

State of New York
Office of the State Comptroller
Division of Management Audit

**DEPARTMENT OF TAXATION AND
FINANCE**

**DIVISION OF TAX COMPLIANCE
SEIZURE AND SALE OF ASSETS**

REPORT 96-S-86



H. Carl McCall
Comptroller



State of New York Office of the State Comptroller

Division of Management Audit

Report 96-S-86

Mr. Michael Urbach
Commissioner
New York State Department Taxation and Finance
W.A. Harriman State Campus, Building 9
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Dear Mr. Urbach:

The following is our audit report about the effectiveness of the Division of Tax Compliance's use of asset seizures and subsequent sales as collection tools.

This audit was performed pursuant to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit

January 30, 1998

Executive Summary

Department Of Taxation And Finance

Division Of Tax Compliance

Seizure And Sale Of Assets

Scope of Audit

The Department of Taxation and Finance (Department) collects the taxes for New York State. Over \$33 billion was collected during the fiscal year ended March 31, 1997. When taxpayers do not comply with provisions of the New York State Tax Law (Tax Law), collection of unpaid taxes becomes the responsibility of the Tax Compliance Division (Division). The Division employs nearly 300 Tax Compliance Agents (TCAs) who focus primarily on collecting taxes owed in business tax cases, primarily sales tax. As of March 1997, the Division had an inventory of 55,000 cases with an outstanding total balance of taxes due of over \$791 million.

The Division's collection process includes actions such as filing tax warrants and levying against bank accounts and business receivables. When these actions are not successful in satisfying the tax debt, the Division can seize the delinquent taxpayer's assets. The Division sells the assets at auction only as a last resort. Of the approximately 1,000 seizures the Division conducts annually, about 30 to 50 cases result in asset sales.

For the period January 1, 1995 through April 30, 1997, we addressed the following questions about the Division's use of asset seizures and asset sales as collection tools:

- Do asset seizures and sales serve as effective collection tools?
- Does the Division follow prescribed procedures and adequately secure assets during seizures?
- Do asset sales realize the maximum return in tax revenues?
- Does the Division protect the interests of delinquent taxpayers during the asset sale process?

Audit Observations and Conclusions

We determined that asset seizures, in general, are effective in collecting tax revenue from delinquent taxpayers, but that asset sales do not generate much revenue and are costly to carry out. We also found that Division personnel follow prescribed procedures and adequately secure assets during seizures. However, since the Division does not properly value the assets it sells, it is not protecting the tax debtor's interests by getting the best possible price.

The Division recognizes a number of stages in the seizure process: authorizing the action and notifying the debtor that assets could be seized; sending TCAs to the location to carry out the seizure; padlocking the business; and, as a last resort, selling the assets at auction. While the first three seizure stages produce significant collections of delinquent taxes, asset sales produce little revenue to apply to tax liabilities. Direct costs (padlock, auctioneer, etc.) paid by the debtor are subtracted from gross proceeds. However, an asset sale also demands about seven days of TCA time - time these staff cannot spend on other, more productive collection activities. We found that if both salary and opportunity cost factors are considered, the Division may have incurred costs of as much as \$1.29 million to generate net proceeds of \$233,000. We recommend that the Division consider these indirect costs in deciding whether or not it is economical to sell a taxpayer's assets. (See pp. 7-8)

We believe the Division should consider alternatives to asset sales, such as revoking the Certificate of Authority (which empowers a business to collect sales tax) from delinquent taxpayers. Division officials state that when they want to close a business to prevent the taxpayer from accumulating more tax debt, revocation, with its relatively low fine, is not effective. We recommend that the Division pursue legislation to increase the penalties for failing to remit sales taxes and for operating without a valid Certificate of Authority. (See pp. 8-9)

To increase the revenue it derives from asset sales, we also recommend that the Division consider other options such as selling certain seized businesses as "going concerns" rather than selling only the business assets. The Division could then take advantage of intangible assets, like a good location or an established customer base. (See p. 9)

Article 41 of the Tax Law requires the Division to sell seized assets for their "fair market value" at the time of sale. The Division interprets this to mean "forced sale value," or almost any amount bid at a tax auction. The Division did an actual valuation of assets in only 3 of the 50 cases we reviewed. We recommend that the Division perform such valuations to help the debtor satisfy the tax liability, and to help the State realize more revenue. (See pp. 13-15)

Comments of Officials

Department officials responded to the six recommendations in the report, indicating a mixture of agreement and disagreement with the recommendations. A complete copy of the Department's response is included as Appendix B to this report.

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Introduction

Background

The Department of Taxation and Finance (Department) administers State tax laws and serves as the general tax collection agent. For the fiscal year ended March 31, 1997, the Department collected over \$33 billion in State revenue from personal, corporate and sales taxes, as well as various miscellaneous taxes. Within the Department, the Tax Compliance Division (Division) has responsibility for collection follow-up with taxpayers who fail to file, register or pay tax bills (assessments). The collection responsibility passes to the Division after a delinquent taxpayer has exhausted his rights to appeal the unpaid tax liability. For the 1996-97 fiscal year, the Division expected to collect over \$1 billion in unpaid tax assessments.

The Division employs nearly 300 Tax Compliance Agents (TCAs) who operate from 12 district offices and the central office. The TCAs in district offices focus their efforts primarily on collecting accumulated taxes owed in business tax cases. As of March 1997, the Division had an inventory of 55,000 cases with a total outstanding balance that exceeded \$791 million. The balance owed in each of these cases could include several unpaid assessments, as well as the penalties and interest that have accrued since the case's inception. A large portion of this total outstanding balance is sales tax which businesses have collected from the public but have not paid to the State.

Sales tax is a "trust" tax. The general public pays the tax to a vendor who is in turn entrusted to remit the tax to the State. Taxpayers and government officials expect the Department to collect all sales tax paid by the general public for goods and services.

The Division has developed a collection procedures manual that details the process by which TCAs collect tax debt. The process follows a 180-day cycle and includes such actions as filing tax warrants and levying against bank accounts, rental income and business receivables. In the case of sales tax collection, these actions can be against a business or against the personal assets of any individual responsible for paying the taxes of the business. When other collection methods fail to satisfy the tax liability, the New York State Tax Law (Tax Law) gives the Commissioner authority to seize and sell the assets of the tax debtor. Division officials told us that they regard seizure as part of a normal progressive collection approach. It is a step the Division uses as a last resort when a taxpayer has not taken other opportunities to satisfy tax obligations. According to the Division, the seizure of business assets serves multiple purposes, including preventing the taxpayer from "pyramiding" the tax debt.

When the district offices seize assets, the assets remain at the business location until the case is resolved. Division policy calls for resolving the case within a 30-day period, even when the assets are to be sold. The Division maintains control over the assets by changing all of the locks at the location and retaining the keys, thereby denying access to the business owners. When seizure actions alone do not induce payment of taxes due, Division policy calls for the assets to be sold. Article 52 of the Civil Practice Law and Rules (CPLR) establishes the process which the Division must follow in disposing of seized assets. Each district office maintains a list of potential auctioneers. Some districts resort to selling assets more often than others. For example, Suffolk, Nassau and Brooklyn district offices accounted for over 50 percent of all the asset sales in the 26-month period ended February 1997.

Audit Scope, Objectives and Methodology

We audited the Division's use of asset seizures and asset sales as collection tools during the period January 1, 1995 through April 30, 1997. The objectives of our program results audit were to determine the following: whether the Division's asset seizures and asset sales serve as effective collection tools; whether Division personnel follow prescribed procedures and adequately secure taxpayers' assets during seizures; whether asset sales realize the maximum return in tax revenues for the State; and, whether the seizure and sale process protects taxpayer interests.

To accomplish our objectives, we reviewed the Division's methods and controls as outlined in its procedures manual. We interviewed Division officials at the central office and at selected district offices. We visited seizure sites and witnessed a seizure and a sale of seized assets. We also reviewed taxpayer information available on the Department's data files and verified that the information recorded on asset seizure cases was accurately recorded on the system, based on case files maintained by the district offices. In addition, we contacted taxpayers whose assets had been seized and sold by the Division.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations which are included within our audit scope. Further, these standards require that we understand the applicable internal control structure and compliance with those laws, rules and regulations that are relevant to our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach to select activities to be audited. This approach focuses our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are used to identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may be relatively efficient and effective. As a result, our audit reports are prepared on an “exception basis.” This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Response of Department Officials to Audit

A draft copy of this report was provided to Department officials for their review and comment. Their comments were considered in preparing this report, and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Taxation and Finance shall report to the Governor, the State Comptroller and the readers of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.



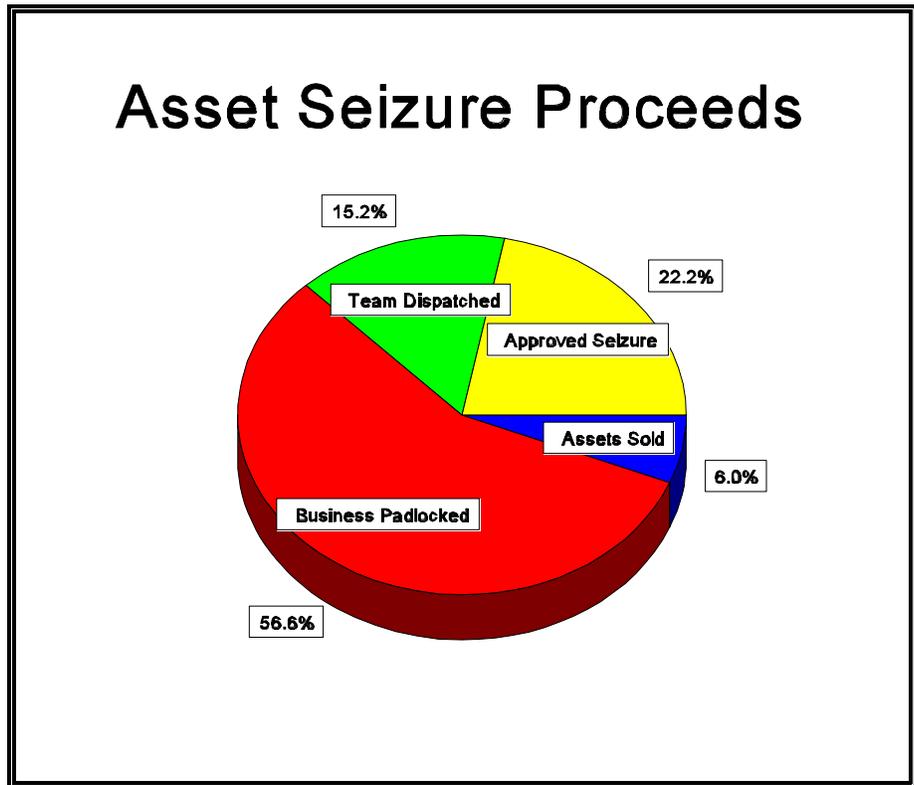
Using Asset Seizure and Asset Sale as Collection Tools

The Division prefers to collect unpaid taxes without seizing business assets, if possible. However, the Division takes action to seize the assets of a business when the taxpayer has exhausted all appeals for relief of taxes owed, has ignored repeated demands for payment or has defaulted on prior payment agreements. The goal of the asset seizure process is to induce delinquent taxpayers to satisfy their outstanding tax debt, to stop the escalation of their tax debt, and to deter noncompliance on the part of other taxpayers.

The Division recognizes a number of stages in the asset seizure process. During the first stage, the Division authorizes the asset seizure action and notifies the delinquent taxpayer that the business's assets could be seized. The second and third stages of the process involve sending TCAs to the business location, and then carrying out the seizure by padlocking the business. The Division proceeds to the last stage in the process - asset sale - only in extreme circumstances. Of the approximately 1,000 seizures the Division approves annually, only about 30 to 50 cases go to the asset sale stage.

The manager at each district office controls the seizure process. Although the Division prefers that delinquent taxpayers pay the debt they owe in full, the district office manager will allow some taxpayers to enter into deferred payment agreements (DPAs) and pay some portion of the outstanding debt according to an agreed upon schedule. Usually the agreement is accompanied by a cash payment as a gesture of good faith. The manager makes the decision as to the amount of cash payment required based on the circumstances of the case.

Asset Seizure Proceeds



The Division tracks the revenue generated during the various stages of the seizure process. According to Division reports, seizures accounted for about \$3 million in revenue during the nine months ended December 31, 1996. As illustrated in the chart above, about 94 percent of the collections for this period were generated in the first three stages of the seizure process, with the greatest amount collected after the Division padlocks the business. The smallest amount (about 6 percent) is collected through the Division's sale of business assets.

The first three stages of the seizure process appear to succeed in producing significant amounts of revenue from delinquent taxpayers. Moreover, we found that, in general, Division personnel follow prescribed procedures when seizing assets, and that they adequately secure these assets according to Division policy. However, we believe that the last stage of the seizure process (the sale of assets), as the Division currently uses it, is not an effective collection tool. Asset sales account for a relatively small percentage of the total revenue generated by the seizure process, as shown above, and are relatively costly to carry out, as explained in the next section of this report.

Division officials acknowledge that asset sales are often not cost effective for collection purposes. But they state that, in addition to generating revenue, asset sales prevent a delinquent taxpayer from accumulating additional tax debt by effectively putting the taxpayer out of business. Officials also stated their belief that asset sales serve as a deterrent to other taxpayers and lend credibility to the Division's overall collection efforts. We cannot validate whether or not the Division's assertion that selling seized assets improves overall compliance with the Tax Law. However, we have identified ways the Division can both use this tool more effectively and use other tools to achieve its compliance goals.

Revenue from Asset Sales

The Tax Law prohibits the Division from seizing property when the cost the Division estimates it will incur to seize and sell the property exceeds its fair market value at the time of the seizure. In arriving at the estimated cost, the Division considers only the direct costs associated with the seizure and sale. The estimate includes the costs for paying a locksmith to change the locks at the seizure site, advertising any pending sale and hiring an auctioneer. All the direct costs the Division incurs during the process become the responsibility of the tax debtor. The Division subtracts the direct costs of the sale from the gross proceeds and credits the tax debtor with only the net proceeds of the sale. However, our review of case files indicated that asset sales rarely, if ever, satisfy the outstanding tax liability, and that any debt that remains after the sale usually goes unpaid.

The Tax Law also prohibits the Division from making the tax debtor responsible for indirect costs, such as the costs associated with TCAs and other Department employees who participate in seizures and sales. However, this restriction does not preclude the Division from considering such costs in deciding whether it is cost effective to sell a business's assets. If Division officials considered these indirect costs, we believe they would find that most asset sales are uneconomical, especially those that gross less than \$5,000.

Between January 1, 1995 and February 28, 1997, the Division seized 1,064 businesses, of which 74 (7 percent) resulted in asset sales. We reviewed the case files for 50 of the more recent and larger sales cases. We found that the 50 cases yielded a total net return of \$233,000 from total gross proceeds of \$373,000, or 62 percent of gross sales. The average sale grossed \$7,468 and netted \$4,657. Only one of the 50 sales grossed more than \$20,000. There were no net proceeds from two of the sales, and the debt was completely paid off in only one case as of March 19, 1997.

While direct costs - technically borne by the debtor - reduce the proceeds than can be applied to paying the tax liability, indirect costs - borne by the Division and State taxpayers - make many asset sales very costly to conduct. For

example, in 25 of the above cases, the asset sale grossed less than \$5,000. After direct costs were subtracted, these cases yielded an average of only \$1,650 to apply to the tax debt. Based on our sample review of cases at three district offices, we determined that asset sale cases generally require about seven days of TCA time to prepare the assets for sale and to participate in the auction. Since TCAs earn from \$160 to \$190 for each day worked, the average sale grossing less than \$5,000 can yield as little as \$320 to the State ($\$1,650 - (\$190 \times 7 \text{ days})$) when the cost of TCA time is considered.

Another, more costly, consideration is the opportunity cost involved in dedicating TCA time to low-yield asset sales. According to Division records, TCAs successfully collect over \$3,500 during each day they spend contacting and visiting taxpayers with outstanding assessments. If we assume that the true cost of TCA time for the 50 asset sales we reviewed includes not only the cost of salaries at the rate noted earlier, but also an opportunity cost of over \$1.2 million ($50 \times (\$3,500 \times 7 \text{ days})$) associated with their not performing other, more productive, collection activities, the true cost of conducting these sales could be as much as \$1.29 million. We cannot state conclusively that TCAs will always bring in \$3,500 during each day they spend on these other collection activities. Neither can we validate whether or not the Division's assertion that selling seized assets improves overall compliance with the Tax Law. We can conclude, however, that most asset sales cost more than they yield in revenue to the State. Consequently, we question the need for these unnecessary costs in order to realize a small benefit. We believe the Division should develop procedures to increase the revenue generated from asset sales, or pursue alternative means of collecting outstanding taxes.

Alternatives to Asset Sales

The Department issues businesses permits called Certificates of Authority (Certificates) that allow the businesses to collect sales tax on behalf of the State. A business that does not comply with the Tax Law can have its Certificate revoked by the Department. Failure to obtain a Certificate or operating a business required to collect sales tax when the Certificate has been revoked is a misdemeanor punishable by at least a \$500 fine. When the expected return from an asset sale is low, we believe that revoking the Certificate would be a good alternative to conducting a sale.

However, according to Division officials, the penalty in the present Tax Law does not deter many businesses from collecting sales tax without a Certificate, or keeping the sales tax they collect. According to these officials, when a business collects and keeps sales tax amounting to thousands of dollars each quarter, the prospect of paying a \$500 fine will not prevent that business from continuing to collect such taxes, with or without a valid Certificate. Division officials also stated that, given the large volume of cases in courts today,

judges are not likely to view “operating without a Certificate” as a serious offense. In the officials’ opinion, the only way to ensure the business does not continue to accumulate tax debt is to close it and sell the assets, regardless of cost.

We agree with Division officials that such businesses should be closed down; however, we believe that selling the business’s assets is not the only way to achieve this objective. We also recognize that the Division will likely not regard an alternative action, such as Certificate revocation, as a feasible alternative to asset sales unless the consequences of operating without a Certificate are made more serious - and more expensive - for the delinquent taxpayer.

The problem of businesses collecting trust taxes, like sales tax from the public or withholding tax from employees, and failing to turn them over to the State is not one that is unique to New York State. However, some other states we contacted assess more severe penalties for doing so. For example, in New York State, not paying a sales tax liability is a civil collection matter as long as the taxpayer files a quarterly tax report acknowledging the tax debt. Filing a tax return prevents the tax debtor from being charged with a crime. In effect, the tax liability represents an unauthorized loan from the State. In Connecticut, however, it is a criminal offense (a misdemeanor) to collect these taxes and fail to pay them to the state. Connecticut can also impose a fine of as much as \$2,000. In North Carolina, not remitting sales tax collections is a misdemeanor which can carry a fine of any amount, and a sentence of up to two years in jail. In Maine, it can be a felony to misappropriate trust funds. Although it is not possible to measure the extent to which more serious penalties improve compliance with tax laws, officials in North Carolina stated their belief that their tax laws reduce the need to seize assets.

Increasing Revenue from Asset Sales

In our judgment, when the Division decides to sell assets, it should consider all options in order to increase the revenue it derives from asset sales. One way to accomplish this objective might be to sell certain seized businesses as “going concerns,” rather than selling just the business’s assets, as is presently done. In this way, the State could take advantage of the intangible assets of the business, such as good reputation, location and established customer base. Also, the Division could consider selling such assets as accounts receivable and customer lists.

We realize that not all seizures lend themselves to “going concern” sales. However, in appropriate circumstances, the option might produce greater proceeds for the State than asset sales currently do. Officials advised us that they have considered this option, however, they believe that it would apply only in rare instances. Other states we contacted (Connecticut, New Jersey

and North Carolina), as well as the Internal Revenue Service, sometimes use this option. These entities reported that they review seized property and determine whether more revenue could be generated by selling the business as a “going concern” or by selling the individual assets. They then proceed with the method they believe will produce the most revenue.

Tennessee uses “selective seizures” to make asset sales more economical to conduct. In these actions, the state seizes only those items which will generate the most revenue at auction. Undesirable items which may not sell or those not likely to produce much revenue will not be seized. As a result, the state can avoid the cost associated with handling undesirable items and can maximize the net proceeds from the sale.

Recommendations

1. Consider all costs, both direct and indirect, in making the decision to sell seized assets. Hold only those asset sales with the potential to yield revenue to the State.
2. Use alternatives to asset sales, such as revoking the Certificate of Authority, when the likelihood that a sale will generate substantial revenue for the State is remote.

(In responding to recommendations 1 and 2, officials agree it is appropriate to consider opportunity costs in evaluating performance and assessing the cost-effectiveness of their collection processes, but not in the context of evaluating specific cases for seizure. Officials did not specifically address our recommendations related to the costs associated with the sale of assets or the use of alternatives to sales. It is important to note that the scope of this audit focused on the use of asset seizure and assets sales as collection tools. It is within this context that we want the Department to consider all costs associated with the sale of assets. We believe this aspect can be evaluated separately from the overall collection process.)

3. Consider requesting the Legislature to increase the penalties for failing to remit trust taxes collected, and for continuing in a business required to collect sales tax when the Certificate of Authority has been revoked.

Recommendations (Continued)

(Department officials stated they will consider the possibility of pursuing legislation to provide for increased penalties. Officials stated their opinion that it is possible that more serious felony penalties, if they were available, might have a significant deterrent effect and create a viable alternative to the seizure and sales process in some instances. While Department officials did not directly respond to recommendation 2, we interpret the Department's response to this recommendation to mean that the intent of recommendation 2 will also be addressed.)

4. Consider using the methods noted in this report, such as selling businesses as "going concerns" and using "selective seizures," to help increase the revenue or reduce the costs associated with asset sales.

(Officials stated their belief that the report does not make a persuasive case for adoption of the alternative methods we proposed. The officials also stated that they will follow up on our suggestion to contact the IRS and the other states to obtain more specifics on the proposed procedures and their potential benefits. Officials further stated it is essential to recognize that very few of the businesses which the Division ends up selling have the attributes which would make them candidates for purchase as a going concern. Officials stated their belief that the sale of commercial properties requires specialized knowledge and that, in general, business owners are in the best position to arrange a sale on the most favorable terms. Officials stated that they try to accommodate tax debtors efforts to sell when it appears the strategy has a realistic change of success. Further, officials stated that they do not understand how our suggestion of selling only individual assets would increase revenue, and that their existing procedures provide a mechanism for getting the best price possible for individual assets. We believe, similar to the practice followed in other states and by the IRS, that in certain instances it may be appropriate to sell businesses as going concerns. The experience of other states has shown that the sale of a customer base and specialized equipment may have resulted in increased revenues. In addition, other states use "selective seizures" to avoid the cost associated with handling undesirable items. The purpose of our recommendation is to reduce the cost of unprofitable sales rather than to increase revenue.)

Safeguarding the Tax Debtor's Interests

Article 41 of New York State Tax Law is commonly cited as the Taxpayers' Bill of Rights. Section 3004 of this Bill of Rights states that the Commissioner shall publish a statement to taxpayers notifying them of their rights, and provide an explanation of the collection process. To serve this purpose, the Division developed Publication 125 which explains the collection process and some of the possible consequences if the taxpayer fails to pay the assessed tax liability. The Division must deliver a copy of Publication 125 to a delinquent taxpayer before a tax warrant may be issued. In accordance with the provisions of the Taxpayers' Bill of Rights, officials believe that taxpayers are given ample opportunities throughout the collection process to comply with the Law.

Article 41 also requires the Division to sell seized assets for "fair market value" at the time of the sale. By requiring that assets sell for fair market value, the Law intends to protect the interests of the tax debtor. Black's Law Dictionary defines fair market value as the value arrived at in a transaction between a willing buyer and a willing seller, neither under any compulsion to buy or sell. In addition, Publication 125 informs taxpayers that seized assets will be sold for at least their fair market value. It further states that the offering (sale) may be canceled and rescheduled at another time if fair market value is not realized.

We interpret these statements to mean that the Division will value the seized assets and determine some minimum amount that will be acceptable to the Division and the tax debtor. However, we found that the Division does not value the assets in most cases and will accept almost any price offered at an auction. Further, the Division interprets the term fair market value to mean "forced sale value," which is defined as an involuntary sale by the owner to satisfy a debt, such as a tax lien. By this definition, virtually any amount resulting from a tax auction could be considered fair market value. Therefore, the interests of the tax debtor may not be protected in a tax auction that yields unreasonably low revenue.

During our review of the 50 sale cases, we found that only three cases contained documents showing that the Division had valued the seized assets. In the three cases where the Division valued the assets, officials sold the assets for less than 60 percent of the estimated value. For example, a truck that Division personnel estimated to be worth \$7,400 was sold for \$1,300. This represents only 18 percent of the asset's estimated (book) value. In another case, a Cadillac valued by the Division at \$6,500 was sold for \$2,500

or 38 percent of the estimated value. In the third case, the Division estimated that the sale should produce \$1,500 to \$2,000. The sale yielded \$884 and the cost of the sale was \$1,435. As a result, the tax debtor received no credit toward the tax liability.

In the remaining 47 cases we found no indication that the Division had attempted to value the assets prior to the sale. In most cases we were not able to place any value on the assets because the descriptions of the assets were not detailed enough to allow us to estimate the value. Details such as model numbers, brand names and the age and condition of the assets are not normally recorded on the business' inventory. We found instances where a refrigerator sold for \$5, a FAX machine sold for \$55 and 4,000 telephones that were part of an electronics store inventory sold for an average of 52 cents each. However, we could not determine if these prices were reasonable based on the condition of the assets at the time.

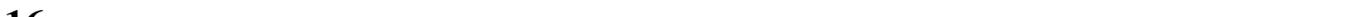
In our judgment, selling seized property for less than a reasonable value may not benefit either the delinquent taxpayer or the State. The tax debtor does not get the liability satisfied and the State does not maximize revenue from asset sales. In responding to this issue, Division officials told us that the Division disposes of seized assets under the provisions of Article 52 of Civil Practice Law and Rules (CPLR). CPLR requires the Division to sell seized assets at public auction. Since, at a tax auction, both the asset owner and the Division are under compulsion to sell, the resulting auction may not produce fair market value. Therefore, Division officials stated their belief that there is an apparent conflict between CPLR and the Taxpayers' Bill of Rights on this point.

In our contacts with other states and with the Internal Revenue Service, we identified some procedures that the Department might consider to protect tax debtors' interests when their assets are readied for auction. For example, Maine establishes a minimum acceptable amount for the seized items and will buy the assets and credit the taxpayer with the minimum established amount if the assets fail to generate the minimum amount at auction. Michigan and the Internal Revenue Service also value seized assets and do not sell the assets unless the auction results in the established amount. This latter option may not be feasible for New York because it would introduce storage costs as a consideration. However, the concept of guaranteeing a minimum amount to the tax debtor may be appropriate to ensure the Division considers the interests of tax debtors and follows the spirit of the Tax Law.

Recommendations

5. Ensure that the interests of tax debtors are adequately protected, such as valuing the assets, when the Division sells seized assets and rejecting unreasonably low offers.
6. Resolve the apparent conflict between CPLR and Article 41 of the Taxpayers' Bill of Rights.

(In response to recommendations 5 and 6, officials responded that their existing procedures are consistent with the Taxpayer Bill of Rights, within the context of Article 52 of the Civil Practice Law, and provide adequate protection of the interests of tax debtors. In addition, officials stated their belief that any apparent conflict between the provisions of these laws related to the sale of seized assets has been resolved by guidance from their Counsel's Office. The officials further note that their procedures are designed to give tax debtors the opportunity of protecting their interests through compliance with their tax law obligations, while providing them with full procedural due process. We maintain that the Department needs to more fully address the intent of the Taxpayers' Bill of Rights at the time of the sale of seized assets. The escalation of tax debt stops at the point of seizure rather than at the time of sale. Selling seized property for less than a reasonable value may not benefit either the delinquent taxpayer or the State. Our report clearly indicates that the Internal Revenue Service and various other states have made significant efforts to protect the rights of the taxpayer. We continue to urge officials to provide taxpayers the full protection that was intended by the Taxpayers' Bill of Rights.)



Major Contributors to This Report

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KEVIN F. MURRAY
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November 7, 1997

Mr. Kevin M. McClune
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Dear Mr. McClune:

Thank you for the opportunity to review and comment on the draft audit report on the Tax Compliance Division's (TCD) seizure and sale of assets (96-S-86).

We appreciate the acknowledgment that TCD personnel followed prescribed procedures when seizing assets and that such assets were adequately secured according to Division policy.

The audit findings seem to separate the seizure and sale process from "normal" collection methods. We feel strongly that it would be more accurate to view that process in the context of the progressive collection approach utilized by TCD. Overall, the seizure technique operates to maintain the credibility and cost-effectiveness of the entire collection process. It helps ensure a revenue stream of approximately \$1 billion annually for New York State. It also prevents the escalation of debt by tax delinquent businesses and helps to ensure a "level playing field" for businesses which comply fully with their Tax Law obligations.

The seizure and sale of business assets is part of the normal set of civil enforcement options available to judgment creditors under the New York State Civil Law. TCD's collection approach begins with automated billings, then moves on to personal contact, and finally employs various civil enforcement remedies in a progressive manner, as necessary, to collect outstanding tax debts. TCD's procedures allow taxpayers numerous opportunities to make payments or set up appropriate installment payment plans consistent with their financial condition, resolve issues concerning the validity or amount of the debt, and protect and conserve their assets by becoming fully compliant with Tax Law requirements. This is a progressive process that fully accommodates taxpayer rights at every step.

Seizure is part of the normal collection process. However, TCD generally utilizes this step as a last resort, when taxpayers have failed to take advantage of prior opportunities to fulfill their tax obligations. The possibility of seizure serves to increase the propensity of debtors to respond to less aversive and costly collection approaches.

We believe that evaluation of the tax sale process must include the true benefits of avoidance of additional escalation of tax debt. These benefits are both measurable and substantial. Very few seizures actually result in asset sales. Most result in payment or partial payment prior to the scheduling of a sale, as acknowledged in the information presented by the auditors.

Tax sales also help to ensure that businesses cannot continue to compete unfairly by lowering their costs through non-payment of trust taxes. They benefit all taxpayers by reducing exposure to businesses which fail to remit the trust taxes turned over to them in good faith by consumers.

Lastly, we would like to clarify the statement on page two of the report that: "...Division policy calls for all seized assets to be sold at auction." The requirement to sell seized assets at auction is a matter of law, rather than TCD policy. Article 52 of the Civil Practice Law and Rules establishes the process which TCD must follow in disposing of seized assets.

Our responses to the formal recommendations are as follows:

Recommendations 1 and 2:

Consider all costs, both direct and indirect, in making the decision to sell seized assets. Hold only those asset sales with the potential to yield revenue to the State.

Use alternatives to asset sales, such as revoking the Certificate of Authority, when the likelihood that a sale will generate substantial revenue for the State is remote.

Response:

These recommendations are integrally related and must be considered together. As noted above, we believe that it is essential to include all benefits of the seizure and sale process, including the effect of that process on preventing the further escalation of tax debt and on maintaining the

credibility and productivity of the overall collection process. Properly considered, the seizure and sale process is productive and a key element underlying the efficacy of our entire collection process. We believe that it is appropriate to consider opportunity costs in evaluating performance and assessing the cost-effectiveness of our collection processes, but not in the context of evaluating specific cases for seizure. Consideration of costs, in that context, should focus on how to increase the net proceeds available to apply to the debtor's liability.

Recommendation 3:

Consider requesting the Legislature to increase the penalties for failing to remit trust taxes collected, and for continuing in a business required to collect sales tax when the Certificate of Authority has been revoked.

Response:

We will consider the possibility of pursuing legislation to provide for increased penalties, as recommended by the auditors. It is possible that more serious felony penalties, if they were available, might have a significant deterrent effect and create a viable alternative to the seizure and sale process in some circumstances.

Recommendation 4:

Consider using the methods noted in this report, such as selling businesses as "going concerns" and using "selective seizures," to help increase the revenue or reduce the costs associated with asset sales.

Response:

We do not believe that the report makes a persuasive case for adoption of the alternative methods proposed. However, we will follow up on the auditors' suggestion to contact the IRS and the other states mentioned in the report to obtain more specifics on the proposed alternative procedures and their potential benefits.

On page eight, the auditors suggest selling seized businesses as "going concerns." It is essential to recognize that very few of the businesses which TCD ends up selling have the attributes which would make them candidates for purchase as a going concern. Generally, they have shrinking or negligible customer bases. They tend to owe substantial debts to other creditors. (New York State's lien position is often

subordinate to other creditors.) Further, these businesses are often several months behind in rental payments. Clearly, they have little to offer prospective purchasers.

Sale of commercial properties requires specialized knowledge and is an expensive and time-consuming process. We believe that, in general, business owners are in the best position to arrange a sale on the most favorable terms possible. They are familiar with the business's competitive environment, operational processes, and customer base, and are in the best position to represent its value to potential purchasers. Businesses often retain the services of specialists in commercial real estate to assist in this process. In those limited instances where a tax debtor has a viable going business and realistic prospects for sale, we do everything reasonable to facilitate the transaction. However, this policy entails significant risks. As it often takes a long time to consummate a business sale, there is the risk of continuing escalation of the tax debt. Also, we find that many business tax debtors are overly optimistic about the prospects for a sale of their business on favorable terms. Often, anticipated purchasers never materialize, or offer terms which the business owner, perhaps unrealistically, considers unacceptable. The main point is that we do, to the extent practical, try to accommodate tax debtors' efforts to sell their business as a means of maximizing the recovery of the tax debt when it appears that strategy has a realistic chance of success.

The auditors also suggest the possibility of selling only individual assets as a means of increasing revenue from asset sales. We do not understand how this would increase revenue. All of our sales include both bulk bids and bids for individual assets or groups of assets. Thus, our existing procedures provide a mechanism for getting the best price possible for individual assets considered particularly valuable. Selective seizure and sale of assets would presumably avoid locksmith charges, but it would increase expenses relating to the removal, storage, and safeguarding of the asset pending sale. As other sale-related expenses would be much the same (e.g., the cost for advertising and compensating auctioneers), it is not clear to us that this approach would increase revenue.

Recommendations 5 and 6:

Ensure that the interests of the tax debtor are adequately protected, such as valuing the assets, when the Division sells seized assets and rejecting unreasonably low offers.

Mr. Kevin M. McClune

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November 7, 1997

Resolve the apparent conflict between CPLR and Article 41 of the Taxpayer Bill of Rights.

Response:

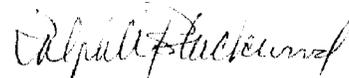
Our existing procedures are consistent with the Taxpayer Bill of Rights, within the context of Article 52 of the Civil Practice Law, and provide adequate protection of the interests of tax debtors.

We believe that any apparent conflict between the provisions of these laws related to sale of seized assets has been resolved by the guidance which we obtained from our Counsel's Office and shared with the auditors.

We disagree with the auditor's comment on page ten that "...the interests of the tax debtor may not be protected in a tax auction that yields unreasonably low revenue." Our procedures are designed to give tax debtors the opportunity of protecting their interests through compliance with their Tax Law obligations, while providing them with full procedural due process. The amount of direct revenue produced through a sale at public auction must be evaluated in the context of that process. Although a tax sale often produces a small amount of tax direct revenue, it stops the further escalation of tax debt.

On page eleven, the auditors' comment that "...selling seized property for less than a reasonable value may not benefit either the delinquent taxpayer or the State. The tax debtor does not get the liability satisfied and the State does not maximize revenue from asset sales." We disagree with this statement. Since the Civil Practice Law requires us to conduct tax sales through the public auction process, fair value for an asset sold in that context is, in fact, the value produced by the sale conducted according to the public auction requirements. The State realizes revenue through that process, both directly and indirectly. The fact that tax sales do not generally produce enough revenue to satisfy the debtor's liability is not a valid argument against the use of the sale to prevent further escalation of tax debt and to produce revenue where no other practical option is available to collect the debt. This is the circumstance in which we initiate the seizure process.

Sincerely,


for Kevin F. Murray
Executive Deputy Commissioner