attorney general, at the instance of the Department, may bring an action in court to reduce a tax liability to judgment from the current six- year period to ten years.
iv. Amend C.P.L.R. §211(b) to make clear that a judgment obtained by such a suit (but not a mere warrant) could be enforced in the usual way for the usual twenty-year period under that statute. Like the federal government, however, the State should not routinely bring suit, but only do this in extraordinary cases.
v. Amend C.P.L.R. §5203 to provide that the tax lien arising from the filing of a tax warrant will terminate ten years after the date of assessment of each tax liability included in the judgment.

For the collection of sales and use taxes under Article 28:

i. Amend Tax Law §§1141(a) and (b) to conform the procedures for the filing of a sales tax warrant and collection to the procedures set forth in Tax Law §692.
ii. Amend Tax Law §1147(b) to be internally consistent with section 1141(b) and to clarify that the procedures for filing a warrant and collection on sales and use taxes are the same as set forth in Tax Law §692.

For the collection of corporation taxes under Article 27:

i. Amend subsections (c), (h) and (j) of Tax Law §1092 to clarify that the procedures for filing a warrant and collection on the tax are the same as set forth in Tax Law §692.

Benefits from change:

A. Provide closure to taxpayers with regard to enforcement of very old tax liabilities.
B. Eliminate the ambiguities regarding the collection period for enforcement of sales tax and corporation tax.
C. Establish a consistent rule for collections of all state taxes.
D. Provide an incentive to the Department to proceed with collection of tax liabilities within ten years of assessment, thereby maximizing collections and reducing the administrative burdens of carrying old, less cost-effective collection files.
E. Provide an incentive to the Department to improve the Offer in Compromise program to resolve tax liabilities that are unlikely ever to be paid in full.
F. Reduce the potential for building insoluble, overwhelming tax liabilities against taxpayers by reason of the accrual of interest and penalties over a long collection period.
G. Reduce incentives for tax debtors to avoid collection by leaving the state or entering the underground economy.

V. Possible Expansion of New York's Powers of Collections and State Taxpayer Relief Programs.

If, as recommended, the New York collection statute is reduced to ten years, the question inevitably arises as to whether the State should be given a greater ability to enforce collections by levy against income and property to offset any revenue loss from shortening the collections statute. Without New York data to determine how much revenue, if any, would be lost from shortening of the collections statute of limitations, however, it is not certain what the impact of a change to shorten the collections statute would be. Certainly, some revenue would be lost since there undisputedly are collections on files more than ten years old. However, after factoring in the offsetting revenue gains to the State from (a) improving collection practices, (b) eliminating costs in administering old, less productive collection files, and (c) stemming the revenue losses from tax debtors leaving the State, entering the underground economy or becoming tax non-compliant, it is not clear whether there would be a net loss from such a change or, if so, what its magnitude would be. We understand that the Department shares our concern regarding the negative impacts from the long collection statute and is currently studying the potential costs and benefits of shortening the statute of limitations.

Another factor that needs to be taken into consideration in determining the impact of shortening the collections statute of limitations is that the State is more restricted in its collection rights than the IRS. While the State can only garnish up to 10% of a tax debtor's gross wages, the IRS may garnish all of the wages over a prescribed exemption amount.[33]

[33] The exemption is the total of the taxpayer's standard deduction and personal exemptions divided by 52 for a weekly wage levy. IRC §6334(d).

The IRS also may reach assets and income that cannot be reached by the State, such as pension funds, 401-Ks, IRAs and social security payments. It is also much easier for a tax debtor to escape collection from the State simply by moving out of state. Escaping federal tax debt, even with a move to a foreign country, is not so simple.

While many constraints on tax collections by the Department derive from federal law limitations, the New York State legislature is free to expand the State's powers of collection on its tax debts in some areas. For example, the wage garnishment limits set forth in the federal "Consumer Protection Act" have an express exemption for a state's enforcement of collection of its tax debt. Accordingly, the New York legislature is free to increase the State's power to allow income executions against a tax debtor's wages of amounts higher than under the present limits (10% of gross wages). Similarly, the restrictions on a New York creditor's access to a debtor's IRA accounts derive from protections granted under state law and are not mandated by ERISA. Creditor access to these accounts could be selectively liberalized to allow the Department to have access to such accounts for the collection of State tax debts.

A related issue is whether New York state law should be amended to expand the scope of taxpayer relief programs for state tax liabilities. It is the experience of the tax practitioners who contributed to this report that the federal OIC and IPA programs generally are effective ways for the IRS to maximize its ability to collect taxes, while providing substantial relief for taxpayers whose tax debts are not collectible or are not collectible in full. Adopting programs with a similar effect in New York State could remove or at least alleviate the incentive for taxpayers to leave the New York state tax system by going underground or leaving the state.

In that regard, we have considered whether the systems now in place at the IRS (*e.g.,* financial guidelines governing Installment Payment Agreements and Offers in Compromise) could be incorporated into any C.P.L.R. change to enhance the Department's collection powers, thereby requiring the Department to give tax debtors an allowance for basic living expenses when approving Installment Payment Agreements and before pursuing forced collection action.[34] We have significant concerns as to whether the Department, as currently structured, could implement the guidelines with consistency and proper oversight.[35] In the past, the Department has resisted even a selective incorporation of the IRS guidelines, as evidenced by the New York State Offer in Compromise Program. Accordingly, any change to these programs should, in our view, be statutorily mandated and should provide a meaningful opportunity for taxpayers to contest the administration of a program if it is not carried out in a manner that is consistent with the legislature's intent.

More generally, we strongly believe that any changes to the Department's powers to collect taxes that would give it access to more of a taxpayer's assets and income must be coupled with changes to the state's taxpayer relief programs. Indeed, *unless restraints are*

[34] An incorporation of the IRS guidelines was made in the 2005 changes to the Bankruptcy Code in order to conform the calculation of allowable living expenses to the rules developed by the IRS. 11 U.S.C. §707(b)(2)(A)(ii).

[35] As discussed in Section II.B, above, the Department does not have the same appeal and review structure as the IRS.

built into the law to assure that the taxpayer is left with enough resources to pay basic living expenses, we would prefer the status quo rather than changes to the law that affect only the statute of limitations and the Department's collection powers. We believe other interested parties also would strongly oppose enhancing the Department's ability to collect against taxpayers unless there are also statutory changes mandating more effective taxpayer relief programs in order to provide safeguards against excessive and overly harsh collections that do not currently exist under the law or Department policy. While, as pointed out earlier, the State is more limited in its collection powers than the IRS, it is not unusual for the State to be in active collection of assets or income against a taxpayer at a time when the IRS has suspended collection action because of hardship. It is this history of harsh collection activity by the State that tempers any consideration of enhancement of its collection powers.

In view of the fact that there is currently no estimate for revenue loss if the statute of limitations were shortened, and in view of the fact that there may be different considerations relevant to administering state and federal tax law, this Report does not make any specific recommendations for enhancing the Department's collection powers or for modifying the state's taxpayer relief programs, other than to reiterate our long-standing recommendation that the state's OIC program be modified and to support the legislation that has been proposed as part of this year's Budget Bill to that effect. As noted above, it is, in our view, essential that any expansion of collection rights to the Department include added taxpayer protections to ensure that the aggregate impact of the changes do not impose even greater burdens on New York State tax debtors than exist under current law. This could include (i) amending the statutory provisions governing the IPA program to mandate guidelines similar to the IRS guidelines in order to ensure that tax debtors are given an allowance for basic living expenses (this could be done by setting out specific guidelines or by incorporating the IRS guidelines by reference to allow flexibility for future developments) and (ii) providing by statute for a state Taxpayer Advocate office modeled on the federal program that assists taxpayers in resolving IRS problems. In order to ensure that any such programs are administered in a manner consistent with legislative intent, it is also essential to provide effective appeal rights to taxpayers, particularly given the experience to date with the manner in which the Department administers the OIC program.

We do not wish to speculate on what, if any, increases in collections rights would be sought by the Department. While the Department has long reputedly chafed under the wage garnishment restrictions of the C.P.L.R., it is not clear that it would seek an increase in its rights to garnish at a higher level from lower income taxpayers should the collections statute be shortened. It is our understanding that the Department might instead prefer to see the law changed to provide for a graduated rate of garnishment that would allow a greater percentage of gross wages to be garnished from higher income taxpayers. We believe the most effective way to develop specific recommendations is for the Tax Section to consult with the Department after the Department has had an opportunity to consider these issues, which we would be pleased to do.

Appendix I

Recommended Statutory Changes to Tax Law and CPLR to Implement Proposed Changes to Statute of Limitations on Collection of Unpaid Tax Liabilities

SYNOPSIS: AN ACT to amend the tax law, in relation to conforming the statutes of limitations on collection of tax liabilities more nearly to those of the Internal Revenue Code.

NOTICE:
[A> UPPERCASE, BOLD TEXT WITHIN THESE SYMBOLS IS ADDED <A]
[D> Italicized Text within these symbols is deleted <D]

TEXT: THE PEOPLE OF THE STATE OF NEW YORK, REPRESENTED IN SENATE AND ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. Subsection (c) of section 692 of the tax law, as amended by chapter 577 of the laws of 1997, is amended to read as follows:

(c) Issuance of warrant after notice and demand.--If any person liable under this article for the payment of any tax, addition to tax, penalty or interest neglects or refuses to pay the same within twenty-one calendar days after notice and demand therefor is given to such person under subsection (b) of this section (ten business days if the amount for which such notice and demand is made equals or exceeds one hundred thousand dollars), the commissioner may within *[D> six <D]* **[A> TEN <A]** years after the date of such assessment issue a warrant under the commissioner's official seal directed to the sheriff of any county of the state, or to any officer or employee of the department, commanding him to levy upon and sell such person's real and personal property for the payment of the amount assessed, with the cost of executing the warrant and to return such warrant to the commissioner and pay to him or her the money collected by virtue thereof within sixty days after the receipt of the warrant. If the commissioner finds that the collection of the tax or other amount is in jeopardy, notice and demand for immediate payment of such tax may be made by the commissioner and upon failure or refusal to pay such tax or other amount the commissioner may issue a warrant without regard to the twenty-one day period (or ten-day period if applicable) provided in this subsection. **[A> A WARRANT ISSUED UNDER THIS ARTICLE OR ARTICLE 30 OF THE TAX LAW ON OR AFTER ____________ SHALL BE VALID ONLY IF IT PROMINENTLY STATES THAT IT IS ISSUED FOR A LIABILITY UNDER EITHER OR BOTH OF SUCH ARTICLES AND, WITH RESPECT TO EACH ASSESSMENT THAT IS INCLUDED IN THE WARRANT, PROVIDES THE ASSESSMENT NUMBER ASSIGNED BY THE COMMISSIONER TO THE ASSESSMENT, THE TAXABLE YEAR TO WHICH THE ASSESSMENT RELATES, THE DATE OF THE ASSESSMENT, AND THE UNPAID BALANCE OF THE ASSESSMENT. <A]**

Section 2. Subsection (h) of section 692 of the tax law is amended to read as follows:

(h) Action by state for recovery of taxes.--Action may be brought by the attorney general at the instance of the *[D> tax commission <D]* **[A> COMMISSIONER <A]** in the name of the state to recover the amount of any unpaid taxes, additions to tax, penalties or interest which have been assessed under this article within *[D> six <D]* **[A> TEN <A]** years prior to the date the action is commenced.

Section 3. Subsection (a) of section 1141 of the tax law, as amended by chapter 577 of the laws of 1997, is amended to read as follows:

(a) Whenever any person required to collect tax shall fail to collect or pay over any tax, penalty or interest imposed by this article as therein provided, or whenever any customer shall fail to pay any such tax, penalty or interest, the attorney general shall, upon the request of the *[D> tax commission <D]* **[A> COMMISSIONER <A],** bring or cause to be brought an action to enforce the payment of the same on behalf of the state of New York in any court of the state of New York or of any other state or of the United States **[A>, EXCEPT THAT ANY SUCH ACTION MAY BE BROUGHT BY THE ATTORNEY GENERAL ONLY WITH RESPECT TO TAX, PENALTIES OR INTEREST WHICH HAVE BEEN ASSESSED UNDER THIS ARTICLE WITHIN 10 YEARS PRIOR TO THE DATE THE ACTION IS COMMENCED <A].**

Section 4. Subsection (b) of section 1141 of the tax law, as amended by chapter 85 of the laws of 1985, is amended to read as follows:

(b) As an additional or alternate remedy, the *[D> tax commission <D]* **[A> COMMISSIONER <A]**, may **[A> WITHIN 10 YEARS OF THE DATE OF ASSESSMENT OF SUCH TAX <A]** issue a warrant, directed to the sheriff of any county commanding him to levy upon and sell the real and personal property of any person liable for the tax, which may be found within his county, for the payment of the amount thereof, with any penalties and interest, and the cost of executing the warrant, and to return such warrant to the *[D> tax commission <D]* **[A> COMMISSIONER <A]**, and to pay it the money collected by virtue thereof within sixty days after the receipt of such warrant. The sheriff shall within five days after the receipt of the warrant file with the county clerk a copy thereof, and thereupon such clerk shall enter in the judgment docket the name of the person mentioned in the warrant and the amount of the tax, penalties and interest for which the warrant is issued and the date when such copy is filed. Thereupon the amount of such warrant so docketed shall become a lien upon the title to and interest in real and personal property of the person against whom the warrant is issued. Such lien shall not apply to personal property unless such warrant is filed in the department of state. The sheriff shall then proceed upon the warrant, in the same manner, and with like effect, as that provided by law in respect to executions issued against property upon judgments of a court of record and for services in executing the warrant he shall be entitled to the same fees, which he may collect in the same manner. In the discretion of the *[D> tax commission <D]* **[A> COMMISSIONER <A]**, a warrant of like terms, force and effect may be issued and directed to any officer or employee of the department of taxation and finance, and in the execution thereof such officer or employee shall have all the powers conferred by law upon sheriffs, but shall be entitled to no fee or compensation in excess of the actual expenses paid in the performance of such duty. Upon such filing of a copy of a warrant, the *[D> tax commission <D]* **[A> COMMISSIONER <A]**, shall have the same remedies to enforce the amount due thereunder as if the state had recovered judgment therefor. **[A> A WARRANT ISSUED UNDER THIS ARTICLE OR SUBPART B OF PART I OF ARTICLE 29 OF THE TAX LAW ON OR AFTER ____________ SHALL BE VALID ONLY IF IT PROMINENTLY STATES THAT IT IS ISSUED FOR A LIABILITY UNDER EITHER OR BOTH OF SUCH ARTICLES AND, WITH RESPECT TO EACH ASSESSMENT THAT IS INCLUDED IN THE WARRANT, PROVIDES THE ASSESSMENT NUMBER ASSIGNED BY THE COMMISSIONER TO THE ASSESSMENT, THE TAXABLE PERIOD TO WHICH THE ASSESSMENT RELATES, THE DATE OF THE ASSESSMENT, AND THE UNPAID BALANCE OF THE ASSESSMENT. <A]**

Section 5. Subsection (b) of section 1147 of the tax law, as amended by chapter 412 of the laws of 1986, is amended to read as follows:

(b) *[D> The provisions of the civil practice law and rules or any other law relative to limitations of time for the enforcement of a civil remedy shall not apply to any proceeding or action taken by the state or the tax commission to levy, appraise, assess, determine or enforce the collection of any tax or penalty provided by this article. However, except <D]* **[A> EXCEPT <A]** in the case of a willfully false or fraudulent return with intent to evade the tax no assessment of additional tax shall be made after the expiration of more than three years from the date of the filing of a return; provided, however, that where no return has been filed as provided by law, the tax may be assessed at any time. Where a purchaser furnishes a vendor with a false or fraudulent certificate of resale or other exemption certificate or other document with intent to evade the tax, the tax may be assessed against such purchaser at any time. For purposes of this subdivision, a return filed before the last day prescribed by law or regulation for the filing thereof or before the last day of any extension of time for the filing thereof shall be deemed to be filed on such last day. Notwithstanding any other provision of this article, if the time to assess additional tax would otherwise have expired on or before December nineteenth, nineteen hundred sixty-nine, the time to assess such additional tax is hereby extended to and including December twentieth, nineteen hundred sixty-nine, except that it may be further extended by a taxpayer's consent in writing as provided in subdivision (c) hereof.

Section 6. Subsection (c) of section 1092 of the tax law, as amended by chapter 577 of the laws of 1997, is amended to read as follows:

(c) Issuance of warrant after notice and demand.--If any corporation or other person liable under articles nine or nine-a for the payment of any tax, addition to tax, penalty or interest neglects or refuses to pay the same within twenty-one calendar days after notice and demand therefor is given to such corporation or other person under subsection (b) of this section (ten business days if the amount for which such notice and demand is made equals or exceeds one hundred thousand dollars), the commissioner may within *[D> six <D]* **[A> TEN <A]** years after the date of such assessment issue a warrant under the commissioner's official seal directed to the sheriff of any county of the state, or to any officer or employee of the department, commanding him to levy upon and sell the real and personal property of such corporation or other person for the payment of the amount assessed, with the cost of executing the warrant, and to return such warrant to the commissioner and pay to him or her the money collected by virtue thereof within sixty days after the receipt of the warrant. If the commissioner finds that the collection of the tax or other amount is in jeopardy, notice and demand for immediate payment of such tax may be made by the commissioner and upon failure or refusal to pay such tax or other amount the commissioner may issue a warrant without regard to the twenty-one day period (or ten-day period if applicable) provided in this subsection. For purposes of this subsection, the term corporation shall include an exempt QSSS of such corporation. **[A> A WARRANT ISSUED UNDER THIS ARTICLE OR ARTICLES 9, 9-a, OR 9-b OF THE TAX LAW ON OR AFTER ___________ SHALL BE VALID ONLY IF IT PROMINENTLY STATES THAT IT IS ISSUED FOR A LIABILITY UNDER ONE OR MORE OF SUCH ARTICLES AND, WITH RESPECT TO EACH ASSESSMENT THAT IS INCLUDED IN THE WARRANT, PROVIDES THE ASSESSMENT NUMBER ASSIGNED BY THE COMMISSIONER TO THE ASSESSMENT, THE TAXABLE YEAR TO WHICH THE ASSESSMENT RELATES, THE DATE OF THE ASSESSMENT, AND THE UNPAID BALANCE OF THE ASSESSMENT. <A]**

Section 7. Subsection (h) of section 1092 of the tax law, as amended by chapter 577 of the laws of 1997, is amended to read as follows:

(h) Action by state for recovery of taxes.--Action may be brought by the attorney general at the instance of the *[D> tax commission <D]* **[A> COMMISSIONER <A]**in the name of the state to recover the amount of any unpaid taxes, additions to tax, penalties or interest which have been assessed under this article or under article nine, nine-a, nine-b or nine-c within *[D>six <D]* **[A> TEN <A]** years prior to the date the action is commenced.

Section 8. Subparagraph (3) of subsection (j) of section 1092 of the tax law, as amended by chapter 558 of the laws of 1983, is amended to read as follows

(3) All taxes, additions to tax, penalties and interest which have become a lien under this subsection shall cease to be a lien after the expiration of *[D> twenty <D]* **[A> TEN <A]** years from date they become due and payable *[D>, except that taxes, additions to tax, penalties and interest which have become a lien under this subsection (i) as to real estate in the hands of persons who are owners thereof who would be purchasers in good faith but for such taxes, additions to tax, penalties or interest and (ii) as to the lien on real estate of mortgages held by persons who would be holders thereof in good faith but for such taxes, additions to tax, penalties or interest, as against such purchasers or holders shall cease to be a lien after the expiration of ten years from date they become due and payable<D]* . The limitations herein provided for shall not apply to any transfer from a corporation to a person or corporation with intent to avoid payment of any taxes, or where with like intent the transfer is made to a grantee corporation, or any subsequent grantee corporation, controlled by such grantor or which has any community of interest with it, either through stock ownership or otherwise.

Section 9. Subsection (b) of section 211 of the civil practice law and rules is amended to read as follows:

(b) On a money judgment. A money judgment is presumed to be paid and satisfied after the expiration of twenty years from the time when the party recovering it was first entitled to enforce it. This presumption is conclusive, except as against a person who within the twenty years acknowledges an indebtedness, or makes a payment, of all or part of the amount recovered by the judgment, or his heir or personal representative, or a person whom he otherwise represents. Such an acknowledgment must be in writing and signed by the person to be charged. Property acquired by an enforcement order or by levy upon an execution is a payment, unless the person to be charged shows that it did not include property claimed by him. If such an acknowledgment or payment is made, the judgment is conclusively presumed to be paid and satisfied as against any person after the expiration of twenty years after the last acknowledgment or payment made by him. **[A> EXCEPT WITH RESPECT TO A JUDGMENT DERIVED FROM AN ACTION BROUGHT BY THE ATTORNEY GENERAL UNDER SUBSECTION (H) OF SECTION 692 OF THE TAX LAW, SUBSECTION (H) OF SECTION 1092 OF THE TAX LAW, OR SUBSECTION (A) OF SECTION 1141 OF THE TAX LAW, IF A MONEY JUDGMENT ARISES FROM A TAX WARRANT ISSUED WITH RESPECT TO LIABILITIES ARISING UNDER ARTICLES 9, 9-a, 9-b, 22, , 27, 28, OR 30 OR SUBPART B OF PART I OF ARTICLE 29 OF THE TAX LAW, THEN THE FOREGOING SENTENCES OF THIS SUBDIVISION SHALL NOT APPLY AND SECTION 212(e) OF THIS CHAPTER SHALL APPLY. <A]** The presumption created by this subdivision may be availed of under an allegation that the action was not commenced within the time limited.

Section 10. Section 212 of the civil practice law and rules is amended by adding a new subsection (e) to read as follows:

[A> (**e) ON A MONEY JUDGMENT ARISING FROM A TAX WARRANT. EXCEPT WITH RESPECT TO A JUDGMENT DERIVED FROM AN ACTION BROUGHT BY THE ATTORNEY GENERAL UNDER SUBSECTION (H) OF SECTION 692 OF THE TAX LAW, SUBSECTION (H) OF SECTION 1092 OF THE TAX LAW OR SUBSECTION (A) OF SECTION 1141 OF THE TAX LAW, IF A MONEY JUDGMENT ARISES FROM A TAX WARRANT ISSUED WITH RESPECT TO LIABILITIES ARISING UNDER ARTICLES 9, 9-a, 9-b, 22, , 27, 28 OR 30 OR SUBPART B OF PART I OF ARTICLE 29 OF THE TAX LAW, THEN THE PORTION OF THE JUDGMENT RELATING TO EACH LIABILITY THAT IS INCLUDED IN THE JUDGMENT IS CONCLUSIVELY PRESUMED PAID AND SATISFIED UPON THE EXPIRATION OF TEN YEARS FROM THE DATE OF ASSESSMENT OF SUCH LIABILITY, AND NO ACKNOWLEDGEMENT OR PAYMENT WITHIN SUCH PERIOD SHALL REBUT SUCH CONCLUSIVE PRESUMPTION. <A]**

Section 11. Section 5203 of the civil practice law and rules is amended by adding a new subsection (c) to read as follows:

(c) **[A> (C) NOTWITHSTANDING SUBSECTION (A) OF THIS SECTION, EXCEPT WITH RESPECT TO A JUDGMENT DERIVED FROM AN ACTION BROUGHT BY THE ATTORNEY GENERAL UNDER SUBSECTION (H) OF SECTION 692 OF THE TAX LAW, SUBSECTION (H) OF SECTION 1092 OF THE TAX LAW, OR SUBSECTION (A) OF SECTION 1141 OF THE TAX LAW, ANY LIEN WITH RESPECT TO LIABILITIES ARISING UNDER ARTICLES 9, 9-a, 9-b, 22, 27, 28, OR 30 OR SUBPART B OF PART I OF ARTICLE 29 OF THE TAX LAW SHALL, WITH RESPECT TO EACH LIABILITY SET FORTH IN SUCH JUDGMENT, TERMINATE TEN YEARS AFTER THE DATE OF ASSESSMENT OF EACH SUCH LIABILITY INCLUDED IN THE JUDGMENT. THIS PROVISION SHALL NOT APPLY TO A MONEY JUDGMENT ARISING FROM A WARRANT ISSUED ON OR BEFORE ____________. <A]**

Section 12. This act shall take effect immediately and shall apply to any liability assessed under articles 9, 9-a, 9-b, 22, 27, 28, or 30 or subpart B of part I of article 29 of the tax law that is unpaid as of the date of enactment.

Appendix II

Sept. 19, 2008 Letter from Legal Aid Society and Others

The Legal Aid Society - **Harlem Community Law Office**
230 East 106th Street New York, NY 10029 Tel: (212) 426-3000 Fax: (212) 876-5365 www.legal-aid.org

Theodore A. Levine
President

Steven Banks
Attorney–in-Chief

Adriene L. Holder
Attorney-in-Charge
Civil Practice

Elizabeth Hay
Attorney-in-Charge
Harlem Community Law Office

September 19, 2008

Hon. Owen H. Johnson
Chair, NYS Senate Finance Committee
Room 913, Legislative Office Bldg.
Albany, NY 12247

Hon. Herman D. Farrell, Jr.
Chair, NYS Assembly Ways & Means Committee
Room 923, Legislative Office Bldg.
Albany, NY 12248

Dear Senator Johnson and Assemblyman Farrell:

We are advocates who assist low income taxpayers throughout New York City in disputes with the Internal Revenue Service and the New York State Department of Taxation and Finance. In our practice, we see many taxpayers who are burdened by tax debt. A significant obstacle to helping low-income taxpayers resolve such problems is what is essentially an unlimited statute of limitations on collection of New York State tax debts. We are writing to request you to consider the impact this has on low income New Yorkers, and the need for reform of the tax law to address the problem.

Low-income taxpayers with few assets are regularly being pursued by the Department for tax debts that were assessed over 20 years earlier. These unpaid debts, while once relatively small, have grown enormous through the accretion of interest and penalties. These taxpayers did not have sufficient funds to take advantage of prior amnesties to pay off these debts. Some are being pursued for debts near or far above $100,000. In the past three years, one of us alone has been contacted by (1) a senior citizen against whom the Department was still seeking to collect 1969 taxes, (2) a small-time actor against whom the Department was still seeking to collect 1978 income taxes (he decided to file for bankruptcy), (3) a self-employed auto mechanic in his 50s earning less than $10,000 a year against whom the Department was seeking to collect over $200,000 in gasoline sales taxes from a few quarters in 1982 when he co-owned a failing gas station (the Department rejected his nominal offer in compromise), (4) an elderly widow living mostly on Social Security against whom the Department was seeking to collect over $80,000 in joint income taxes from the early 1980s about which she knew nothing (the Department accepted a nominal offer in compromise), and (5) a blind former newspaper-stand vendor against whom the Department was trying to collect tens of thousands of dollars of sales tax, interest, and penalties estimated to be due because she failed to file her last quarterly return when closing the stand in 1986 (the Department accepted a nominal offer in compromise).

Unfortunately, most low-income taxpayers do not contact tax clinics for assistance. Few low-income taxpayers are aware of the offer in compromise program. Even those who are find the Department often refusing to accept offers for debts that will clearly never be paid. Taxpayers often resort to closing their bank accounts to avoid Department levies and cashing their checks (even Social Security checks exempt from levy) at check cashing establishments. These taxpayers also often fail to file tax returns that would request refunds – even as to refundable credits to which they would be entitled, such as the New York City school tax credit or the earned income credit. After a few years of filing, they learn that any credits or overpayments are not sent to them, but are applied against the old tax debts. We suspect that some taxpayers are even being driven into the underground economy because of these very large old debts still subject to collection.

Our proposal to remedy this situation would be to make the New York collection system for the personal income tax more similar to the federal system. (Enclosed with this letter is a brief description of the current federal and State procedures.) This can easily be done first by amending Tax Law §692(c) to provide for warrants to be issued up to 10 years after assessment (to finally match the federal 10-year collection statute). Then, amend CPLR §211(b) to provide that, except as noted in the next paragraph, if a money judgment arises from a tax warrant filed with respect to an individual under Tax Law Article 22, the liability reflected in the warrant is conclusively presumed paid upon the expiration of the period in Tax Law §692(c) for issuing a warrant, and no subsequent acknowledgements or payments extend that period.

Tax Law §692(h) currently allows the attorney general, at the instance of the Department, to bring an action in court to reduce a personal income tax liability to judgment, but such action currently must be commenced within six years of assessment. This six-year period should also be changed to 10 years, and CPLR §211(b) should be amended to make clear that a judgment obtained by such a suit (but not a mere warrant) could be enforced in the usual way for the usual 20-year period under that statute. This again would conform to the federal practice in that it would make the Department focus as the 10-year collection statute expiration approached on whether there were sufficient still-uncollected assets to pursue. If the state wanted to pursue such assets, it could by bringing suit. Like the federal government, however, we assume that the state would not routinely bring suit, but only do this in extraordinary cases.

Although this proposal applies solely to collection of personal income tax, study should be given as to how and whether to afford similar relief to individuals regarding sales tax liabilities not collected within ten years of assessment. See Tax Law §§1141 and 1147(b).

Research data compiled by IRS suggests that maintaining collection efforts for very old tax debt is not cost effective. New York State is expending resources on maintaining large amounts of tax debt that it is unlikely to receive. The cost of our proposal in lost revenues, compared to the economic stimulus effect of relieving the debt burden to low income taxpayers, is likely to be minimal. Our proposal is not necessarily the only way to address the problem, or amend the

statute, and we would be happy to discuss other possible modifications to the existing law, including the possibility of holding hearings on the issue to invite wider input.

Sincerely,

Carlton Smith,
Clinical Associate Professor of Law
Director, Cardozo School of Law Tax Clinic

Elizabeth A. Hay, Attorney in Charge
Harlem Community Law Office
The Legal Aid Society
William Nelson, Interim Supervising Attorney, Low Income Taxpayer Clinic

Mae Watson Grote, Executive Director
The Financial Clinic

Elizabeth Maresca
Associate Clinical Professor of Law
Fordham University School of Law

cc: Robert L. Megna, Commissioner, NYS Dept. of Taxation & Finance
Jamie Woodward, Deputy Commissioner, NYS Dept. of Taxation & Finance
William J. Comiskey, Deputy Commissioner, NYS Dept. of Taxation & Finance
Robert D. Plattner, Deputy Commissioner, NYS Dept. of Taxation & Finance
Laura Anglin, Director, Division of the Budget
David S. Miller, Chair, Tax Section, NYS Bar Assn.

Federal Procedures

In order to understand the issue, one must first understand the federal tax collection system and federal statutes of limitations and remedies, on which the New York system is loosely based. The differences between enforcement mechanisms, however, trigger the "unlimited" New York collection statute problem.

In the federal area, once a tax is assessed, it may be collected for 10 years. IRC §6502(a). After assessment, the IRS sends a "notice and demand" (i.e, a bill) to the taxpayer for the assessed taxes, plus interest and penalties thereon. IRC §6303(a). If a taxpayer ignores the notice and demand, the amount billed becomes a lien in favor of the United States on all of the taxpayer's property and rights to property, whether real or personal. IRC §6321. The lien continues until the liability is satisfied or the collection statue of limitations expires. IRC §6322.

The federal lien can be enforced either by the government levying on the taxpayer's property (an administrative action that the IRS can perform on its own) or by its bringing suit in federal district court. The IRS almost always first chooses to use its administrative levy rights. Using a levy, the IRS can obtain the proceeds of bank accounts and garnish wages. IRC §6331(a), (b), (c), and (e). The only requirement before levying is that the IRS first issue to the taxpayer a notice of intention to levy 30 days in advance. IRC §6331(d). That notice also affords the taxpayer an opportunity to request a hearing at the IRS Appeals level to propose a collection alternative, such as an installment payment agreement, an offer in compromise, or being placed into currently not collectible status. IRC §6330. If a taxpayer does not request such a hearing at Appeals, the IRS can proceed to levy or garnish, and can do so repeatedly over the remainder of the 10-year collection statute of limitations.

On some occasions, the federal government brings suit in district court with respect to the tax debt. The government typically prefers to do so when it wants to foreclose on real property in payment of the tax debt. For example, the government may bring an action under IRC §7403 to enforce the lien or subject property to payment of tax. See, e.g, United States v. Rodgers, 461 U.S. 677 (1983) (foreclosure on real property). The federal government also sometimes brings suit simply to reduce a tax debt to a judgment. Judgments in either of such cases are enforceable like other federal judgments. A lien from the judgment lasts 20 years and can be renewed for another 20 years with court approval. 28 U.S.C. §§3002(3)(B) and (8) and 3201(c). If the government brings such a suit, the judgment is not merged into the lien provided under IRC §6321. United States v. Hodes, 355 F.2d 746 (2d Cir. 1966). Further, IRC §6502(a) provides that if a timely proceeding in court is commenced within the 10-year collection period provided therein, "the period during which such tax may be collected by levy [under IRC §6331(a)] shall be extended and shall not expire until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable."

Bringing suit to reduce the tax debt to judgment can be used to extend the normal 10-year period in which to collect tax. However, because the federal government must affirmatively bring suit

to obtain this extension, it very rarely does so. In the experience of the authors, the federal government (through the Department of Justice) brings suit in far less than 1% of cases, and usually only where the federal government is aware of substantial valuable property at the end of the 10-year period that would justify its expenditure of effort to bring suit. Thus, 10 years is the "practical" statute of limitations on collection with respect to an individual taxpayer not owning very valuable assets at the end of such period. Only those rare individual taxpayers who for some reason have not used their valuable property in 10 years to pay a tax debt need be concerned about a longer statute of limitations. In the authors' experience, low-income taxpayers with few assets and who rent are never subjected to a federal suit to extend the statute by reducing the liability to judgment. Such a suit would be a waste of the federal government's time. Thus, we simply advise our low-income clients that the federal collection statute of limitations as to them is 10 years.

New York Procedures

In the case of personal income taxes imposed by Article 22 of the Tax Law, the New York collection system is patterned on the federal system. Thus, like the federal system, after taxes are assessed, the Department of Taxation and Finance is directed to issue a notice and demand for payment of tax, penalties, and interest. Tax Law §692(b). If that notice is not paid (in either 10 or 21 days, depending on the amount sought in the notice), the Commissioner is authorized to issue a warrant either to a Department employee or the sheriff of any county "commanding him to levy upon and sell such person's real and personal property for the payment of the amount assessed, with the cost of executing the warrant and to return such warrant to the commissioner and pay to him or her the money collected by virtue thereof within sixty days after the receipt of the warrant." Tax Law §692(c). If a warrant is issued, a copy must be filed within five days with the clerk of the appropriate county and be recorded in the county's judgment debtor docket. Tax Law §692(d). Also, upon filing of a warrant, the Department "shall, in the right of the people of the state of New York, be deemed to have obtained judgment against the taxpayer for the tax or other amounts". Tax Law §692(e). The Department employee or sheriff "shall thereupon proceed upon the warrant in all respects, with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record." Tax Law §692(f). This means that the state ends up with the same rights as a private judgment creditor – to enforce its "judgment" under Article 52 of the Civil Practice Law and Rules. Under those rules, for example, a judgment creditor can levy on a bank account and garnish up to 10% of gross wages. CPLR §§5201(b) and 5205(d)(2).

The warrant filing in connection with the levy differs from federal procedure, which allows the IRS to make an administrative levy without any court filing. Under the New York law, a warrant may only be issued within six years after the date of the assessment. Tax Law §692(c). While this differs from the normal federal 10-year collection statute at IRC §6502(a), it should be noted that, at the time Tax Law §692(c) was enacted, the federal statute of limitations at IRC §6502(a) was six years. Tax Law §692(c) was not amended to increase the statute of limitations on

collection after the federal statute was extended in 1990 to 10 years by §1 1317(a)(1) of Pub. L. 108-508.

A collateral effect of the warrant filing which accompanies any attempt to levy is that the warrant extends the collection statute of limitations by at least 20 years. The warrant, being treated as a money judgment, is governed by CPLR §211(b), which states that "[a] money judgment is [conclusively] presumed to be paid and satisfied after the expiration of twenty years from the time when the party recovering it was first entitled to enforce it." Usually, the Department issues a warrant against any taxpayer owing more than a few thousand dollars within the first few years of the six-year collection statute. So, for example, if a warrant was issued and docketed two years after the collection statute began, the collection statute would be extended another 20 years – i.e, to be 22 years in all. In that 22 years, the Department would be able to try to collect through levy or through offset of later-year income tax refunds.

Further, by the mere expedient of levying on a bank account (even one with only a few dollars in it) sometime during the 20-year period of the warrant, the Department can again extend the statute of limitations by another 20 years from the date of the levy. The statute provides that if any written acknowledgement of or payment is made on the "judgment", "the judgment is conclusively presumed to be paid and satisfied as against any person after the expiration of twenty years after the last acknowledgement or payment made by him." Id. In addition, "[p]roperty acquired by an enforcement order or by levy upon an execution is a payment, unless the person to be charged shows that it did not include property claimed by him". Id. So, by levies on bank accounts at least every 20 years (or perhaps even by taking later-year overpayments and applying them to pay down the debt), the Department can and regularly does effectively make the collection statute of limitations against individuals unlimited.

Matter of Castellana v. New York State Dept. of Tax. & Fin., 239 A.D.2d 749 (Third Dept. 1997) is typical of the Department's enforcement against individuals. In that case, the taxpayers neglected to report changes to their 1959, 1960, and 1961 federal income taxes to the Department. So, in 1969, the Department properly assessed against the taxpayers additional New York income taxes based on these federal changes. In 1970, the Department filed tax warrants in Kings County. In later years, the Department also filed warrants in other counties. Between 1971 and 1991, the Department engaged in nine income executions under the CPLR. Between 1972 and 1995, it also obtained a number of partial payments. When the Department levied on one of the taxpayers' bank accounts in 1994, however, the taxpayers brought suit to annul the seizure, arguing laches and the expiration of statute of limitations. The court, however, upheld the Department's 1994 levy as timely with respect to the 1969 assessments. Here, there was a 25-year gap between the assessments and the levy.

Proposed Change

Our proposal to remedy this situation would be to make the New York collection system for the personal income tax more similar to the federal system. This can easily be done first by amending Tax Law §692(c) to provide for warrants to be issued up to 10 years after assessment (to finally match the federal 10-year collection statute). Then, amend CPLR §211(b) to provide that, except as noted in the next paragraph, if a money judgment arises from a tax warrant filed with respect to an individual under Tax Law Article 22, the liability reflected in the warrant is conclusively presumed paid upon the expiration of the period in Tax Law §692(c) for issuing a warrant, and no subsequent acknowledgements or payments extend that period.

Tax Law §692(h) currently allows the attorney general, at the instance of the Department, to bring an action in court to reduce a personal income tax liability to judgment, but such action currently must be commenced within six years of assessment. This six-year period should also be changed to 10 years, and CPLR §211(b) should be amended to make clear that a judgment obtained by such a suit (but not a mere warrant) could be enforced in the usual way for the usual 20-year period under that statute. This again would conform to the federal practice in that it would make the Department focus as the 10-year collection statute expiration approached on whether there were sufficient still-uncollected assets to pursue. If the state wanted to pursue such assets, it could by bringing suit. Like the federal government, however, we assume that the state would not routinely bring suit, but only do this in extraordinary cases.

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 Section[1] 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".

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[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

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[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

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.

New York State Bar Association

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October 2, 1997

The Honorable Michael H. Urbach
Commissioner
Department of Taxation and Finance
W. A. Harriman Campus, Building 9
Albany, New York 12227

Re: Report on Proposed Regulations for New York State Offers in Compromise

Dear Commissioner Urbach:

I am pleased to submit for your consideration the enclosed report commenting on the proposed regulations to implement the Commissioner's authority to compromise taxes under Section 171(fifteenth) of the New York State Tax Law. The principal authors of this report are Sherry S. Kraus, Kenneth Bersani and William J. Neild of the Committee on Individuals and Maria T. Jones of the Committee on New York State Franchise and Income Taxes.

The report commends the Department for the writing of regulations to improve implementation of the Commissioner's compromise authority under subdivision fifteenth. It notes that, in the past, the New York State Offer in Compromise program has been widely perceived by tax practitioners as a difficult and often futile process, in contrast to the federal Offer in Compromise program which has proved to be an increasingly effective procedure for resolving liabilities not likely to be collectible in full.

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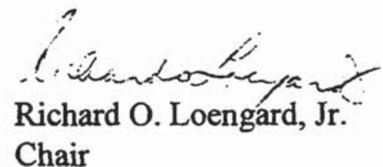
The report analyses the underlying enabling legislation for New York State Offers in Compromise and for federal Offers in Compromise and concludes that, while there are some differences between the federal and state enabling statutes, the fundamental objectives of the programs are the same. The report recommends incorporating into the proposed regulations selected portions of the federal Offer in Compromise guidelines to provide needed detail and guidance to taxpayers in making offers and to the Department in evaluating offers.

The report urges broadening the program, reflecting our belief that a fair and effective state Offer program will have the dual benefit of increasing collections to the state and giving tax debtors who cannot pay their full tax liability a fresh start toward future compliance with the tax laws. To that end the report suggests various ways in which the statutory requirement of taxpayer insolvency might be interpreted so as to make the program more accessible without impairing the discretion of the Department to reject offers in appropriate cases. The report also addresses various valuation issues and urges that a realistic approach be taken, similar to that used in the federal program.

Again we congratulate the Department on its effort to invigorate the Offer in Compromise program. If we can be of further assistance to you in the drafting of these important regulations, please let us know.

Yours very truly,



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NEW YORK STATE BAR ASSOCIATION
TAX SECTION

REPORT ON PROPOSED REGULATIONS FOR NEW YORK STATE OFFERS IN COMPROMISE[1]

The Tax Section of the New York State Bar Association has been asked by the New York State Department of Taxation and Finance (hereinafter "Department") to comment on the proposed regulations to implement the Commissioner's authority to compromise taxes under Section 171 (fifteenth) of the New York State Tax Law (hereinafter "subdivision fifteenth"). At present, the only regulations implementing the Department's authority to compromise taxes have been issued under Section 171 (eighteenth-a) (hereinafter "subdivision eighteenth-a") which deals with the compromise of taxes in the limited period prior to the tax becoming finally and irrevocably fixed and no longer subject to administrative review.[2] Since there are substantial differences in the Commissioner's authority to compromise tax liabilities under subdivision eighteenth-a and subdivision fifteenth, the subdivision eighteenth-a regulations have been of limited usefulness in providing guidance to taxpayers and their representatives in submitting Offers in Compromise for tax liabilities under subdivision fifteenth.

We commend the Department for undertaking the writing of regulations under the Commissioner's potentially broader compromise authority of subdivision fifteenth.

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[1]The principal authors of this report are Sherry S. Kraus, Kenneth Bersani, William J. Neild and Maria T. Jones. Helpful comments were provided by Richard O. Loengard, Jr., Robert Wild, Parker Brown, Arnold Kapilof, Arthur Rosen, Eugene Vogel, James Locke, David Sachs, William Randolph and Robert H. Scarborough.

[2]20 New York Code of Rules and Regulations ("20 NYCRR") Part 5000.

An effective Offer in Compromise program can lead to increased collections to the state and can restore tax debtors to future compliance with the tax laws.

In the past, the New York State Offer in Compromise program has been widely perceived by tax practitioners as a futile process. This perception is in stark contrast to the federal Offer in Compromise program which has proved to be an increasingly effective procedure for resolving liabilities not likely to be collectible in full. While there are some differences between the federal and state enabling statutes, we believe that the fundamental objectives are the same and that a well designed state Offer in Compromise program can work as well as its federal counterpart in achieving the mutual goal of collecting "what is potentially collectible at the earliest possible time and at the least cost to the government."[3]

I. STATUTORY FRAMEWORK FOR OFFERS IN COMPROMISE

A. Federal Offers in Compromise.

The authority underlying the Internal Revenue Service's ability to compromise federal tax, interest and penalties derives from Section 7122(a) of the Internal Revenue Code, as amended, which provides as follows:

> The Secretary may compromise any civil or criminal case arising under the internal revenue law 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.

[3]Internal Revenue Service Manual 57(10)1.1.

While the treasury regulations implementing this compromise authority are very limited (*i.e.*, less than two pages),[4] the Internal Revenue Service has developed extensive and detailed guidelines for the submission and evaluation of Offers in Compromise in its manual provisions. See Internal Revenue Service Manual 57(10), Offers in Compromise.[5] The policy underlying the federal Offer in Compromise program is stated as follows:

> The Service, like any other business, will encounter situations where an account receivable cannot be collected in full or there is a dispute as to what is owed. It is an acceptable business practice to resolve these collection and liability issues through compromise. Additionally the compromise process is available to provide delinquent taxpayers with a fresh start toward future compliance with the tax laws. IRM 57(10)(1).

B. New York State Offers in Compromise.

The authority of the Commissioner of Taxation and Finance to compromise state taxes, interest and penalties derives from Section 171 (fifteenth) and Section 171 (eighteenth-a) of the New York State Tax Law. Currently, the state has promulgated regulations only under subdivision eighteenth-a. Subdivision eighteenth-a authorizes the Commissioner to compromise tax liabilities in the limited timeframe "prior to the time the tax or administrative action becomes finally and irrevocably fixed and no longer subject to administrative review." The regulations promulgated under subdivision eighteenth-a are contained in Part 5000 of Chapter VIII of 20 NYCRR.

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[4]See Treas. Reg. Section 301.7122-1.

[5]Hereinafter, all references to this manual will be preceded by the abbreviation "IRM".

Until now, however, regulations have not been proposed under the compromise authority of subdivision fifteenth. Under 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."

While the subdivision fifteenth compromise authority is limited to taxpayers who have been discharged in bankruptcy or are insolvent, the Commissioner's authority under this provision has the potential for much broader application than the compromise authority under subdivision eighteenth-a since the compromise may be granted for taxes that have already become final and with respect to which warrants or judgments have been filed. In contrast, Offers in Compromise submitted under subdivision eighteenth-a are limited to taxes that have not yet become final and irrevocably fixed. The subdivision eighteenth-a authority has been useful as an alternative for settlement of disputed tax cases where issues of liability (and, therefore, hazards of litigation) as well as issues of collectibility, are a factor.[6]

However, the great majority of potential Offers in Compromise fall into the category of "final and irrevocably fixed" liabilities that are beyond the tax debtor's ability to pay. In most cases, tax warrants have been filed on these liabilities. For these tax

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[6]A liability can be compromised under subdivision eighteenth-a on the ground of "doubt as to liability" as well as the ground of "doubt as to collectibility". 20 NYCRR Section 5000.1.

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debtors, the Commissioner's compromise authority under subdivision eighteenth-a offers no relief and they must make their case for compromise under subdivision fifteenth or not at all. Because of the larger number of tax debtors that will potentially seek relief under subdivision fifteenth, the regulations now under review have enormous importance in determining the success of the Offer in Compromise program in New York. Hence, we applaud the decision of the Department to publish regulations which will serve to effectuate the Offers in Compromise program.

II. SUMMARY OF PROPOSED REGULATIONS

The proposed regulations add to the existing regulations, a new Part 5005 entitled "Compromises Under Subdivision Fifteenth of Section 171 of the Tax Law". Consistent with the underlying enabling legislation, the regulations provide for compromise of the liability on the single ground of "doubt as to collectibility".[7] Significant features of the proposed regulations are as follows:

- The tax liability must be fixed and all protest rights exhausted prior to making an Offer in Compromise. Prop. Regs. Section 5005.1(a).
- The tax debtor must have been discharged in bankruptcy or shown, by proof, to be insolvent. Prop. Regs. Section 5005.1(b)(1).
- The amount acceptable in compromise cannot be less than the amount the Department could collect through legal proceedings. *Id.*

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[7] A federal Offer in Compromise can also be based on "doubt as to liability".

    - The compromise amount "must equal or exceed the amount the Department would be able to collect, over a period of time, through legal proceedings" including the collection procedures set forth in Article 52 of the Civil Practice Law and Rules (hereinafter "CPLR") that permit the seizure and sale of real and personal property, seizure of bank accounts and motor vehicles, levy of debts owed to the taxpayer by a third party and income executions of up to 10% of the taxpayer's gross wages. Prop. Regs. Section 5005.1(b)(3).
    - "Trust tax liabilities" (*e.g.*, withholding tax or sales and use tax)[8] cannot be compromised for less than the amount of outstanding tax due. Prop. Regs. Section 5005(b)(1).
- As a condition to accepting the Offer in Compromise, the taxpayer must submit a statement of financial condition. Prop. Regs. Section 5005(c)(2).
    - A taxpayer may be required to submit certified financial statements. *Id.*
- In addition to the Offer amount, a taxpayer may be required to enter into a collateral agreement, <u>i.e.</u>, pay over a fixed percentage of future earnings or other income for a specific period of time as an additional amount paid toward the Offer. Prop. Regs. Section 5005(c)(2)(i).

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[8]We question the inclusion of use taxes within the category of "trust tax liabilities" since use taxes are imposed directly upon the purchaser. In contrast, persons required to collect and pay over sales taxes and employment taxes serve in a fiduciary role. New York State Tax Law Section 1133(a); 20 NYCRR Section 532.3.

- The taxpayer must agree to give up all refunds and credits due through overpayments of tax for periods ending before or within the calendar year in which the Offer is accepted. Prop. Regs. Section 5005(c)(3)(i).
- The taxpayer must waive the running of the statute of limitations of collection of the tax for the period during which the Offer is pending or, if an installment payment of the Offer is made, for the installment payment period and for one year thereafter. Prop. Regs. Section 5005(c)(3)(iv).
- The taxpayer must remain current in all filings and payments and immediately pay in full any new tax assessment that may be issued for a period of five years from the date of acceptance of the Offer. Prop. Regs. Section 5005(c)(3)(v).
- The taxpayer is limited to making only one Offer in Compromise. Prop. Regs. Section 5005(c)(4).
- The Offer will be reviewed by the Tax Compliance Division which will recommend acceptance or rejection. Prop. Regs. Section 5005(d)(1). Upon receipt of a recommendation for acceptance of an Offer, the Commissioner will accept or reject the Offer and the Department will notify the taxpayer in writing of such action. Prop. Regs. Section 5005(d)(2)(i).
- If the amount to be forgiven is more than $25,000, any Offer recommended by the Department for acceptance must be referred to a justice of the Supreme Court for approval prior to the Commissioner's notification of acceptance. The Offer is not effective until approved by a

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justice of the Supreme Court. Prop. Regs. Section 5005(d)(2)(ii).

- Grounds for rejection of the Offer include:
  - Evidence of conveyance of assets for less than fair market value. Prop. Regs. Section 5005(e)(2)"(e)".
  - Public policy reasons (*i.e.*, not in the best interests of the State). Prop. Regs. Section 5005(e)(2)"(f)".
  - The taxpayer has not demonstrated a good faith effort to repay/resolve the tax debt, *i.e.*, where the taxpayer has displayed a wanton disregard for the tax debt over an extended period of time and disposed of significant assets and other holdings. Prop. Regs. Section 5005(e)(2)"(g)".
- An accepted Offer in Compromise may be ruled by the Department as in default if the taxpayer does not comply with the conditions of the Offer (including requirements of future payment under a collateral agreement) and if there is evidence of a substantial misrepresentation of a material fact subsequent to the acceptance of the Offer. Prop. Regs. Section 5005(f).
- In cases of default, the Department may reimpose the full tax liability, including all interest and penalties, apply all amounts paid under the Offer and immediately, without notice, proceed to collection for the balance of the original liability. *Id.*

III. COMMENTS

A. General.

While the subdivision fifteenth enabling legislation allowing the compromise of state tax liabilities is not identical to the enabling language of Section 7122 of the Internal Revenue Code allowing the compromise of federal tax liabilities, the underlying policies of the statutes are fundamentally the same, i.e., permitting satisfaction of the tax debt at an amount less than full payment where the liability is unlikely to be collected in full. We also believe that the New York State subdivision fifteenth requirement that "the amount payable be no less than the amount recoverable through legal proceedings" is substantially the same as the Internal Revenue Service guideline requirement that "the amount offered reasonably reflects collection potential". IRM 57(10)1.1.

In essence, while there are some differences in the enabling legislation underlying the federal and state Offer in Compromise programs, the basic policy reasons underlying the state's ability to compromise a liability under subdivision fifteenth can reasonably be concluded to be the same as those underlying the federal Offer in Compromise program, to wit, (1) to resolve a tax liability receivable which cannot be collected in full; (2) to effect collection of what could reasonably be collected at the earliest time possible and at the least cost to the government; (3) to give taxpayers a fresh start to enable them to voluntarily comply with the tax laws; and (4) to collect funds which may not be collectible through any other means. IRM 57(10)1.2.

New York State has arguably even greater incentives than the federal government for putting in place an effective Offer in Compromise program. Unlike a federal tax debtor, a New York State tax debtor faced with a liability beyond his/her reasonable expectation of paying may defeat or stymie collection of that debt by moving out of (or staying out of) the state. While New York could attempt an extra-territorial collection against the tax debtor by use of its tax lien, or by levy in New York upon financial institutions which have branches in other states, this is a hit or miss process and assumes that the state can determine the whereabouts of the debtor.

Other reasons that the state can sustain losses in collections are (1) a lower assessment priority to that of the Internal Revenue Service and other creditors and (2) the statutory collection restrictions that limit access to the tax debtor's assets (e.g., pension plans are exempt from levy) and/or income (e.g., maximum 10% gross wage levy).

The greater vulnerability of the state to losses in collection heighten the importance of putting in place an effective Offer in Compromise program. A fair and effective Offer program not only will result in increased collections to the state but will give tax debtors who cannot pay the full tax liability an alternative to resolving their tax debts other than fleeing the state to escape collection.

Another factor in the need to provide an effective state Offer in Compromise program is the long period of collection which the state has to collect against the taxpayer. Under federal tax law, the statutory period for collection is ten years from the date of assessment unless extended by agreement or judgment. IRC Section 6502. In

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contrast, under New York State law, a filed tax warrant empowers the department to use the collection procedures in Article 52 of the Civil Practice Law and Rules relating to enforcement of money judgments. This means that the tax collection period for levy of real property and personal assets and for use of income executions against wages extends for a period of twenty years after the date of assessment.[9]

The significantly longer collection period for New York State increases the potential of large uncollectible liabilities against taxpayers. Even a small unpaid tax liability can grow significantly over a twenty year period by accrual of interest and penalties. While some tax debtors may find relief in bankruptcy court for tax debts, many of the potentially largest tax debts, such as those for withholding and sales taxes, cannot be discharged in bankruptcy. 11 USC Section 507. Without relief from an Offer in Compromise program, a tax debtor without the financial resources to pay the liability will have no other means for resolving the liability.

Since we believe that the federal and state Offer in Compromise programs have the same basic objectives, we recommend that the federal Offer in Compromise program be utilized as a model for the New York State program. The federal compromise program has been in place for many years and is generally viewed by the

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[9]Newly enacted Section 174-a of the New York State Tax Law conforms the life of New York State tax liens against real property to the ten year period applicable to other judgment creditor liens. This law overrules a 1988 New York State Department of Taxation and Finance opinion of counsel that took the position that the life of a tax lien against real property was twenty years even though not refiled at the conclusion of the initial ten year period. The law does not , however, reduce the Department's twenty year period for collections against real and personal property under Article 52 of the CPLR where a tax warrant has been filed.

Internal Revenue Service, taxpayers and tax practitioners as working well. Part of the reason this program has worked well is that the Service has developed extensive guidelines over the years to assist the taxpayer in submitting an Offer and to assist the Service in the uniform implementation of the program. We believe that the guidelines for the New York program should take a similar approach, i.e., answer as many questions as possible in advance and leave few issues on which the Department and taxpayers will be without direction in respectively evaluating and making the Offer.

At the federal level, these detailed guidelines are set forth in the Internal Revenue Service Manual rather in the Section 7122 treasury regulations. In this manner, the guidelines can be easily altered and revised on an ongoing basis. If the state could adopt and implement its Offer in Compromise guidelines in a similar form, this would allow for ongoing adjustments more easily than incorporating the guidelines into regulations.

However, regardless of whether the guidelines are incorporated into the regulations or set forth in more easily modifiable form, we believe that the state Offer in Compromise guidelines must set forth more detailed criteria for evaluation of Offers in Compromise than are now present in the proposed regulations. The federal Offer guidelines provide detailed guidance on almost all issues which present themselves to taxpayers and representatives in preparing an acceptable Offer. The state Offer guidelines can easily provide this detail by a selective borrowing from the federal guidelines. In this manner, answers will be provided to many questions that are otherwise left unaddressed in the proposed regulations, e.d., the proper method for

valuation of assets; delineation of which of the taxpayer's assets must be considered and which are exempt from consideration in the Offer process; the effect of loss of collection potential through potential discharges of tax in bankruptcy; the proper way to deal with individual offers in the event of a joint liability; the method for valuing the amounts which the state can expect to collect from future income over time; guidelines for collateral agreements; the effect of an accepted Offer on certain tax attributes in returns filed in the future; additional procedures if the Offer is rejected; procedures for implementation of an accepted Offer; and procedures for processing and collecting a defaulted Offer.

By selectively incorporating the federal guidelines, the Department can provide the needed guidance and procedures at very little cost to itself. Furthermore, because many taxpayer representatives have had experience in submitting federal Offers in Compromise, the preparation and submission of a state Offer in Compromise will be expedited by conformity to the federal guidelines. Our suggestions for incorporation of the federal Offer in Compromise guidelines are contained in the following specific comments on the Proposed Regulations.

B. Specific Comments.

1. "Grounds for Compromise".

The proposed regulations incorporate the subdivision fifteenth statutory requirement that the taxpayer must either be discharged in bankruptcy or, by proof, be insolvent as a ground for making an Offer. The provision further states that a taxpayer is "insolvent" if the taxpayer's liabilities exceed the taxpayer's assets. In determining

liabilities, the amount of the taxpayer's state tax debt will be included. Prop. Regs. Section 5005.1(b)(1) and (2).

Comment:

(a) Discharge in Bankruptcy.

Further guidance should be given on this threshold requirement for making an Offer. If, for example, the taxpayer makes an Offer in 1998 and can show a discharge in bankruptcy in 1996, is this adequate or must the discharge have been received in closer proximity to consideration of the Offer? Presumably, discharges in bankruptcy (whether under Chapter 7 or Chapter 13) were viewed by the legislature as indicative of impaired collection potential. Since a taxpayer who can demonstrate a "discharge" in bankruptcy does not need to provide proof of insolvency, it would seem reasonable for the regulations to require the discharge in bankruptcy be in close proximity to the Offer date (e.g., not more than one year prior to the submission of the Offer). Furthermore, for Chapter 13 bankruptcy discharges, which are technically not granted until completion of a three to five year payment plan, a rule also requiring proof of current insolvency would be reasonable.[10]

(b) Insolvency.

Taxpayers who have not received a discharge in bankruptcy must prove insolvency. However, the question arises as to which assets and liabilities are included in that determination, as well as the proper valuation of those assets. Some guidance

[10]In many cases, a Chapter 13 debtor will carry substantial assets through the bankruptcy payment plan. Consequently, many Chapter 13 debtors will not be insolvent upon completion of the plan at the time of "discharge".

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on this point is contained in the definition of insolvency under Section 270(f) of the New York State Debtor/Creditor Law. This definition of insolvency, however, does not answer the important question as to what assets will and will not be counted in the determination of insolvency. For example, would a tax debtor's pension plan be counted in this determination even though the assets would not be available to creditors in bankruptcy? Under New York State law, no creditor, including the Department, can recover against the assets of the pension plan either inside or outside bankruptcy. NYCPLR Section 5205(c); see also NYEPTL Section 7-3.1.

In many cases, a taxpayer's pension plan may be his most valuable asset. The policy argument for inclusion of the asset in the determination of insolvency is that the state does not wish to simply ignore this asset and extend Offer in Compromise relief to taxpayers who have built up substantial value in pension plans or other assets beyond the reach of creditors. However, the arguments against inclusion of the plan in the determination of insolvency are that (1) the pension plan would not be counted as an available asset for distribution to New York creditors in federal bankruptcy proceedings and, thus, would not prevent a "discharge" in bankruptcy and (2) the pension plan is not an available asset to the Department of Taxation for collection. NYCPLR Section 5205(c). Accordingly, if the pension asset is valued in determining the threshold issue of "insolvency", such could result in inconsistent treatment to taxpayers depending upon whether the tax debtor proceeds with an Offer in Compromise on the ground of a discharge in bankruptcy or on the ground of insolvency. For example, assume Tax Debtor A has no significant asset other than a

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pension plan valued at $300,000. He has received a recent "discharge" in bankruptcy (the pension plan was not counted as an available asset for bankruptcy distribution). Accordingly, he has established grounds for proceeding with an Offer in Compromise. In contrast, Tax Debtor B, who also has no significant assets other than a pension plan valued at $300,000, but who has not gone through a bankruptcy, will be denied consideration of his Offer in Compromise because, after counting the pension plan as an asset, he cannot demonstrate that he is insolvent.

In our view, the threshold determination of which assets should be counted in determining insolvency should be based on similar criteria to the determination of whether the tax debtor would receive a "discharge" in bankruptcy. In other words, if an asset would not be counted as an available asset to creditors, and thus not preclude a discharge in bankruptcy, the asset should not be counted in determining "insolvency" under subdivision fifteenth.

(c) Valuation For Purposes of Determining Insolvency.

Further guidance should also be provided in the proposed regulations in valuing the assets taken into account in determining whether the tax debtor is "insolvent". Since subdivision fifteenth treats discharges in bankruptcy and insolvency as equally acceptable grounds for proceeding with an Offer in Compromise, there is an argument that the method used to value assets in determining insolvency should conform as closely as possible to the valuation methods utilized in the bankruptcy courts and under New York State Debtor/Creditor Law, i.e., a full fair market valuation

of the debtor's assets.[11]

However, we see the Offers in Compromise program as being useful to taxpayers and tax administrators alike and believe its expansion is a desirable goal which would be furthered by a broader definition of insolvency. A broader definition of insolvency does not mandate that the Department enter into agreements with each taxpayer who comes within it; in each case the Department is able to weigh the offer made by the taxpayer and to reject it if it fails to meet the criteria discussed below. Moreover, since the statute is not specific regarding the requirements for establishing insolvency, we believe a somewhat broader definition could be used if desired. For example, instead of using a full fair market valuation of the tax debtor's assets in determining insolvency, the regulations could establish a value which more closely reflects the collection potential from the asset, e.g., "quick sale" value.[12] In this manner, the Offer in Compromise process could be made available to a larger number of tax debtors by liberalizing the standard necessary to demonstrate insolvency. Since we believe it is in the interests of the Department and the taxpayers to open up the Offer in Compromise process to as many tax debtors as possible, we urge the Department to consider use of this method for valuing assets in determining whether the tax debtor has demonstrated the threshold ground of insolvency.

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[11]As discussed in the next section, it will not always be the case that fair market value is the appropriate method for valuing an asset in determining the appropriate "minimum offer".

[12]A fuller discussion of this approach for valuation of assets appears later in this report under the section entitled "Evaluation of Assets".

2. Minimum Offer.

The proposed regulations provide that the amount acceptable in the compromise cannot be less than the amount the department could collect through legal proceedings. This concept is more fully developed in a subsequent provision which states that the amount offered "must equal or exceed the amount the department would be able to collect over a period of time through legal proceedings." In determining collection potential, all legal collection proceedings available to the Department must be considered, including the collection rights of the Department against the debtor's personal and real property under Article 52 of the Civil Practice Law and Rules. By way of example, the proposed regulations state that the examiner should look at the results of a seizure and sale of the taxpayer's real and personal property, including but not limited to the seizure of money from the debtor's bank account, seizure of motor vehicles, debts owed to the taxpayer by third parties and income executions of up to 10% of the taxpayer's gross wages. Prop. Regs. Section 5005(b)(1) and (b)(3).

Comment:

We believe that the statutory subdivision fifteenth requirement that the state recover in an Offer in Compromise "the amount, if any, recoverable through legal proceedings" can be fairly interpreted to be the same as the objective of the federal Offer in Compromise program in cases where the compromise is based on "doubt as to collectibility", i.e., the Offer must "reasonably reflect collection potential." IRM 57(10(10).1. Under federal guidelines, an Offer will "reasonably reflect collection potential" if it takes into account:

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(a) the amount collectible from the taxpayer's assets;

(b) the amount collectible from the taxpayer's present and future income;

(c) the amount collectible from third parties, e.g., trust fund recovery penalty and transferee; and

(d) the amount the taxpayer should reasonably be expected to raise from assets in which he or she has an interest but the interest is beyond reach of the government. For example, property located outside the United States or property owned by tenancy by the entirety. Id.

Given the similar objectives for recovery under the federal and state Offer programs, we recommend that the proposed regulations incorporate IRM 57(10)(10),[13] of the federal Offer guidelines in determining an adequate minimum Offer.

(a) Evaluation of Assets.

Essential in determining the minimum acceptable Offer amount is guidance to the taxpayer and to the Department on evaluation of specific assets. The proposed regulations should give guidance regarding what assets will and will not be included in the "minimum offer" determination as well as the method for evaluating these assets. However, this asset listing and method for valuation may differ from that used in determining the threshold issue of "insolvency" since the assets to be included in "the amount collectible from the taxpayer's assets" should be based on the Department's realistic evaluation of the reasonable collection potential on the asset.

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[13]Some modifications would be required by removing 57(10)(10).3, 57(10)(11).2 and 57(10)(11).3 which are not applicable to state procedures.

For example, while the regulations may require that an asset be included at full fair market value in determining whether the taxpayer is insolvent, such a valuation would not necessarily be appropriate in determining asset value in the calculation of a minimum acceptable Offer since fair market valuation may not reflect reasonable collection potential to the Department on the asset.

A significant portion of the Internal Revenue Manual on Offers in Compromise is devoted to the issue of asset valuation for a minimum Offer. The section entitled "Evaluation of Special Assets" (IRM 57(10)(13)) gives detailed instructions regarding the inclusion and valuation of cash, securities, life insurance, pension and profit sharing plans, furniture, fixtures and personal effects, machinery and equipment, trucks, automobiles and delivery equipment, receivables, real estate and jointly owned property. In each case, guidelines are set forth which attempt to measure as accurately as possible the true collection potential of the asset. For example, "quick sale value" (i.e., 75% of fair market value) is viewed under the IRS guidelines as a more realistic method for valuing real property than fair market value since this is the more likely amount to be realized by the Internal Revenue Service upon a forced sale or foreclosure on the asset. IRM 57(10)(13).91.

Furthermore, in the case of a tax debtor who jointly owns real property with a person who is not liable for the tax, the guidelines recognize that it is neither reasonable nor appropriate in all instances to count the value of the tax debtor's interest in the property at a full 50% of the net equity in the property. The IRS Manual gives examples of where a lesser percentage (e.g., 20%) would be the more appropriate

evaluation of the tax debtor's interest in the property. This approach reflects the practical difficulty to a creditor of recovering more than 20% of the net value of the property in a foreclosure sale on a co-tenant's interest in real property (as opposed to selling the underlying property), especially where the property is held in joint tenancy or tenancy by entirety. IRM 57(10)(13).92.

The IRS Manual also addresses the difficult issue of asset inclusion and valuation of pension and profit sharing plans. IRM 57(10)(13).4. Under this section, the Internal Revenue Service counts as an available asset only IRAs and voluntary "401(k)" contributions since the Internal Revenue Service can and does levy on these types of accounts. However, the Internal Revenue Service has more extensive powers of collection against such plans than New York State.[14] Under ERISA and NYCPLR Section 5205(c), a tax debtor's pension and profit sharing plans, including IRAs and voluntary 401(k) contributions, would be exempt from collection by the Department. Since the Department would not be able to levy upon the pension plan or payments from the plan to satisfy the tax debt, we do not believe that a New York tax debtor's pension plan should be counted as an available asset for purposes of determining minimum offer amount. The protection of pension plans from creditors reflects a strong and overriding policy decision at the state and federal levels which should not be undermined in determining the amount acceptable in a New York State Offer in Compromise.

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[14]These powers derive from Treas. Regs. 1.401(a)-13(b)(2).

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(b) Evaluation of Income.

Another critical point on which the proposed regulations need to give more detailed guidance to taxpayers and to the Department is on the evaluation of present and future income. The proposed regulations direct that, in determining an adequate Offer in Compromise, the Tax Compliance Division must take into account the collection procedures that would be available to the Department under Article 52 of the CPLR, including income executions of up to 10% of the taxpayer's gross wages. Since a New York State tax liability secured by a filed tax warrant will have a collection life of twenty years under New York State law, there are numerous questions that arise in connection with the state's evaluation of income for Offer in Compromise purposes, including (a) the underlying time period over which collections will be assumed to be made and (b) the method for valuation (i.e., whether the assumed future collections should be discounted to present value).

(i) Assumed Period of Collection.

In determining the period over which the income execution should be assumed collectible for state Offer in Compromise purposes, we recommend adoption of the Internal Revenue Service method for evaluation of future income for federal Offers in Compromise. Even though the Internal Revenue Service has ten years from the date of assessment in which to collect the tax (IRC Section 6501), the Service recognizes that in cases where a tax liability cannot be recovered in full and the taxpayer must make installment payments of the liability over time "that any agreement that requires more than five years to complete has a high probability of not being

completed." IRM 57(10)(13).(10)(1)(c). Accordingly, an Offer by the taxpayer that represents the present value of a five year payment plan (or for a lesser period if fewer than five years remain on the collection statute) reflects the reasonable collection potential from the taxpayer's present and future earned and unearned income. IRM 57(10)(13).(10)(2). Since the recovery rate on liabilities that have been outstanding for more than five years is low in comparison to the cost in administering long delinquent accounts, Internal Revenue Service acceptance of an amount equal to the discounted present value of a five year payment plan meets the goal underlying the Offer in Compromise program of "achiev[ing] collection of what is potentially collectible at the earliest possible time and at the least cost to the government." IRM 57(10)1.1. This method for valuation of future collections is also in line with the Service's objective that the Offer in Compromise program be "a legitimate alternative to declaring a case as currently not collectible or to a protracted installment agreement." Id.

We believe that the same considerations are applicable in evaluating the future income collection potential for state Offer in Compromise purposes. Projecting a taxpayer's wage earning potential (or, for that matter, whether the taxpayer will still be within the state or still earning income) for more than five years into the future is highly problematic. Furthermore, it is likely that the state has also experienced low recovery rates on accounts more than five years old. Since the objective of the state Offer in Compromise program can be fairly interpreted as the same as the federal program, (i.e., to retire accounts that would otherwise not be fully collectible for an amount representing the reasonable collection potential of that

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account), we believe that the approach of the Internal Revenue Service in valuing future collections from income should be adopted. This would establish a value for future wage garnishments equal to the discounted present value of a five year wage garnishment based on the taxpayer's current wage.[15]

A further reason for the state to consider adopting this valuation approach is the significant increase in the minimum Offer required if a longer term is used. Assume, for example, a tax debtor who currently earns wages of $48,000. The state could now garnish up to $400 a month under a 10% income execution to collect on tax debts. If the federal guideline for evaluation of future income collections is used, the future collections would be valued at $19,428, i.e., the discounted present value of a five year payment plan at $400 a month.[16] If, however, the collection evaluation assumes a continuation of the existing wage levy of $400 per month for the remainder of the twenty year collection statute, the valuation could be as high as $44,458, (assuming a full twenty year term). If the income execution were not discounted to present value, the collections from future income would be valued at $96,000, i.e., $400 a month for twenty years.

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[15]We do not believe that the subdivision fifteenth requirement that the minimum compromise amount be "the amount, if any, recoverable through legal proceedings", requires an assumption that the value of an income execution be deemed equal to a 10% wage garnishment of the taxpayer's current income over the entire remaining life of the twenty year collection statute.

[16]The discount rate (currently 9%) for computing present value under the Internal Revenue Service Manual guidelines is based on the current rate charged on underpayments. IRM 5171.

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Of all the factors that are taken into account in determining the minimum Offer amount, the valuation of future income collections is potentially the most critical since an overvaluation of this asset can easily make the minimum Offer amount out of reach of most taxpayers. This is a result that is not in the interest of either the state or the taxpayer. We believe that the valuation approach now employed by the Internal Revenue Service in its Offer in Compromise program reflects the reasonable collection potential from future collections and should be adopted by the state. Furthermore, as demonstrated by the example given above, the longer the assumed collection period, the more likely it will be that the minimum Offer amount will be out of reach for most taxpayers.[17] The higher the hurdle is made for the tax debtor to resolve the liability through an Offer in Compromise, the more appealing will be a Chapter 7 or Chapter 13 bankruptcy -- where any payment will often be a fraction of the amount required for an Offer. (See discussion infra.)

(ii) Effect of Potential Bankruptcy Discharge.

In evaluating the state's collection rights against the taxpayer's future earnings, the Department also needs to address in the proposed regulations the effect of dischargeability of the tax debt in a bankruptcy proceeding. Where, for example, the liability involves income taxes that can be discharged by the debtor in bankruptcy, to what extent should this be a factor in evaluating the reasonable collection potential of the Department as to that liability?

[17]In addition to the value of future income collections, the tax debtor must also add to the "minimum offer" the net value of all assets.

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We recommend that the proposed regulations incorporate the Internal Revenue Service guidelines on this subject. IRM 57(10)(13).(12). These provisions grant the needed flexibility to the Service to accept an Offer amount less than would normally be required under a strict "asset/income" analysis if the Service concludes that a lesser amount would be recovered if the taxpayer were to seek bankruptcy relief instead. For example, assume the case of a taxpayer who under a strict "asset/income" calculation would need to make a minimum Offer of $40,000. If, however, the taxpayer could demonstrate that the IRS would receive only $10,000 in a bankruptcy payout, the Service would be free to accept the taxpayer's Offer of $25,000. By incorporating this guideline into the proposed regulations, the Department will build in needed flexibility to resolve the tax debt on terms that maximize potential collections.

3. Compromise of Trust Fund Taxes.

The proposed regulations provide that in the case of "trust tax liabilities" (e.g., withholding tax, sales and compensating use tax), the amount of the Offer should reflect at least the amount of the outstanding tax due. Prop. Regs. Section 5005(b)(1).

Comment:

This provision appears to be based on a policy decision by the Department to require a potentially higher minimum Offer amount for the compromise of trust fund taxes[18] than would be strictly required by statute, i.e., "the amount, if any, recoverable

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[18]As noted earlier, we do not believe that "use" taxes fall within the category of "trust fund" taxes since the tax debtor is directly liable for the tax. In contrast, the obligation to collect and pay over sales taxes and withholding taxes imposes a fiduciary

through legal proceedings." We understand the Department's concern that the Offer in Compromise program not undermine taxpayer compliance in paying use taxes and collecting and paying over withholding and sales taxes.

Similar considerations are taken into account at the federal level in the compromise of employment taxes. The Internal Revenue Service guidelines provide that in considering the compromise of employment taxes that "[w]hen the same business is operating, we would normally not accept an offer for an amount less than the tax, exclusive of penalties and interest." IRM 57(10)(14).1. The guidelines go on to provide, however, that

> if, considering all factors, including the taxpayer's demonstrated ability to stay current, it is obvious that accepting an offer would be in the total best interest of all parties, an offer can be accepted for an amount less than the taxes as long as the amount offered reasonably reflects collection potential. Id.

In cases where employment tax liabilities are sought to be compromised at the federal level by taxpayers that are no longer in the same business or by individuals liable under the "trust fund recovery penalty" provisions of Section 6672 of the Internal Revenue Code,[19] the Internal Revenue Service does not impose a higher minimum Offer standard than for other types of tax delinquencies. An Offer will be accepted if it reasonably reflects collection potential. IRM 57(10)(14) et seq.

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duty. Tax Law Section 1133(a); 20 NYCRR Section 523.3.

[19]IRC Section 6672 is the federal counterpart of the responsible officer liability for employment taxes and sales taxes under Sections 685(g) and 1133(a) of the New York State Tax Law.

We are concerned that the imposition of a minimum Offer amount equal to the underlying tax liability in the case of trust fund taxes may deny needed flexibility to the Department in evaluating the Offer and may deny access to the taxpayers most in need of the Offer program. Many taxpayers with the largest liabilities, and, thus, the most need for the Offer in Compromise program, have withholding and/or sales and use tax assessments against them. Often, the underlying assessment is based on a "responsible officer" assessment for unpaid taxes of a business that has failed.[20] In some cases, the individuals might have been able to assert meritorious defenses against the "responsible officer" liability had they availed themselves of the appeals process to challenge the assessment. Given the short timeframe for appeal (90 days) and the lack of understanding that many individuals have in connection with this liability, many do not do so and the tax becomes final without any further opportunity for review except through the refund process, which requires payment of the tax.[21] While the same can be said of many "trust fund penalty tax" assessments against "responsible persons" for unpaid federal employment taxes, a review of "responsible person" liability under Section 6672 of the Internal Revenue Code can be undertaken at the federal level as part of the Offer in Compromise evaluation since "doubt as to liability" is one of

[20]Tax Law Sections 685(g) and 1133(a). Again, there is some question as to the appropriateness of "responsible officer" assessments in the case of use taxes assessed against a business since there has been no personal failure to collect and pay over the tax.

[21]While the Department does, at times, cancel unwarranted assessments through the use of the "courtesy conference", this procedure is available only at the discretion of the Department and is generally requested only by taxpayers who have tax advisers with substantial experience in dealing with New York State tax matters.

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the grounds for compromise of the liability.

Given the broad range of circumstances that can underlie a trust fund tax assessment against an individual, it is our view that the state Offer in Compromise program needs to preserve as much flexibility as possible in dealing with the compromise of trust fund taxes. Although subdivision fifteenth does not allow the Commissioner to compromise a tax liability on the ground of "doubt as to liability", we believe that if a taxpayer has made an Offer to the state to compromise a trust fund tax liability by payment of an amount that would be sufficient under "asset/income" guidelines (and thus reflects the reasonable collection potential of the liability), the Commissioner should be permitted to accept that Offer and close out the account without regard to whether the amount reflects full payment of the tax portion of the liability. While delinquencies in payment of trust fund taxes are reprehensible and in no way to be encouraged, the imposition of an inflexible minimum Offer amount in the compromise of trust fund taxes has the potential for requiring a higher Offer amount than can be paid by the tax debtor or reasonably recovered by the state. Since denial of such Offers does not advance the goal of the program and would unnecessarily deny collection recoveries to the state, we recommend incorporating into the proposed regulations the federal guidelines of IRM 57(10)(14) in connection with the compromise of trust fund taxes.[22]

[22]The discretionary authority of the Department in granting Offers in Compromise can serve to weed out abusive or close cases.

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4. Statement of Financial Condition.

The proposed regulations provide that as a condition to accepting an Offer in Compromise, a taxpayer must submit a statement of financial condition and other information prescribed by the Department. The regulations further provide that a taxpayer may be required to submit certified financial statements. Prop. Regs. Section 5005(c)(2).

Comment:

The regulation should make it clear to the field that requiring "certified financial statements" will only be appropriate where an established and substantial going business is involved. Individual wage earners and sole proprietorships would find it close to impossible to obtain such statements. If they could be obtained at all, they would be prohibitively expensive at a time when expense could hardly be afforded. Also, such financial statements based on standard auditing procedures (such as sampling) are far from "guaranteed" by a certified public accountant and would add very little of significance for these purposes to financial statements submitted by the parties under penalties of perjury. Finally, and perhaps most importantly, a certified public accountant can only issue such financial statements based on "generally accepted accounting principles" which simply would not be applicable to the vast majority of the taxpayers that are likely to be involved in the Offer in Compromise system.

5. Post Offer Compliance Period.

The proposed regulations provide that if an Offer in Compromise is accepted, the taxpayer agrees "to remain current in all taxpayer filing and payment

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requirements and to immediately pay in full any new tax assessments which may be issued for a period of five years from the date of the acceptance of the offer;". Prop. Regs. Section 5005(c)(3)(v).

Comment:

The imposition of a condition that the tax debtor maintain compliance for a five year period after acceptance of the Offer is similar to a requirement imposed upon acceptance of a federal Offer in Compromise. However, the wording of the proposed regulation differs slightly from the federal provision and raises an issue of substantial importance, i.e., whether the condition imposed by the proposed regulations would require a taxpayer to pay in full any new tax assessment made within the subsequent five year period even if the assessment relates to a tax filing made prior to acceptance of the Offer in Compromise. For example, assume that a taxpayer's Offer is accepted in 1997 to compromise taxes owed for 1990, 1991 and 1992. In 1998, a deficiency assessment for tax year 1995 is made against the taxpayer and he is unable to make full payment. Would the failure to full pay the 1995 assessment result in a default of the agreement, thus nullifying the Offer in Compromise? We believe that it should not.

The federal five year compliance condition, as stated in Form 656, reads as follows:

> I/We will comply with all provisions of the Internal Revenue Code relating to filing my/our returns and paying my/our required taxes for 5 years from the date IRS accepts the offer.

This condition requires the taxpayer to remain current for the future in the filing and payment of all tax returns during the five years following the Internal Revenue Service's

acceptance of the Offer. Any additional federal assessment made against the taxpayer (which is not full paid) during the five year compliance period which relates to a tax filing that pre-dates the Offer, would not, in our view, result in a breach of the agreement so as to allow the Internal Revenue Service to nullify the Offer. See IRM 57(10)(20) and IRM 57(10)(21).5.

One objective of the Offer in Compromise program is to provide tax debtors with a fresh start toward future compliance with the tax laws. Once an Offer in Compromise has been accepted, there should be no opportunity for either party to rescind or nullify the Offer in the absence of (a) fraud, (b) mutual mistake as to a material fact, (c) noncompliance with payment of the Offer amount, or (d) failure to comply with the tax laws prospectively for at least five years. If there is an additional assessment against the taxpayer during the post-Offer five year compliance period which does not relate to a filing made by the taxpayer after acceptance of the Offer, we do not believe that a failure of the taxpayer to be able to full pay this assessment should be grounds for rescission of the Offer.[23] Accordingly, we recommend that the five year post-Offer compliance condition in the proposed regulations be reworded as follows:

> "Agrees to comply with all provisions of the New York State tax law relating to filing of returns and paying required taxes for all returns required to be filed in the five year period beginning with the date of the acceptance of the offer;"

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[23]Such an assessment would likely have been unforeseen at the time of the Offer. Otherwise, the taxpayer would have included the period within the Offer.

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6. One Offer.

The proposed regulations provide that the taxpayer may make only one Offer in Compromise regarding a particular tax liability for a particular taxable period. The Offer may be amended prior to final submission to the Tax Compliance Division. Prop. Regs. Section 5005(c)(4).

Comment:

This limitation tracks a similar limitation imposed in the regulations under subdivision eighteenth-a. See 20NYCRR Section 5000.3(f). Subdivision eighteenth-a, however, applies only to Offers in Compromise submitted to the Department in the limited timeframe prior to when the tax or administrative action becomes finally and irrevocably fixed and no longer subject to administrative review.

In the case of Offers submitted under subdivision fifteenth, where the tax has already become final and tax warrants or judgments are likely to have been filed, we do not believe that such a restriction should be imposed. Unlike the limited timeframe applicable for submission of Offers in Compromise under subdivision eighteenth-a, a tax debtor submitting an Offer under subdivision fifteenth faces a twenty year period of collection in connection with that tax liability. The tax debtor's financial circumstances and collection potential may change significantly over that twenty year collection period and an Offer rejected in year five of the collection period may well be acceptable in year twelve of the collection period if there is a change in circumstances or the Offer is increased. The federal Offer in Compromise program has no limitation on the number of Offers that can be submitted and, in the case of a rejected Offer, taxpayers often are

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encouraged to pursue another Offer in the future.

We believe that it is in the best interest of the state and the taxpayer to allow for the submission and processing of Offers in Compromise without restriction during the collection period of the liability. The making of an Offer is a "privilege" not a "right" to the taxpayer and the Department will have the discretion to reject frivolous offers or those made simply for the purpose of delaying collection of tax liabilities. Proposed Regulations Section 5005.1(e)(2)"(i)".

7. Offer Processing.

The proposed regulations provide that an Offer in Compromise will be reviewed by the Tax Compliance Division, which, in turn, will recommend acceptance or rejection of the Offer to the Commissioner. Upon a recommendation of acceptance by the Tax Compliance Division, the Commissioner may either accept or reject the Offer. If the amount forgiven is more than $25,000, any Offer accepted by the Commissioner must be referred to a justice of the Supreme Court for approval prior to any notification to the taxpayer of acceptance. Prop. Regs. Section 5005(d)(1) and (d)(2).

Comment:

The proposed regulations do not address whether the initial evaluation by the Tax Compliance Division of the Offer in Compromise is to be made by a field representative or by a centralized Offer in Compromise specialist.[24] Whatever the

[24]While there are advantages in setting up a centralized group specializing in the review and evaluation of offers, we also encourage the use of field representatives for direct contacts with the tax debtor if questions arise regarding valuation of assets or other issues.

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procedure for evaluation, we urge the Department to put in place an appeal process for review of any Offer in Compromise denied at the Tax Compliance level. Such would track the process in place at the federal level where denial of an Offer can be appealed for independent evaluation to Appeals. IRM 57(10)1.(12).

An appeal procedure not only insures a more uniform application of the standards imposed for granting or denying Offers in Compromise, but also fosters a sense of fairness in the administration of the program. Putting in place an independent appeals process, whether in the Commissioner's Office, Chief Counsel's Office or by conciliation conference, will ensure greater uniformity and fairness in the implementation of the Offer program.

8. Defaulted Offers.

The proposed regulations provide that where a taxpayer does not comply with the conditions of the Offer in Compromise, or where there is evidence of a substantial misrepresentation of a material fact subsequent to the acceptance of the Offer, the Department may deem the Offer in default and reimpose the full tax liability and proceed to collect the balance of the original liability without notice to the taxpayer. Prop. Regs. Section 5005(f).

Comment:

We recommend that the procedures dealing with default of an Offer in Compromise be conformed to those applicable to federal Offers in Compromise. Under the federal guidelines, an Offer in Compromise is binding on the parties in the absence of mutual mistake as to a material fact or false representations made by one party

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about a material fact. While the Internal Revenue Service has the power to nullify, rescind or deem the Offer in default and, consequently, to reimpose the liability and proceed to collection without notice, the approach of the Internal Revenue Service has been to attempt to secure compliance on potential defaulted cases rather than to proceed immediately to termination of the Offer. These procedures are set forth in IRM 57(10)(20) and IRM 57(10)(21).

Given the severe repercussions to the taxpayer upon default of an Offer in Compromise, we believe that the more restrained approach taken in the federal guidelines should be adopted in the state Offer in Compromise regulations.

9. Collateral Agreement.

The proposed regulations provide that, in an appropriate case, the Department may require as a condition of approval of the Offer a "signed agreement wherein the taxpayer agrees to pay over a fixed percentage of the taxpayer's future earnings or other income for a specific period of time." Prop. Regs. Section 5005(c)(2)(i).

Comment:

While the Internal Revenue Service has for many years sought collateral agreements to collect additional amounts to be paid over and above the amount accepted in an Offer in Compromise, the use of collateral agreements has been discouraged in recent years with efforts focused instead on securing lump sum payments of Offers in Compromise.

> "Collateral agreements should not be routinely secured but secured only when a significant recovery can reasonably be expected. Securing of a

> collateral agreement should be the exception and not the rule." IRM 57(10)(15).1(3).

The advantage to this approach is quite clear. A major benefit to the government in securing an Offer in Compromise is to achieve collection now of an account unlikely to be collectible in full. To the extent the account must continue to be overseen or managed for several years, either by reason of installment payment of the Offer or the need to oversee compliance with a collateral agreement, the government continues to incur costs in connection with that account. Closure of the account upon receipt of payment of the Offer frees up personnel to pursue accounts with higher collection potential.

From the taxpayer's standpoint, the imposition of a collateral agreement adds considerable uncertainty regarding the amount to be paid to resolve the liability. The collateral agreement also undermines the objective of the Offer program to grant a "fresh start" to the taxpayer in rebuilding assets or increasing earnings for the life of the collateral agreement (usually five years). Accordingly, we urge that the regulations incorporate the federal guidelines under IRM 57(10)(15), entitled "Use of Collateral Agreements".

CONCLUSION

Since the goals and underlying policies of the state Offer in Compromise program are consistent with those of its federal counterpart, we urge incorporation into the proposed regulations of selected portions of the federal Offer in Compromise

guidelines to provide needed guidance to taxpayers and to the Department in administering the state Offer in Compromise program. An Offer program that is fairly administered and which gains the confidence of taxpayers and their representatives is in the best interest of the state and its taxpayers since, on the one hand, tax debtors will be given a fresh start toward future compliance with the tax laws and, on the other hand, the state will achieve, at a minimal cost and at the earliest possible time, the amount reasonably collectible on the account.

As a final note, we believe that the New York State Offer in Compromise program would benefit significantly from statutory changes to the underlying enabling legislation. The present subdivision fifteenth requirement that a tax debtor demonstrate a discharge in bankruptcy or insolvency to be eligible for an Offer in Compromise is, in our view, a needlessly restrictive condition which does not advance the overall goals of the program. At the federal level (and also in subdivision eighteenth), no such showing need be made in order for a tax debtor's Offer to be considered. Since the tax debtor must make a minimum Offer which equals or exceeds the net equity in his assets, the restriction is counterproductive since the tax debtor must pay down his assets to the point of insolvency if the Offer is accepted. To require that the tax debtor demonstrate a balance sheet insolvency prior to making the Offer eliminates many potential tax debtors from the Offer program.[25] There is no reason apparent to us why solvent, but

[25] The problem arises if there is any disparity in assets counted or valuation method used in determining "insolvency" and "minimum offer" amount. For example, assume a tax debtor with assets having a fair market valuation of 100, but a "quick sale" value of only 60. Assume also secured debt of 50 and tax debt of 25. In the federal Offer in Compromise program, a minimum offer of 10 would reflect the net

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hopelessly indebted taxpayers, should not be allowed to participate in the New York State Offer in Compromise program and to pay down the net equity in their assets to satisfy their tax debts just as they would be able to do under the federal Offer in Compromise program.

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equity in assets owned by the taxpayer and thus be potentially acceptable to compromise the 25 tax debt. Under the New York program, if assets are valued at fair market value to determine "insolvency", an offer would not even be entertained since the tax debtor would show a balance sheet solvency of 25.