

TAX SECTION

New York State Bar Association

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

By Committee on New York State Tax Matters

July 28, 1989

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TAX SECTION**New York State Bar Association**

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August 3, 1989

Saul Heckelman, Esq.
 Special Counsel to Commissioner
 of Taxation and Finance
 New York State Department of
 Taxation and Finance
 State Campus - Building 9
 Albany, New York 12227-0215

Dear Saul:

Enclosed is a Report on the Department of Taxation and Finance's Uniform Procedure Bill (Departmental Bill # 89-1). The principal draftsman of this Report was James A. Locke.

The Report enthusiastically supports the Bill as a major contribution to bringing badly needed order and simplification to the procedural and administrative provisions in the State tax law. It notes and commends the substantial efforts made in the Bill to improve or correct procedural traps and inequities.

A basic recommendation of the Report is to maintain conformity with the federal rules where the structure of the substantive State tax law provisions permits. It endorses several conforming changes made by the Bill (including increasing the fraud penalty from 50% to 75% and adopting mailing rather than "actual receipt" as the basic notice concept for sales taxes), but opposes the non-conforming addition of a State penalty for failure to file prior to the date a notice of deficiency is issued to a taxpayer.

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The Report accepts the changes in the civil penalty provisions subject to further federal law reforms and recommends that action on the Bill not await the outcome on any further federal changes. But it also draws attention to the fact that growing recognition of the regressive and overly complex nature of the federal rules may lead to further federal reforms and recommends that New York give prompt consideration to such reforms through further revisions in the Bill (or prompt consideration of a supplemental bill if the Bill itself is already approved).

Sincerely,

WLB/JAPP
Enclosure

Wm. L. Burke

cc(w/encl.): William F. Collins, Esq.
Deputy Commissioner and Counsel
New York State Department of
Taxation and Finance
State Campus - Building 9
Albany, New York 12227

The Honorable Tarky Lombardi, Jr.
Chairman Senate Finance Committee
Room 612 Legislative Office Building
Albany, New York 12247

The Honorable Donald Halperin
Ranking Minority Member
Senate Finance Committee
Room 612 Legislative Office Building
Albany, New York 12247

The Honorable Saul Weprin
Chairman, New York State Assembly
Ways and Means Committee
Room 923, Legislative Office Building
Albany, New York 12248

The Honorable John C. Cochrane
Ranking Minority Member
New York State Assembly
Ways and Means Committee
Room 444, State Capitol
Albany, New York 12248

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July 28, 1989

NEW YORK STATE BAR ASSOCIATION
TAX SECTION

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

By Committee on New York State Tax Matters*

The New York State Department of Taxation and Finance ("Department") has drafted a Uniform Procedure Bill as its 1989 Legislative Proposal No. 1 ("Bill") to unify, simplify and strengthen the procedural and administrative provisions of most of the taxes administered by the Commissioner of Taxation and Finance. This report is in response to the Department's request for our comments on the Bill.

In 1984 the Tax Section submitted a report ("1984 Report") to the Department on the need for procedural uniformity in the New York Tax Law. Members of the Committee had several meetings with personnel from the Department and staff members from various committees of the Legislature to discuss issues raised in that report. In 1988, the Department prepared a 1988 Study Bill on Uniform Procedure upon which the Tax Section prepared a report ("1988 Report") which favorably commenced on the Study Bill and made several' recommendations for improvement. The principal recommendations made by the Committee in the

* This report was drafted by James A. Locke. Helpful comments were provided by E. Parker Brown, II, William L. Burke, John A. Corry, Paul H. Frankel, Raymond N. McCabe, Joseph W. Pinto, Robert Plautz and Joseph C. Small.

1984 Report and most of the comments made in the 1988 Report have been incorporated into the Bill by the Department. The Bill also incorporates the changes in the interest rate rules included in the 1989 Budget Bill.

We believe that the Bill, if enacted, will make significant progress in bringing order and simplification to the procedural and administrative provisions of the New York Tax Law ("Tax Law"). The Bill will eliminate a number of procedural traps and inequities for taxpayers and streamline the administration of the Tax Law by the Department. We believe that the Department is to be commended for both the well-conceived structure of the Bill and its even-handedness. While we have some suggestions to improve the Bill and to avoid apparently unintended substantive changes in law, we enthusiastically support its enactment.

The Bill does not apply to New York City taxes, other than those administered by the Department (e.g., sales and use and personal income taxes). New York City has many local taxes closely modeled after similar New York State taxes. In order to avoid procedural traps for taxpayers, the Committee strongly recommends that the procedural rules for New York City taxes be conformed with the provisions for the comparable New York State tax.

I. OVERVIEW

Unlike the Internal Revenue Code, the Tax Law does not currently contain any unified or even consistent procedural and

administrative provisions. The various articles of the Tax Law were added at different times and each contains its own procedural and administrative rules. As a result, any uniformity in procedures is more a historical accident than an intentional objective. As was pointed out in the 1984 Report, the current rules are unnecessarily complex and confusing in a manner which serves no logical objective. In addition, the subtle differences in procedural rules among the various articles have created procedural traps for taxpayers and administrative complexity for the Department.

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

In addition, certain fundamentally unfair provisions of current law (e.g., the requirement that a taxpayer pay certain contested taxes prior to seeking an Article 78 review of a Tax Tribunal decision and the unusually short period of time to seek a refund of sales and use taxes) have been eliminated. These changes were recommended in the 1984 Report.

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

II. COMMENTS

A. General Scope of Bill

Article 35 will apply to most, but not all, New York taxes. It will not apply to the estate tax except for the additional taxes imposed by Sections 954-a and 958-a of the Tax Law (tax on certain*premature dispositions of property by heirs). While the Committee continues to believe that the procedural rules for the estate tax should be similar to those of the other major New York taxes, such a change would require major structural changes to the underlying tax scheme and is not appropriate for inclusion in the Bill. The Committee continues to support the recommendations previously made on this subject.*

Only those provisions of Article 35-that relate to conciliation conferences, division of tax appeals and judicial review will apply to the mortgage recording tax (Article 11), the stock transfer tax (Article 12), and the taxes in the Racing,

* See New York State Bar Association Tax Section Report, "Recommendation for Simplification of New York Estate Tax Exemptions and Procedures" (September 1967) at p. 38-3 3; New York State Bar Association Tax Section, "Report On Procedural Uniformity in the New York Tax Law" (July 1984) at p. 7-8.

Pari-Mutuel Waging and Breeding Law. This limitation on the scope of Article 35 may be proper in view of the unique nature of the" taxes.

B. Definitions

The definition of a "corporation" in Section 1601(b) of the Bill needs to be amended to include publicly-traded partnerships treated as corporations under Section 7704 of the Internal Revenue Code to conform with the changes made in the definition of a corporation in the 1989 Budget Bill.

C. General Procedures

1. Notice of Deficiency and Assessment Procedure

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

(a) Elimination of Notice of Determination Provisions

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

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

The change in procedure will also eliminate one taxpayer "benefit" under the current sales tax procedures for giving notice to a taxpayer. Under the current sales tax procedures, a taxpayer must receive actual notice of a notice of determination.* Article 35 adopts the rule used in the current personal income and franchise tax provisions that a mailing by certified or registered mail to a taxpayer's last known address

* See *Ruggerite v. State Tax Commissioner*, 64 N.Y.2d 688 (1984).

is sufficient. Although some members of the Committee believe that retaining the current "actual receipt" standard for sales tax is preferable, we support this change since it conforms with the existing federal procedural rules.

(b) Estimated Audits

The Bill would make a major substantive change in the sales and use tax audit rules which we believe is unintended. Under existing law, the Department may not use external indicies or test period audits to estimate sales tax unless the taxpayer's records are inadequate to conduct a complete audit.* The language in Section 1610(a)(1) of the Bill, which is derived from the personal income tax procedural rules, read together with Section 1610(a)(3) of the Bill, creates' a potential problem. Section 1138(a) of the Tax Law currently provides that a sales tax audit can be estimated based upon external indicies only "if necessary". Since taxpayers which maintain adequate books and records to record their sales tax liability should be entitled to have such books and records serve as the basis of any sales tax audit, we believe that the Bill must be revised to conform to existing law on this important substantive issue.

* See Chartair Inc. v. State Tax Commission, 65 A.D.2d 44 (3rd Dept. 1978).

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

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

(d) Burden of Proof

The burden of proof rules contained in Section 689(e) (personal income tax) and Section 1089(e) (franchise tax) should be expressly incorporated into Article 35 and made applicable to all taxes to avoid the possible implication that their deletion indicates a change in such rules.

2. Interest

The Bill incorporates the interest provisions recently added by the 1989 Budget Bill. These new rules generally conform to the federal rules for determining interest on underpayments and overpayments of tax as was recommended in the 1984 Report. However, unlike the federal rules, interest is paid on refund claims only from the time the refund claim is filed and no interest is paid if the refund is paid within three months of filing of the claim. As indicated in our prior comments on the 1989 Budget Bill, we fail to see a good tax policy reason

for this rule. However, this is a criticism of the 1989 Budget Bill provision and not the manner such provision is incorporated into Article 35.

3. Limitation on Period for Assessment

(a) General Rules

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

(b) Six Year Statute of Limitations for Substantial Omission of Gross Income

Section 1612(d) and (e) of the Bill incorporates the- provision from the current personal income and franchise tax law that if a taxpayer omits in excess of 251 of gross income from a return, the period for assessing a deficiency for such return is increased from 3 years to 6 years. This provision does not apply, however, to the extent the taxpayer discloses in the return or in a statement attached to the return, information sufficient to apprise the Department of the nature and amount of the item in issue. We recommend that these provisions explicitly provide that adequate disclosure in a federal tax return which is filed with a state return is adequate disclosure.

(c) Report of Federal Changes

The Bill adopts the recommendations made in the 1988 Report to change the provisions of existing law with respect to- the limitation period when a taxpayer is required to report federal income tax changes for purposes of the franchise and personal income taxes. Under current law, if a taxpayer files a report of the federal change, the Department may assess additional New York tax related solely to such change for a period of two years after the filing of the change report, regardless of the otherwise applicable limitation period. If a taxpayer fails to file the change report (even if the change would allow the taxpayer to seek a refund of tax), the assessment period for the taxpayer's entire liability for franchise or personal income taxes for the year in question never expires. See Tax Law §§ 683(c)(1)(C) and 1083(c)(1)(C). Thus, a taxpayer who inadvertently fails to file a report of a federal change may be surprised to discover that many years later, the Department may assess additional taxes unrelated to the federal changes. While it may be argued that the existing law encourages taxpayers to file reports of federal changes, most taxpayers (and practitioners) are unaware of the harsh result of this obscure rule.

The Bill would change existing law by allowing an assessment of additional tax at any time if a report of federal changes is not filed but only to the extent of any deficiency resulting from the federal change. The Department's adoption of

this recommendation is a good example of its efforts to eliminate many inequitable provisions in existing law.

4. Limitation on Period for Refunds

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

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

5. Mailing Rules

Section 1620 of the Bill adopts the mailing and other miscellaneous rules for timely complying with deadlines contained in the franchise and personal income taxes. While the Committee

believes that these uniform rules are desirable, there will be problems if uniform regulations are not also adopted. Currently, regulations have been promulgated under the sales and use, personal income and motor fuel tax laws which provide rules for the timely filing of documents dated with a private postal meter. No such regulations have been issued under the franchise tax. Thus, the use of a private postal meter can lead to a filing which is timely under one tax, but which would be untimely under another tax. Clearly, this inconsistency should be resolved when the Bill is adopted by uniform regulations for all taxes based upon the rule in the sales and use and personal income tax regulations which provide rules modeled after the federal rules for the use of private postal meters.

6. Judicial Review

Under current law, several taxes, including the sales and use and the real estate transfer gains taxes, require either the payment of such taxes or the filing of a bond as a condition of seeking judicial review of a decision of the Tax Tribunal. Section 1619 of the Bill generally adopts the judicial review rules currently contained in the personal income and franchise tax laws which allow an Article 78 proceeding without the prior payment of disputed taxes. This adds substantial fairness to the procedure for seeing judicial review. As under existing law, the Department may institute collection procedures after the Tax Tribunal's decision is final unless a bond or other security is provided so that this change should not adversely affect the collection of taxes. This change was recommended in the 1984 Report.

C. Civil Penalties and Additions to Tax

The Bill would bring about three fundamental changes to New York law with respect to civil tax penalties. If enacted, the Bill would (1) consolidate existing penalty provisions of various articles of the Tax Law into a single article; (2) amend existing penalty provisions to conform with changes in federal law brought about by the Tax Reform Act of 1986, and (3) increase certain penalties and add new penalties for delinquency and negligence.

Consolidation of penalties into a single article is an integral part of achieving procedural uniformity, which would make the Tax Law less complicated and confusing. However, the penalty system itself is complex and confusing and this complexity is not resolved merely by consolidation. Moreover, penalty provisions are more substantive than procedural in nature. They impose additional liabilities on taxpayers which, if applicable, are subject to the same assessment, protest and collection procedures as the underlying tax. Consequently, the goal of procedural uniformity can be accomplished without major revisions to existing penalty provisions.

The New York's civil tax penalty structure is modeled after federal law. The Tax Reform Act of 1986 made a number of changes to the federal penalty structure, including:

(1) increasing the penalty for failure to pay tax for any month following ten days after notice of intent to levy is filed or (in the case of a jeopardy assessment) for any month after the date notice and demand for payment of tax is made, from 0.5 to 1.0 percent;

(2) increasing the civil fraud penalty from 50 to 75 percent;

(3) increasing the penalty for substantial understatement of liability from 10 to 20 percent (the Omnibus Reconciliation Tax Act of 1986 had previously increased the penalty to the current 25 percent);

(4) amending the coordination between the negligence and fraud penalties so that each may apply to the same underpayment where portions are attributable to fraud and portions are attributable to negligence; and

(5) defining the term "negligence".

The Bill incorporates corresponding amendments to New York's penalty provisions with certain modifications discussed below and adds a limited number, of new penalties.

The federal tax penalty structure, upon which New York's penalty structure is based, is now widely perceived to be too complicated, too harsh and too difficult to administer fairly. The sheer number of penalties and the substantial overlap between them have been identified as lying at the root of the federal tax penalty problem. The introduction of federal penalty reform legislation suggests that Congress may soon take action to rectify the problems currently associated with the federal tax penalty structure.

We would not oppose these amendments to conform New York rules to the changes in federal penalty provisions brought about

by the Tax Reform Act of 1986 if the federal rules are not further revised. It should be recognized, however, that these amendments in many respects are regressive and add to the complexity of the penalty structure. At a time when a consensus has grown in favor of penalty simplification and reform, it would be unfortunate for New York to adopt rules that are both contrary to the consensus and still out of conformity with the federal rules. While the Bill involves too many other important parts to postpone pending federal action on penalties, if the federal rules are revised, we would urge that New York similarly revise its rules promptly, preferably by revising the Bill if it has not already been acted upon or promptly considering an additional bill if it has been. New and increased penalties for which there exists no federal counterparts must also be viewed in the light of the growing consensus in favor of reform and simplification.

1. Failure to File/Failure to Pay Tax

The penalties for failure to file and failure to pay tax applicable to the personal income tax, corporate franchise taxes and the real property transfer gains tax is derived from Sections 685(a)(1) and 1085(a)(1) of the Tax Law. The Bill would add additional penalties for failure to file and failure to pay tax. These new penalties would also apply to failure to file and failure to pay tax with respect to withholding tax, sales and use tax, motor fuel tax, and cigarette and tobacco product tax.

First, the Bill adds a new penalty, equal to 0.5 percent per month if no return is filed prior to the date a notice of deficiency is issued to the taxpayer, up to an additional 25 percent. Bill §1646(a)(3); see also, §§1660(a)(3)1, 1674(a)(3), 1687(a)(3) and 1690(a)(3). Under a coordination provision, the new penalty would not apply to any month in which the "basic" failure to file penalty (5 percent per month, not exceeding the aggregate of 25 percent) also applies.

The proposed new penalty has no counterpart under federal law. Under the coordination provision, the new penalty reduces the "basic" failure to file penalty for the first five months after the due date of the return (the period the "basic" penalty applies by reason of the 25 percent aggregate threshold). Thus the maximum penalty for simple failure to file under the Bill (without regard to the second proposed additional penalty discussed below) is 47.5 percent. In contrast, the proposed penalty for civil fraud, the most egregious act of taxpayer misconduct, is 75 percent.

The new penalty adds to the number and to the overlap of penalties applicable to a single act of misconduct. We favor conformity with the federal penalty structure.

The Bill also provides that the new penalty for failure to file, together with the penalties for failure to pay tax, shall be increased from 0.5 to 1.0 percent for any month beginning after the earlier of the following dates:

(A) ten days after notice of tax lien is given,
or

(B) the day notice and demand for payment of
the tax is made.

This provision is derived from a corresponding federal provision enacted as part of the Tax Reform Act of 1986, but is modified in the following respects. Under the federal provision, the increased penalty is not imposed until ten days after notice of intent to levy has been issued except in the case of a jeopardy assessment. Insofar as New York's tax lien also serves as an execution on the property of the taxpayer, New York does not provide for issuance of a notice of intent to levy. Accordingly, the Bill provides for imposition of the increased penalty ten days after issuance of a notice of tax lien. The Bill also provides for imposition of the increased penalty upon issuance of a notice and demand for payment of tax, if it occurs before (or within ten days after) the issuance of a notice of tax lien. Finally, the increased penalty rate applies to the "new" failure to file penalty as well as the failure to pay penalty. The corresponding federal provision applies to failure to pay tax alone.

The Joint Committee explanation to this provision in the Tax Reform Act of 1986 indicates that the additional federal failure to pay tax penalty reflects Congress desire to shift the cost of collecting delinquent taxes from the general taxpaying public, to delinquent taxpayers. The explanation further provides that the increased rate of penalty will

generally not apply until the Internal Revenue Service has made repeated efforts to collect the tax from the taxpayer by informal (and less expensive) means and "must switch to methods of collecting the tax that are generally much more expensive." The justification for the federal penalty provision has no relation to the obligation to file' returns. Accordingly the corresponding federal penalty does not apply to failure to file returns and as a matter of conformity, New York should adopt a similar rule. It is difficult to discern a justification for increasing the New York State penalty for failure to file after the tax has been assessed and collection activity has been initiated.

Thus, we recommend that the proposed "new" penalty for failure to file, and the proposed additional tax for failure to file should be eliminated. Of course, the additional penalty for a failure to pay could be applicable to a failure to pay tax shown or required to be shown on a return.

2. Accuracy Penalties - Civil Fraud, Negligence and Substantial Understatement of Liability

The proposed negligence and civil fraud penalties are derived from Sections 685(b) and 1085(b) of the Tax Law. The substantial understatement of liability penalty is derived from present Sections 685(p) and 1085(k). The Bill makes the following changes to these penalties.

First, the civil fraud penalty is increased from 50 to 75 percent. This change conforms with the federal civil

fraud penalty. The current proposal for reform of the federal tax penalty structure retains this 75 percent fraud penalty. Tax fraud should be severely sanctioned. Increasing the penalty to 75 percent appears warranted and we support this change.

Second, coordination between the civil fraud and negligence penalties would be modified. Under present law, the civil fraud penalty applies to the entire underpayment of tax if any portion of the underpayment is due to fraud. The interest component of the fraud penalty applies only to the portion of the underpayment attributable to fraud. Similar rules apply to the negligence penalty. The civil fraud penalty may be imposed only in lieu of the negligence penalty.

Under the Bill, the negligence penalty may be imposed only on the portion of the underpayment due to negligence. The civil fraud penalty may be imposed only on the portion of the underpayment due to fraud. If portions of the underpayment are attributable to fraud and negligence, both penalties apply to the applicable portions of the underpayment.

The substantial understatement of liability penalty is increased from 10 to 25 percent. Other provisions of the penalty remain substantially unchanged. This- penalty is imposed on the portion of the underpayment attributable to the substantial understatement. The penalty may be imposed in conjunction with the negligence and civil fraud penalties, except that the penalty may not apply to that portion of the underpayment which-is attributable to fraud.

The Bill's coordination provisions conform with corresponding provisions of federal law. However, as noted above, present federal law does not adequately address the substantial overlap and lack of coordination between the federal accuracy penalties. Notwithstanding the degree of overlap and lack of coordination among the accuracy penalties, the revised coordination rules are an improvement over current law.

The Bill also includes the definition of "negligence" and "intentional disregard" for purposes of applying the negligence penalty. It also retains the interest based components of the civil fraud and negligence penalties.

Although the proposed coordination amendments do not go far enough to eliminate the complexity of the civil penalty structure, they represent an improvement over present law. Further federal reform currently is under active consideration and appears to be moving on a "fast track". We would recommend consideration of the Bill without awaiting further federal developments. But to avoid additional confusion, should further revisions in federal law be enacted we would urge that the Bill be revised with a view to conformity, or if it has already been adopted, that a further bill that reflects the federal changes be introduced and acted upon promptly.

3. Other Provisions

The definition of "negligence" and "intentional disregard" should be retained. The interest based components of the civil fraud and negligence penalties, although adding to the

complexity of the penalty structure, should be retained pending the results of federal penalty reform.

D. Collection Provisions

The current collection provisions of the taxes subject to Article 35 are consolidated in Part IV of Article 35. The provisions are generally based upon the collection provisions in the personal income tax law. Section 1706 of the Bill requires the giving of ten days notice of lien before the enforcement of any collection activity. We recommend that this be conformed to the 30 day period under the federal tax levy rules. See I.R.C. §6331(d). Several new provisions are added which are based upon federal collection provisions.

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

E. Effective Date

The Bill would be generally effective for returns or reports required to be filed on or after January 1, 1991.

July 28, 1989