NEW YORK STATE BAR ASSOCIATION TAX SECTION REPORT

ON

THE NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE

NONRESIDENT AUDIT GUIDELINES

January 31, 2011

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Report No. 1233

NEW YORK STATE BAR ASSOCIATION TAX SECTION REPORT ON THE NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE NONRESIDENT AUDIT GUIDELINES[1]

Introduction

This report recommends changes to the Nonresident Audit Guidelines of the State of New York that were issued by the Department of Taxation and Finance (the "Department") on March 31, 2009 (the "Guidelines").[2] The Guidelines are intended to aid auditors and their supervisors in the audits of nonresident tax returns where the auditor is considering whether the individual should have filed as a New York resident. According to the Guidelines:

> These guidelines explain the tax law and regulations concerning residency, discuss audit policies and procedures regarding the subject, and address various technical and complex issues through examples and explanations. They have been established to ensure uniformity and consistency in the examination of nonresident returns.[3]

The Guidelines include an explicit statement that they "do not replace existing law, regulations, case law or materials issued by the Department." Under the Department's Regulations as well as under the New York State Administrative Procedure Act, the Guidelines have no legal force or effect. Furthermore, and we are pleased to see, they provide:

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[1] This Report was prepared by the Committee on New York State Tax Issues, Robert Brown and Arthur Rosen, co-chairs. Robert E. Brown and Mark R. Kossow were the principal drafters of the report. Helpful comments were received from Paul Fusco, Maria Jones, Arthur Rosen, Peter Faber, Diana Wollman, Irwin Slomka, Paul Comeau, Sherry Kraus, Robert Levinsohn, Carolyn Joy-Lee, and Peter Blessing. Opinions expressed in the report are those of the Tax Section of the New York State Bar Association, and do not represent those of the New York State Bar Association unless and until they have been adopted by the Association's House of Delegates or its Executive Committee.

[2] The Guidelines replace the 1997 Revised Manual For Nonresident Audits.

[3] Note that the Guidelines apply not only to determinations of New York State residency, but also to determinations of New York City and Yonkers residency.

> . . . the Department recognizes that there may be situations encountered on audit where such rules may not be appropriate. In these situations, it is up to the supervisor and the auditor to work together to ensure that the spirit of the guidelines is carried out when interacting with taxpayers and their representatives. This requires flexibility in applying the guidelines coupled with a commonsense, practical approach in auditing nonresident cases.[4]

Notwithstanding these statements of limitation and flexibility, the Guidelines provide that "[t]hey are generally binding on audit staff who are expected to follow the rules and procedures outlined in the guidelines when conducting an audit."[5]

Expeditious and accurate audits benefit both the Department and taxpayers by reducing errors that result in controversy. They also narrow issues so that appeals that do occur are less costly. In order for the Guidelines to result in more expeditious and accurate audits, the Guidelines should be a dispassionate explanation of the route to an objective determination of residency. They should not be a strategic document that simply helps auditors assert New York residency. While we believe that the Guidelines go a long way in the right direction, we also believe that in certain respects they could be improved. It is our hope that the amendments suggested herein will assist the Department in revising the Guidelines to better fulfill their intended goals.

The 1997 nonresident audit manual (which the Guidelines replaced) began with several pages of introduction that stressed that audits need to be conducted in the context of reasonableness and practicality. So for example, the introduction to the 1997 manual pointed out specifically that the taxpayer does not have to eliminate all of his or her contacts with New York.[6] They went on to note that "[t]he auditor should apply common sense with a practical application of the audit process" and that "[a]udit staff should

[4] Guidelines, p. 4.
[5] Guidelines, p. 4.
[6] 1997 Revised Manual for Nonresident Audits, p. 5.

balance the audit process to ensure that the revenues of New York are protected and at the same time economic activity by nonresidents, in New York, is not discouraged and that the burdens place on taxpayers are neither unfair nor unreasonable." One suggestion is that the Guidelines include the introduction from the 1997 manual to emphasize the importance of these principles.

Background

New York Resident Taxpayer

An individual who is a New York "resident" under the New York State rules is subject to New York State income tax on all of his/her income, from whatever sources. By contrast, a nonresident individual is liable for New York State income tax only on income from sources within the State. Consequently, for individual taxpayers with personal presence both within and without New York, the determination of residency for State tax purposes has substantial economic consequences.

Under Section 605(b) of the Tax Law,[7] a resident individual generally means an individual:

(a) who is domiciled in New York ("a resident"); or

(b) who is not domiciled in New York but maintains a permanent place of abode in New York and spends in the aggregate more than one hundred eighty-three days of the taxable year in the state ("a statutory resident").[8]

Pursuant to 20 NYCRR Section 105.20, a person domiciled in New York is nevertheless treated as a non-resident for a specific taxable year if for that year such person satisfies one of the following two sets of requirements:

[7] NY CLS Tax §605(b).
[8] There is an exception from "statutory residence" for an individual in active service in the armed forces of the United States.

(a)

(i) such person maintains no permanent place of abode in New York during such year,

(ii) such person maintains a permanent place of abode outside New York during such entire year, and

(iii) such person spends in the aggregate not more than 30 days of the taxable year in New York;

or

(b)

(1) within any period of 548 consecutive days such person is present in a foreign country for at least 450 days,

(ii) during such period of 548 consecutive days such person is not present in New York for more than 90 days and does not maintain a permanent place of abode in New York, and

(iii) during the nonresident portion of the taxable year with or within which such period of 548 consecutive days begins and the nonresident portion of the taxable year with or within such period of 548 consecutive days ends, such person is present in New York for a number of days which does not exceed an amount which bears the same ratio to 90 as the number of days contained in such portion of the taxable year bears to 548.

Domiciled in New York

Definition of Domicile

As outlined above, an individual who is "domiciled" in New York is taxed as a New York resident, unless certain conditions are met. Thus, the definition of "domicile" is a significant issue in the audit of a nonresident return. According to 20 NYCRR Section 105.20(d), domicile, in general, is the place that an individual intends to be such individual's permanent home – the place to which such individual intends to return whenever such individual may be absent. Moreover, a domicile once established continues until the individual in question moves to a new location with the bona fide intention of making that location such individual's fixed and permanent home. A person can have only one domicile at one time.

The Five Primary Factors for Determining Domicile

The Guidelines provide five primary factors that an auditor is instructed to analyze to determine the location of a person's domicile: (1) home, (2) active business involvement, (3) time, (4) items "near and dear", and (5) family connections. These five primary factors must be analyzed before any other factors are considered. According to the Guidelines, the auditor may consider only the primary factors (at least in the first instance) if they point toward a definite tie to New York, or are at least equal in weight for New York and another location.

Other Factors Affecting Domicile

In addition to the primary factors, there are other factors that can shed light on a taxpayer's domicile. According to the Guidelines, these other factors are subordinate to the primary factors and, in most cases, need not be reviewed to ascertain domicile. According to the Guidelines, where the primary factors indicate a New York domicile, the other factors should be considered but will not carry the weight and significance of

the primary factors. However, in situations where the domicile location remains unclear after an analysis of the primary factors, the other factors will be given greater significance.

These other factors are as follows:

a. The address at which bank statements, bills, financial data and correspondence concerning other family business is primarily received.

b. The physical location of the safe deposit boxes used for family records and valuables.

c. Jurisdiction of auto, boat, and airplane registrations as well as the individual's personal driver's or operator's license.

d. Identification as to jurisidiction where the individual is registered to vote and an analysis of the exercise of such privilege.

e. Possession of a Manhattan Parking Tax exemption.

f. An analysis of telephone services at each residence, including the nature of the listing, the type of service features, and the activity at the location.

g. The citation in legal documents that a particular location is to be considered the individual's place of domicile or that a particular residence is considered to be a primary residence.

h. A "green card" indicating that the individual may legally reside in the United States on a permanent basis.

Nonfactors of Domicile

According to the Guidelines, there are several factors that should not be considered in determining domicile. These non-factors include (but are not limited to) the following:

a. the place of interment;

b. the location where the taxpayer's will is probated;

c. passive interests in partnerships or small corporations;

d. the mere location of bank accounts;

e. contributions made to political candidates or causes;

f. the location where the taxpayer's individual income tax returns are prepared and filed.

Statutory Resident

As set out above, there are two varieties of New York residents; an individual who is not "domiciled" in New York (and thus a "resident") will instead be a "statutory resident" if such individual (i) maintains a permanent place of abode in New York for substantially all of the taxable year (generally, the entire taxable year disregarding small portions of such year) and (ii) spends in the aggregate more than 183 days of the taxable year in New York. Thus, the definition of "permanent place of abode" and the meaning of "substantially all of the taxable year" can be significant issues in the audit of a nonresident return.

Permanent Place of Abode

According to the Regulations, a permanent place of abode means a dwelling place of a permanent nature maintained by the individual, whether or not owned by such

individual, and will generally include a dwelling place owned or leased by such individual's spouse. However, a mere camp or cottage, which is suitable and used only for vacations, is not a permanent place of abode.[9]

Substantial Part of the Year

The Regulations define "substantially all" to mean a period exceeding 11 months.[10]

Recommendations

Definition of Domicile

The Guidelines emphasize that domicile is defined as the place an individual intends to be his permanent home, the place he intends to return to whenever he may be absent. This definition is technically correct and consistent with New York statutory law and the Regulations, but without further explanation, we believe that it places too much emphasis on the concept of permanency. In the context of domicile, "permanent" does not imply "forever." When a person has moved from one place to another with the intention of remaining there for an indefinite period of time, the person becomes a domiciliary of the new place even if he has a "floating intention" to return to his former domicile at some future and indefinite time.[11] So, for example, an individual who moves from New York to another state with the intention of remaining in the new state becomes a domiciliary of the new state even if she intends to return to New York "after she retires."

For this reason, a better definition of domicile for purposes of the Guidelines would be: the place a person is making his home without a present intention of leaving

[9] 20 NYCRR §105.20(e).
[10] 20 NYCRR §105.20(a).
[11] See 28 CJS Domicile, Paragraph 11 at 19 [1941].

after some particular time. Therefore, we recommend that the Guidelines be revised to reflect the following definition: domicile is the place an individual makes his home, not necessarily with a present intention to remain there forever, but without a present intention to leave at some particular future time or occasion. A secondary definition might be: domicile is the place an individual spends his or her time when there is no specific reason to be elsewhere.

We believe that more examples drawn from actual decisions, both where the taxpayer was found to be a domiciliary of New York as well as where the taxpayer was found to not be a domiciliary of New York, might offer more practical and helpful guidance to auditors and should be included in the Guidelines.

Burden of Proof as to Domicile

The Guidelines correctly note that the burden of proof as to domicile is upon the party asserting the change.[12] The Guidelines go on to state, however, that "an individual who moves into New York is subject to the same rules concerning burden and 'clear and convincing' evidence as someone moving out of New York."[13] We believe that this statement is confusing and should be replaced with a statement that makes clear that the burden of proof lies on the Department when it is asserting a change of domicile to New York and that the burden of proof lies on the taxpayer when he or she moves out of New York and asserts a domicile other than New York.

Determination of Domicile: Primary Factor Home

The Guidelines assert that "if a couple resides in a particular community while raising their children and sells their residence to purchase or rent a smaller residence in

[12] *Matter of M. John Hosley* v. *Curry*, 85 N.Y.2d 447 (Ct of Appls. 1995).
[13] Guidelines, p. 12; *Matter of Bodfish* v. *Gallman*, 50 AD2d 457.

the same community after their children are grown, that new residence, regardless of the length of time spent there, takes on the same range of sentiment the couple has for the community in which they reside."[14]

In our view, this assertion is not necessarily true as a factual matter in every case. The auditor should properly examine all the actual facts and circumstances when assessing the factor of "home".

Suppose for example that the couple reared their children in an area of New York that has excellent summer recreational opportunities. After their children leave home, the couple sell their residence and move permanently to a state where there is no snow, with no present intention to return. Because of the summer recreational opportunities in that area of New York, however, the couple decide to buy a smaller summer residence in the same community that is closer to the waterfront. In this case, the fact that the couple keep a smaller residence in New York has very little relevance to the question of their domicile.

For this reason, we recommend that the quoted language be modified to indicate that the purchase of a smaller residence in the historic domicile may imbue the new residence with "the full range of sentiment the couple has for the community in which they reside, but that this must be assessed in the context of the other facts and circumstances of the couple's life."

Another problem raised by this part of the Guidelines is the use of the term "community." We request that there be a clear statement that "community" is a small location geographically and giving as an example that Westchester County and Manhattan are two different and distinct communities.

[14] Guidelines, p. 15.

Determination of Domicile: Primary Factor Time

The Guidelines correctly note that the fact that the taxpayer spends more time in New York than in the state he claims as his domicile does not necessarily mean that he is domiciled in New York.[15] We believe that the Guidelines should reference the Tribunal decision in *Knight*[16] in which the Tribunal found that, in the case of individuals who commute to work in New York, the preponderance of time spent in New York may be particularly inapposite to determining domicile. The Guidelines should also make it clear that the rule that a day is a "New York day" if the taxpayer is present in the State for just a few minutes during that day does not apply in determining domicile. (That rule applies in the context of determining statutory residence, as discussed below.)

Use of Affidavits By the Taxpayer To Establish Facts

The Guidelines provide that an affidavit from a third party individual *may* clarify facts regarding an individual's location on a particular day, and refers to Tribunal decisions where such affidavits were found to corroborate the taxpayer's location.[17] In our experience, auditors often do not give affidavits due credence because the auditors view them as self-serving. We believe that the Guidelines should provide guidance to correct this tendency. The Guidelines should specifically state that an affidavit of a third party, signed under penalties of perjury, should be treated as presumptively true. The weight to be given to those facts would, of course, be governed by the applicable law.

Definition of Statutory Residence: Permanent Place of Abode

To be a statutory resident, an individual must maintain a "permanent place of abode" in New York. This means that an individual who spends more than 183 days in

[15] Guidelines, p. 26.
[16] *Matter of Craig F. Knight, DTA No. 819485*, Tax Appeals Tribunal (Nov. 9, 2006).
[17] Guidelines, pp. 27-28, 29 and 84.

New York during a year may still not be a statutory resident for that year if he or she does not maintain a permanent place of abode in New York during the year.[18]

With respect to the meaning of "maintains" and "permanent", the Guidelines quote extensively from the *Evans*[19] decision. We believe the Guidelines should also discuss and quote from the *Knight*[20] decision to illustrate the subtle nature of the distinctions necessary to determine whether a taxpayer maintains a permanent place of abode. In *Knight*, the taxpayer spent more than 183 days in 1997 in New York living at his girlfriend's house; he did not use the house for daily access to his job and he had neither unlimited access nor a room of his own. He did not keep clothing or belongings at the apartment, nor did he depend on it for his daily life. The Tribunal distinguished *Evans* where the taxpayer was found to have "maintained" a room at a church rectory because he kept clothing and belongings there, he had free unfettered access to it, he used the room to access his full time job, and he used the room for certain daily living essentials.

Furthermore, *Matter of Gaied* [21] makes clear that it is not only the use of an abode but also its physical characteristics and *how* it is used by the taxpayer that determines whether it is a "permanent" place of abode for the taxpayer. John Gaied filed a New York nonresident return for part of 2001 and all of 2002 and 2003, indicating his address as a residence in Old Bridge, New Jersey, and reporting New York source wages from

[18] A simple example of this is an individual domiciled in another state who is assigned by her employer to work in New York for a fixed and limited period and is expected thereafter to return to her home state. We note that amendments to 20 NYCRR Section 105.20(e)(1) purport to change this result for tax years ending on or after December 31, 2008 (see TSB-M-09(2)I, January 16, 2009) but there is substantial question whether the change is effective absent an amendment to Tax Law Section 605(b)(1)(B) that would modify the plain meaning of "permanent".
[19] *Matter of Evans*, Tax Appeals Tribunal (June 18, 1992).
[20] *Matter of Craig F. Knight*, supra.
[21] *Matter of Gaied*, Tax Appeals Tribunal, July 8, 2010

two automobile service stations owned by the taxpayer and located in New York. The service stations required the taxpayer to work long hours and to cover additional shifts if his employees did not show up. Before and during the years in question, the taxpayer occupied a residence in New Jersey which was a 30 to 45 minute drive from his service stations. The taxpayer lavished great effort to make the New Jersey residence his "dream house". Initially, taxpayer's parents lived with him in his dream house, but after becoming annoyed by their presence, in 1999 he bought a residence on Staten Island near his service stations and moved his parents there. This residence contained three separate apartments, and his parents lived in one. All notices sent to the taxpayer as landlord were sent to him at that address; the taxpayer maintained a telephone number in his name at that address, and the gas and electric service for his parent's apartment was billed to that address in the taxpayer's name. Taxpayer's parents had no income, and they relied on him entirely for their support. He claimed them as dependents on his tax returns. Furthermore, taxpayer was called upon to provide physical support to his parents at least once every month or two, particularly because of his father's serious health issues. Because of his parents' medical needs, but only when they requested it, the taxpayer would occasionally spend the night at their apartment. He had no bed there, so he slept on the couch. He did not keep clothing or personal possessions at the apartment.

In 2003, the taxpayer sold his home in Old Bridge, New Jersey to pay some outstanding tax liabilities. He then renovated the boiler room at the Staten Island residence for his ultimate occupancy. During the time of renovation he did not stay at his parents' home but rather he stayed with an uncle in New Jersey.

The Tribunal found that the taxpayer was a domiciliary of New Jersey, but he was present in New York more than 183 days in each year. In holding that the taxpayer did not have a permanent place of abode in New York, the Tribunal noted that the facts were the reverse of the facts in *Evans*. In that case the petitioner stayed in a residence he did not own. In *Gaied* the petitioner did not have a place to stay in a residence that he owned but maintained for his parents.

We suggest that the Guidelines should make clear that it is the character of a residence and how it is used by the taxpayer that determines whether it is a permanent place of abode and not technical facts of ownership or occupancy.

Residence Not Used or Used by Others

The commentary in the Guidelines that illustrate that investment property and property used by people other than the taxpayer might not be a permanent place of abode should make clear that such property could have been acquired by the taxpayer for investment or converted from residential to nonresident use by the taxpayer. As the Guidelines now read,[22] they could be taken to mean that the only circumstances in which residential property owned by the taxpayer but used by others would not be a permanent place of abode is when the property devolves upon the taxpayer through an estate settlement or divorce settlement, which clearly is not correct.

Corporate Apartments

The Guidelines state "In *Matter of Craig F. Knight, DTA No. 819485,* the Tax Appeals Tribunal reversed the ALJ in finding that a New York City apartment that was leased to a partnership was not the taxpayer's PPA."[23] We suggest that, to avoid

[22] Guidelines, pp. 47 and 48.
[23] Guidelines, p. 51.

confusion, this sentence be rephrased to make clear that the Tax Appeals Tribunal reversed the ALJ and held that the New York City apartment in question was not the taxpayer's PPA.[24] Further, this aspect of the *Knight* decision is an important articulation of the elusive concept of permanent place of abode,[25] and as such it would be helpful if the Guidelines would discuss this aspect of the case more fully.

Substantial Part of the Year

The Guidelines correctly mirror the Regulations by noting that, in order to find that an individual is a statutory resident, the individual must maintain a permanent place of abode in New York "for substantially all of the taxable year (generally, the entire taxable year disregarding small portions of such year)."[26] The Guidelines provide:

> Audit policy defines substantial to mean a period exceeding 11 months. Audit Division policy considers the "substantial part of a year" rule to be a general rule rather than an absolute rule.[27]

The position of the Department is that facts and circumstances may dictate that a taxpayer has maintained a permanent place of abode even though the strict requirements of the 11 month rule have been met.

A 2004 Advisory Opinion[28] concluded that a non-domiciliary taxpayer did not maintain a permanent place of abode for substantially all the taxable year where he donated the use of his New York home to charity for three months of the year pursuant to a written lease. In the Advisory Opinion, the taxpayer's telephone was disconnected during the period of the charity's use, he removed all of his clothing and other personal effects, and he had no access to the house for any purpose during the time of the lease.

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[24] *Matter of Craig F. Knight*, supra.
[25] See *A Very Good Knight for Taxpayers*, Timothy P. Noonan, 43 State Tax Notes 815 (March 19, 2007
[26] 20 NYCRR §105.20(a)(2).
[27] Guidelines, p. 52.
[28] TSB-A-04I, July 6, 2004 .

The Advisory Opinion notes, however, that if an individual enters into similar leases year after year, the 11 month rule might not be applied as a strict rule in such a case. Similarly, the Guidelines quote an ALJ opinion (*Brodman*)[29] in saying:

> "Defining 'substantially' by the implementation of an absolute '11 month rule' in every instance, as petitioners urge, would allow the statutory resident provisions of the Administrative Code [[30]] and the implementing regulations to be easily circumvented by the simple expedient of giving exclusive use of one's place of abode to another person for a period in excess of one month for any reason (e.g., while on vacation)."

The actual holding of the ALJ opinion in *Brodman* was based principally on a finding that the taxpayers never relinquished legal control of the property, but simply allowed a family member to use it as a "gesture of familiar generosity." The permanent nature of the taxpayers' maintenance of the property was therefore never broken.

The Guidelines illustrate the nonrigidity of the 11-month rule further by setting forth the Department's view that an annual sublet of taxpayers' apartment year after year to their son would not interrupt permanence, and the apartment would be a permanent place of abode.[31]

Taken as a whole, the Guidelines statements about the meaning of "substantial part of the year" do not give as much, or as rounded, guidance to the audit staff or to taxpayers as we believe is appropriate. What happens, for example, if a taxpayer occupies a principal place of abode for fewer than 11 months in one year, maintains no principal place of abode in New York for several months and subsequently acquires a new principal place of abode and maintains it for fewer than 11 months in the next year?

[29] *Matter of Michael Brodman & Karen Grimm*, DTA No. 818594.
[30] New York City Administrative Code § 11-1705(b)(1)(B).
[31] Guidelines, p. 52.

Does it matter why (for example, a vacation, or a temporary work assignment) the taxpayer maintained no principal place of abode in New York during the interim?

What happens if the principal place of abode is uninhabitable by reason of construction or natural disaster for a portion of the year? Does the fact that the taxpayer owns or repairs the property during the period in which it is not habitable mean that it is maintained for a substantial part of the year? How would habitability rules relate to the requirement that a second home be "suitable for year-round" living.

Even if the taxpayer regularly rents a New York residence to another person for one or more months a year, that should not necessarily result in a determination that the taxpayer is maintaining a permanent place of abode in New York. For example, if the taxpayer has no use for the residence or chooses to use the residence to derive rental income, those facts may be inconsistent with the purpose of the statute, which is to tax those who are actually full-time residents of New York.

We recommend that the Guidelines include more examples applying the permanent place of abode and substantial part of the year principles in order to give the audit staff and taxpayers more balanced direction in this very murky area. At the very least, the Guidelines should reaffirm that the holding of the 2004 Advisory Opinion remains the position of the Department for substantially similar fact patterns.

A Day Spent in New York

The Guidelines note that "presence within New York State for any part of a calendar day constitutes a day spent within New York State" for purposes of the 183-day rule[32] The Guidelines recognize that literal interpretation of the rule could be bizarre in

[32] Guidelines p. 55 (referring to 20 NYCRR, Section 105.20; and *Matter of Leach v. New York State Tax Commission, 150 AD2d 842, 540 NYS2d 596*).

certain circumstances particularly if the time spent in New York is minimal, and they provide that "common sense must prevail."[33]

The Guidelines also quote *Matter of Klingenstein,*[34] however, in affirmation of the well-established principle that a brief period of time in New York can constitute a "day". In *Klingenstein,* the taxpayers came into New York on 21 days in one year and 22 days in another year to shop or to dine. These counted as "New York days" were sufficient to make the taxpayers statutory residents. The ALJ wrote:

> There is, unfortunately, no shopping or dining exception in the statute, regulation or case law. In fact, the recognized exceptions stand in contrast to purposeful presence in the state. Here, petitioners' presence in New York on the border days was not an in-transit presence, and was not unintended, unavoidable, unplanned, inadvertent or involuntary. Rather, petitioners' presence was purposeful and voluntary."

We suggest that the Guidelines present more examples for audit staff and taxpayers of minimal presence resulting in a "New York day" or a non-New York day .

What happens, for example, when a Connecticut domiciliary with a substantial vacation home in the Adirondacks at which she spends 30 days per year, works for a Connecticut employer, commutes to work by automobile and parks across the street from the employer in a public parking lot located in New York? What happens if the taxpayer's commute from his home in Connecticut to his place of business in Connecticut takes him through New York, and he stops occasionally in New York on the way home to buy groceries thereby making the "continuing travel" exemption that would otherwise apply inapplicable? Should these occasional stops count as days in New York? What happens if the taxpayer plays golf at a golf course located partly in New York and partly in Connecticut?

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[33] Guidelines, p. 55.
[34] *Matter of John & Patricia D. Klingenstein,*, DTA No. 815156, August 8, 1998.

The Guidelines should pose examples such as these and suggest some workable "incidental presence" test like the incidental test in the travel exemptions that would facilitate "common sense" audits.

Audit Techniques

In general, the Guidelines do not provide for appropriate safeguards and procedures when information is being sought from persons other than the taxpayer. The Guidelines suggest that auditors make personal observations of people and places as a part of the audit.[35] Most often, the personal observations made by auditors and the interviews taken by auditors of people such as door attendants, building superintendents and mail carriers are made without the presence of the taxpayer or the taxpayer's representative. If the audit procedures are designed in part to result in expeditious settlement of residency issues, it is very important that the auditors take comprehensive notes, make recordings or utilize standard questionnaires to make certain that the personal observations accurately reflect the facts about residency. Short, conclusory observations of the process in the auditor's own notes do not produce an adequate record for the taxpayer or the taxpayer's representative to review and will run the risk of drawing out the audit or forcing a litigated controversy.

We recommend that the Guidelines explicitly state that auditors and Field Audit Management must formally notify the taxpayer and the taxpayer's representative of the use of a third party subpoena. This is not now uniform procedure. The facts in a recent decision, the Tax Appeals Tribunal indicate that the Division of Taxation issued third party subpoenas to telephone companies requesting the taxpayer's telephone records without giving notice to the taxpayer or his representative until after the subpoenaed

[35] Guidelines, p. 71.

information had been received.[36] Furthermore, the Division's letters to the telephone companies instructed the telephone companies not to "notify he subscribers" of the subpoenas.[37] In this case, there was no fraud, there were no penalties or additions to tax asserted by the Division, the Division specifically acknowledged that it was not questioning the petitioner's integrity or honesty, and the Tax Appeals Tribunal found that the taxpayer had the "highest reputation for integrity, character and honesty."[38]

If the subpoena is directed to the taxpayer personally, we believe that the Guidelines should specifically require that the auditor and Field Audit Management advise the taxpayer of the right to have a qualified representative present and to record any interview. We recommend that the Guidelines set forth the rights afforded the taxpayer under the Taxpayer Bill of Rights and state that the auditor must explain those rights to the taxpayer.

We also recommend that the Guidelines set forth specific procedures for the auditor to follow if he or she suspects fraud or criminal activity. We suggest that the Guidelines state that in such an event the auditor must immediately refer the case to the Special Investigations Unit, and that they stress that action must be taken immediately. Failure to do so may deprive the taxpayer of fundamental rights and prejudice any criminal or fraud actions sought by the Department.

The Guidelines assert that the auditor "must bear the burden" in justifying the imposition of appropriate penalties.[39] All too often it seems penalties are routinely

[36] *Matter of Robertson,* Tax Appeals Tribunal (September 23, 2010) Findings of Fact 96 and 97.
[37] *Robertson,* Finding of Fact 97.
[38] *Robertson,* Findings of Fact 3 and 5.
[39] Guidelines, p. 75.

asserted to be used as a bargaining chip in later attempts at settlement. We believe that this is highly inappropriate, and the Guidelines should specifically prohibit this practice.

The 1997 guidelines directed the auditor to provide the taxpayer with written notification of the results of the audit regardless of the outcome. This notification was designed to "protect the individual from subsequent audits covering the same issue for the same period" and to relieve the burden of producing documentation for a period for which a resolution was reached.[40] We think this is sound policy that should be continued and set out in the Guidelines.

Finally, we suggest that the Guidelines make clear that audit work papers are to be made available to taxpayers prior to the closing conference so that the taxpayer and the taxpayer's representative can adequately prepare for the conference. Some auditors refuse to provide work papers at all in which case the taxpayer must resort to an action under the Freedom of Information Law. This is unduly burdensome, and does not contribute to sound tax administration.

Conclusion

Whatever the "spirit" of the Guidelines, any audit, particularly a residency audit, is a tense, intrusive, and adversarial process for the taxpayer. In the residency context, it is incumbent on the Department to make sure that its audit process minimizes needless inconvenience and intrusion into the taxpayer's personal life and business affairs. The Department should establish a policy that discourages auditors from simply "building a case for residency" and encourages a more dispassionate search for a correct answer to what is often a very complex and subtle set of issues.

[40] 1997 Revised Manual, Section 10E.

Case after case has held that the Guidelines are just that. They are not law. They have, however, a very powerful influence on whether the audit process is efficient, fair and effective. The flexibility built into the Guidelines and the invitation to follow their "spirit" can only work if the auditors and Field Audit Management understand them and internalize a desire to conduct the process as a fair inquiry into the facts and not as an exercise in maximizing revenue. Accordingly, we support a revision to the Guidelines, as well as continued training of audit staff and Field Audit Management.