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OFFICE OF THE STATE COMPTROLLER

August 22, 2006

Mr. Andrew S. Eristoff
Commissioner
Department of Taxation and Finance
State Office Campus - Building 9
Albany, NY 12227

Re: Report 2006-F-11

Dear Mr. Eristoff:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; and Article II, Section 8 of the State Finance Law, we have followed up on the actions taken by officials of the Department of Taxation and Finance to implement the recommendations contained in our audit report, *Administration and Oversight of the Tax Protest Resolution Process* (Report 2003-S-42).

Background, Scope and Objectives

The Department of Taxation and Finance (Department) is responsible for collecting tax revenue and providing associated services in support of New York State government operations. For the fiscal year ended March 31, 2006, the Department collected \$51.4 billion in taxes, net of tax refunds.

In the course of administering the New York State Tax Law, the Department may make adjustments in the tax liabilities claimed by taxpayers or determine amounts are owed by taxpayers who have not filed tax returns. Under the New York State Taxpayer Bill of Rights, if a taxpayer does not agree with the adjustment or determination made by the Department, the taxpayer can file a protest with the Department. Such protests may be either formal or informal. Most of the tax protests filed with the Department are informal. The Department received 312,245 informal and 5,065 formal protests during the fiscal year April 1, 2005 to March 31, 2006.

Taxpayers filing a formal protest may request either a formal hearing or a conciliation conference. Formal hearings are held before an administrative law judge of the Division of Tax Appeals, a separate State agency that is totally independent of the Department. Conciliation conferences are held with the Department's Bureau of Conciliation and Mediation Services. If the taxpayer does not accept the conciliation order that is issued by the Department after the conciliation conference, the taxpayer may petition for a formal hearing with the Division of Tax Appeals. Under State Tax Law, several mandated waiting periods are built into each successive step of the formal protest process. These waiting periods are intended to give the taxpayer adequate time to consult

with counsel. If a taxpayer takes every available protest option, the successive waiting periods in the formal protest process can add up to a total of 405 days.

Informal protests are initiated when taxpayers notify the Department, either by phone or by mail, of their disagreement with the Department's tax determination. Mailed protests are received by the Department's central office, and are entered into the automated Case and Resource Tracking System (CARTS). Phoned protests are received at a taxpayer call center, and are also entered into CARTS. CARTS is programmed to assign each informal protest to the appropriate Department unit. The management of that unit must then assign the case to a tax representative before resolution activity can begin. A related system called COGNOS, uses the information from the CARTS to produce monthly management reports on the age of the cases.

If a tax liability is protested, the Department suspends collection efforts on the amount owed until the protest is resolved (prospective interest and penalties continue to accrue). To expedite the resolution of informal protests, the Department uses CARTS to monitor the timeliness of the resolution process. At the same time, the Department strives to ensure that the protests are resolved in a fair manner.

Our initial audit report, which was issued on November 2, 2004, examined the Department's administration and oversight of the tax protest resolution process for the period January 1, 2002 through September 30, 2003. The objective of our performance audit was to determine whether Department administration and oversight enable tax protests to be resolved in a timely manner. Our audit focused on the timeliness of the resolution process for informal protests. We did not address the timeliness of the resolution process for formal protests, because mandated waiting periods are built into this process by State Law and the process may be administered by another State agency (the Division of Tax Appeals). Our audit also did not address the appropriateness of resolution outcomes.

Our report identified certain enhancements that can be made in the Department's monitoring system and further improvements are needed in the timeliness of the resolution process. For example, three of the four units within the Audit Division generate a management report comparing the unit's performance against its timeliness goal. We further recommended that, when such reports show that timeliness goals have not been met, Department officials determine why the goals were not met and take corrective action when appropriate. The objective of our follow-up, which was conducted in accordance with generally accepted government auditing standards, was to assess the extent of implementation as of July 21, 2006 of the four recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found that Department officials made significant progress in implementing the recommendations. Of the four audit recommendations, all four recommendations have been implemented. We acknowledge the significant improvements the Department has made in the timeliness of the protest resolution process.

Follow-up Observations

Recommendation 1

Ensure that TSRD and the Transaction and Transfer Tax Audit Bureau develop performance measurement reports comparing their performance against their timeliness goals.

Status - Implemented

Agency Action - We reviewed documentation provided by the Taxpayer Services Revenue Division (TSRD). We found TSRD has developed performance measurement reports that are generated and monitored on a monthly basis. Further, based on our review of the documentation provided by the Department, the Transaction and Transfer Tax Audit Bureau (TTTB) has developed quarterly reports to compare actual performance to the goal of resolving disputes within 90 days.

Recommendation 2

When the performance measurement reports of the Audit Division and TSRD show that their timeliness goals have not been met, determine why the goals were not met and take corrective action when appropriate.

Status - Implemented

Agency Action - We reviewed the TSRD's performance measurement report for April 2006 and TTTB's Desk Audit and Field Audit reports for March 2006. We found the reports for both units explain the reasons timeliness goals were not met.

TSRD performance reports are discussed in monthly management meetings to review progress and reasons for work falling below standards with the intent to focus employees to resolve protests as quickly and accurately as possible to meet the standard. TSRD officials stated performance has become part of the management culture. Supervisors in TSRD know each of the cases that did not meet the performance goal and the reasons. Further, management took corrective action when appropriate.

The Audit Division's TTTB officials discuss the reports quarterly when they are produced. Any deficiencies and solutions are shared with all of the staff and corrective action is taken, as needed.

Recommendation 3

Develop a management report that clearly identifies the protest cases approaching the 90-day benchmark and the cases older than 90 days, and clearly identifies which of these cases have yet to be assigned for resolution. Use this management report to expedite the assignment and resolution of these cases.

Status - Implemented

Agency Action - TSRD has established procedures requiring employees print and review an inventory of their cases daily. Employees use this print-out to identify cases approaching the 90-day benchmark. Additionally, supervisors are required to print an inventory of all employee cases twice a week to monitor the progress of the cases and help to assign new cases.

TTTB developed quarterly management reports which compare actual performance to a goal of resolving cases within 90 days. This report also shows any case not assigned.

Recommendation 4

Develop a management report to track the status of cases that are transferred between units, and use this report to ensure that such cases are properly accounted for.

Status - Implemented

Agency Action - TSRD has specific procedures to track the status of cases that are transferred between units.

TTTB audits are self generated and generally not transferred from other units. TTTB does, on occasion, transfer informal protest cases to the Case Creation Unit if a case was mistakenly assigned to TTTB. These transfers are tracked on CARTS, if necessary. TTTB officials generate an open case management report monthly to ensure all cases are accounted for.

Major contributors to this report were Donald Paupini and Donald Collins.

We wish to thank the management and staff of the Department for the courtesies and cooperation extended to our auditor during this process.

Very truly yours,

Kenneth I. Shulman
Audit Manager

cc: Lisa Ng, Division of the Budget
Andrew Maguire, Department of Taxation and Finance