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STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

June 29, 2005

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

Re: Methods Used to Settle  
Outstanding Tax Liabilities  
Report 2004-S-54

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 audited the controls established by the Department of Taxation and Finance over certain methods used to settle outstanding tax liabilities. Our audit covered the period January 1, 2002 through December 31, 2004.

**A. Background**

The Department of Taxation and Finance (Department) administers the State's tax laws and serves as the State's general collection agency. The Department is responsible for collecting over \$42 billion in State revenue annually. The Tax Compliance Division (Division) is responsible for collecting delinquent taxes. The Division uses a variety of methods authorized by the New York State Tax Law (Tax Law) to collect delinquent taxes, including, but not limited to, the Offers in Compromise (OIC) Program, the Settlement Agreement (SA) Process, and the Installment Payment Agreement (IPA) Program. The Department's Counsel's Office (Counsel) is responsible for representing the Department when a taxpayer files a petition disputing his or her tax liability. Once the liability amount is settled and agreed to, the taxpayer may request to use the various methods offered by the Division for payment of the tax due amount.

An OIC is a contractual agreement that allows a taxpayer to settle his or her tax liability for less than the full amount. In accordance with the Tax Law, generally, only a taxpayer whose liability is fixed and final (i.e., the taxpayer has exhausted all available appeal rights) and who is found to be clearly insolvent (i.e., the taxpayer's liabilities exceed his or her assets) is eligible to participate in the OIC Program. From January 1, 2002 through July 31, 2004, the Division accepted 621 OIC cases.

The SA is typically initiated by a taxpayer. Frequently, the SA starts out as an OIC but does not meet statutory requirements for an OIC. Although the taxpayer's financial situation is distressed, the statutory requirements for an OIC have not been met (i.e., insolvency). From January 1, 2002 through July 31, 2004, the Division accepted a total of 28 SA requests.

An IPA allows taxpayers who are not financially able to pay the full amount of their tax all at once, the opportunity to pay in installments over a set period of time, usually no more than 24 months. From January 1, 2002 through July 31, 2004, the Division processed over 190,000 IPA requests.

The Department has also established a specialized team of tax auditors at its Queens District office to monitor and collect on high dollar assessments from downstate businesses. High dollar assessments from upstate businesses are handled by the taxpayer's local district office. Approximately 150 high dollar cases were assigned in this manner during our audit period.

Within the provisions of the Tax Law, taxpayers may also file a petition for a re-determination of their tax liability. In these instances, Counsel typically tries to settle the dispute through correspondence with the taxpayer's representative rather than going through a costly formal hearing process within the independent Division of Tax Appeals (Appeals). Approximately 800 petition cases were settled in this manner during our audit period.

**B. Audit Scope, Objective and Methodology**

We audited certain controls established by the Department over the settlement of outstanding liabilities for the period January 1, 2002 through December 31, 2004. The objective of our audit was to determine whether the Department has adequate assurance that the methods used to collect delinquent taxes are being administered in accordance with Departmental policies and procedures, the Tax Law, and in a manner consistent with efficient operating practices and appropriate internal controls. To accomplish our objective, we reviewed applicable policies, procedures, and the Tax Law, interviewed Department officials, and reviewed a sample of cases for each of the settlement methods that were discussed in the introduction section of this report.

We conducted our audit in accordance with Government Auditing Standards. Such standards require that we plan and perform our audit to adequately assess Department operations included in our audit scope. Further, these standards require that we understand the Department's internal control structure and compliance with those laws, rules, and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on 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 that our audit provides a reasonable basis for our findings and conclusions.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other

payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

### **C. Results of Audit**

We found that Division management is very knowledgeable about the Department's collection methods. Our review of a sample of outstanding tax liability cases, for the collection and settlement methods that we audited, showed that they are processed in accordance with the Tax Law and applicable policies and procedures. Our audit determined that the methods used by the Department to settle and collect outstanding tax liabilities are operating as intended and in a manner consistent with efficient operating practices and appropriate internal controls.

#### **1. Offers in Compromise Program**

An OIC is a contract between the Department and the taxpayer, which allows the taxpayer to settle existing tax liabilities for less than the full amount of the debt. The Tax Law states that, generally, only a taxpayer whose liability is fixed and final (i.e., the taxpayer has exhausted all available appeal rights) and who is found to be clearly insolvent (i.e., the taxpayer's liabilities exceed his or her assets) is eligible to participate in the OIC Program. An offer cannot be accepted if it is less than the amount the Department would be able to collect through legal proceedings or any other means. In cases involving debts of trust tax (principally sales taxes and withholding taxes), policies and procedures generally require that accepted OIC cases be at least for the amount of the outstanding tax due excluding penalties and interest. The goal of the OIC program is to return the taxpayer to solvency.

If the offer is accepted, the OIC program requires the taxpayer to submit the accepted amount within 30 days (unless additional time is granted), not incur any additional liabilities for five years, file all future returns on time and provide full payment on these returns. In addition, all refunds due the taxpayer in the year the offer is initiated are automatically applied to his or her liability, and the taxpayer must forgo all other tax incentives (e.g., capital loss carryovers or any other carry-forwards).

The OIC Section monitors compliance with OIC stipulations. If payments are not received in the allotted timeframe a revocation warning letter is sent to the taxpayer indicating if he or she fails to pay by a certain date it will result in revocation of the OIC. If payment is still not received, another revocation letter is sent to the taxpayer indicating that the Department did not receive a response to the warning letter, the OIC has been revoked, and the original liability has been reinstated minus any payments received on the offer (if applicable).

To assess the adequacy of OIC processing by Division personnel, we selected a judgmental sample of 20 OIC cases from the 621 OIC cases accepted within our audit period. Our OIC sample included cases with the highest tax liability, cases represented by the same tax attorney, and cases in

which the proposed and accepted offer was the same but was well below the original liability amount.

We reviewed each case for adherence to Departmental policies, procedures, and the Tax Law. We found that Division personnel followed Departmental policies and procedures during case processing for all 20 OIC cases. Case file documentation contained meeting minutes, worksheets, and memorandums summarizing the relevant facts of each case. We also found that full payment (or installment payments, if specified) was received within the required timeframes, and that each case reviewed contained the appropriate sign-offs by Department officials.

We also performed an additional review of 5 of the 20 OIC case files included in our sample to determine the adequacy of monitoring efforts by the OIC Section. Documentation within each of the five case files indicated that Division personnel monitored compliance with the OIC program's other requirements such as timely filing of later returns, etc. Division officials have developed reports and worksheets to document both payment of taxes and compliance. We also found that all of the cases reviewed were in compliance with their payment agreement and filing agreement.

## **2. Settlement Agreements**

The SA is another way for a taxpayer to settle an outstanding liability for less than the full amount of the debt. For a settlement agreement to be viable, the case details should indicate some compelling element, such as: the subject debt is escalating more rapidly than any reduction from regular payments (such as garnisheed wages), the taxpayer is in grave health, or the original liability has been paid several times over and the resulting liability is only penalty and interest. If a taxpayer requests an SA, a reviewer prepares a listing of the conditions of the SA and discusses the case with a supervisor. If the SA is accepted, SA documentation is submitted for Division management review and approval, and if approved it is sent to the Deputy Commissioner for Operations for final approval. An acceptance letter and the settlement agreement are then sent to the taxpayer, who is required to sign and return the agreement within 30 days.

We selected a judgmental sample of 5 SA cases from the 28 SA cases accepted by the Department during our audit period. Our test disclosed that the Department complied with all applicable procedures and policies for the five cases in our sample, when agreeing to a settlement.

## **3. Installment Payment Agreements**

An IPA is a formal agreement between a delinquent taxpayer and the Department in which the taxpayer agrees to a monthly payment schedule to liquidate a tax liability. IPAs are granted as a means by which the Department can maximize the recovery of unpaid taxes where a taxpayer's resources for full payment are not immediately available.

Under the IPA program, a taxpayer can pay off his or her total tax liability in monthly installments regardless of the amount owed. However, interest and penalty still continue to accrue on any unpaid balance. To qualify for an IPA, a taxpayer must complete a financial statement and submit other applicable documentation to prove the inability to make full payment. Upon approval of the IPA, the taxpayer is required to submit timely payment of all future taxes. If the taxpayer

does not comply with this requirement, he or she will be in default of the IPA and collection action may resume, or the Department may modify or terminate the IPA. The Department may also terminate an IPA if the information provided before entering into the agreement is found to be inaccurate or incomplete, or if the Department believes collection of the liability is in jeopardy. In addition, the Department may modify or terminate the agreement if the financial condition of the taxpayer changes significantly, but only after giving the taxpayer at least 30 days prior notice explaining the reason why the Department believes the taxpayer's financial condition has changed. During the course of the IPA, the Department may require the taxpayer to submit updated information to determine if payment terms need modification. If the taxpayer fails to provide a financial condition update, the Department may modify or terminate the IPA.

All downstate IPA's and other collections cases that are classified as high dollar value (based on a set dollar amount), are assigned to the "high dollar value team" at the Department's Queens District office. Upstate cases considered high dollar value are assigned to the district office of origin. A Division representative creates an IPA in conjunction with the taxpayer and follows Department guidelines when advising/selecting the monthly payment amount and timeframe (shortest timeframe possible). The duration and amount of the IPA dictates the required level of approval.

To determine Division compliance with IPA processing procedures and assess collection processes for cases that are not OIC, SA, or IPA cases, we first reviewed ten high dollar value IPA cases (the ten highest cases), from a population of 37 cases at the Queens District office, and one of the two high dollar IPA case at the Schenectady District office. We selected these cases for review since the Department identifies them as having a significant tax liability. In addition, we also selected a judgmental sample of 11 high dollar collection cases, all of which had a dollar value exceeding \$200,000, from a population of 1,109 at the Queens District office that did not include a request for an IPA agreement. We found that Division personnel followed Departmental policies and procedures during case processing and that they were actively pursuing collections for those taxpayers that did not have an IPA or other agreement in place. For example, we found documentation to show that Division personnel placed levies against bank accounts, visited a taxpayer's residence, and performed work to identify a taxpayer's assets. Case files also contained copies of payments made by taxpayers (when applicable) to the Department towards their tax liability.

#### **4. Counsel Petition Settlements**

Counsel is responsible for representing the Department when a taxpayer files a petition for re-determination disputing his or her tax liability before it becomes fixed and final under the provisions of the Tax Law. Counsel will attempt to settle the dispute over the tax liability through correspondence with the taxpayer's representative rather than going through the more costly formal hearing process at Division of Tax Appeals. We judgmentally selected and reviewed ten settled cases from a total population of 800 active petition cases handled by Counsel for the period January 1, 2002 to July 31, 2004. The purpose of our review was to determine how the Counsel's office settles tax liability disputes and if the case dispositions are substantiated by documentation in the case files that were in the Counsel's office inventory records awaiting final approval. Our review of

these cases showed that the files contained sufficient documentation and communication to support Counsel's final decision.

### **Conclusion**

*We conclude that for the programs tested, the methods used by the Department to settle and collect outstanding tax liabilities are operating as intended and in a manner consistent with efficient operating practices and appropriate internal controls.*

We provided draft copies of this report to Department officials for their review and comments. Their comments were considered in preparing this final report and have been included as Appendix A.

Major contributors to this report were Arthur F. Smith, Andy Fischler, Jason Kearney, Darci Christopher, Jonathan Deeb, and Paul Bachman.

We wish to thank the management and staff at the Department for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Steven E. Sossei  
Audit Director

cc: Robert Barnes, Division of the Budget



STATE OF NEW YORK  
DEPARTMENT OF TAXATION AND FINANCE  
W.A. HARRIMAN CAMPUS  
ALBANY, NY 12227

Barbara G. Billet  
Executive Deputy Commissioner

May 17, 2005

Mr. Steven Sossei  
Audit Director  
Office of the State Comptroller  
11<sup>th</sup> floor  
110 State Street  
Albany, NY 12236

Dear Mr. Sossei:

Thank you for the opportunity to comment on the findings in the working draft report for the audit entitled, "Methods Used to Settle Outstanding Tax Liabilities, 2004-S-54".

We are very pleased that you have concluded that the Department's methods to settle and collect outstanding liabilities in every instance were operating efficiently and appropriately. We are gratified that our ongoing efforts to improve operations have resulted in an audit that contained no recommendations for the Department.

We appreciate your input.

Very truly yours,

A handwritten signature in black ink that reads "Barbara G. Billet". The signature is written in a cursive style with a large, prominent initial 'B'.

Barbara G. Billet  
Executive Deputy Commissioner