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STATE COMPTROLLER



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STATE OF NEW YORK  
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COMPTROLLER

April 30, 1998

Mr. Michael Urbach  
Commissioner  
Department of Taxation and Finance  
Building #9  
State Campus  
Albany, New York 12227

Re: Report 97-F-40

Dear Mr. Urbach:

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, we have reviewed the actions taken by officials of the Department of Taxation and Finance (Department), as of December 31, 1997, to implement the recommendations contained in our prior audit report 91-S-11. Our prior report, which was issued September 20, 1991, focused on the Department's activities aimed at sales tax revenues due the State that are not voluntarily paid. The audit addressed how effectively the Department's procedures were for ensuring registered vendors are filing tax returns and paying the correct amount of sales tax and for identifying and ensuring that unlicensed vendors are brought into compliance with the sales tax law.

**Background**

The Department administers the State's tax laws and serves as its general tax collection agency. New York State Sales and Use Tax Laws, Article 28 and 29, require the Department to administer sales taxes imposed by both the State and its localities. Sales tax is a "trust tax"; the public pays the tax to the vendor who is entrusted to forward the tax to the State. The Department is responsible for ensuring that all vendors are registered, filing tax returns and paying the correct amount of sales tax. During the State fiscal year ended March 31, 1997, the Department collected \$7.3 billion in State sales tax revenue. The vast majority of this amount represents voluntary payments by vendors with their tax returns. Our prior report addressed the Department's activities aimed at collecting that portion of the sales tax revenues due the State that was not voluntarily paid.

The enforcement of the law involves many different Department units. The sales tax enforcement process includes identifying and registering vendors, processing sales tax forms, depositing revenues, field auditing vendors by staff in the Audit Division's District Office Audit Bureau (District Audit), desk auditing by the Central Office Audit Bureau, resolving protests through the Bureau of Conciliation and Mediation Services (Mediation) and determining final tax liability by the Division of Tax Appeals. Our audit focused on activities within District Audit, Mediation and the Office of Counsel since these units play the most critical role in ensuring that sales taxes paid by the public are remitted to the State.

### **Summary Conclusion**

In our prior audit, we found that the Department's procedures to ensure that all registered vendors file tax returns and pay the correct sales tax needed significant improvement. We found that the sales tax enforcement process was lengthy. It is important that this process be completed expeditiously because the longer the process takes the less likely it is the Department will collect all the sales taxes to which the State is entitled. At the time of our audit, we found that, on average, it took the Department 589 days to resolve (i.e., reach agreement with the vendor) the audits we sampled, not including the time taken to collect any additional taxes after resolution had been reached.

To improve the timeliness of this process, we recommended that one Department unit be assigned an oversight role to monitor the process and evaluate its effectiveness. In addition, we identified the need to establish time standards to measure and control the length of the process and the need to review and evaluate collection activity as part of the analysis of the overall effectiveness of the process. We also made recommendations to establish procedures to determine and monitor the cost of their enforcement efforts, to evaluate reasons for the reductions in taxes, to sponsor legislation to establish certain time requirements, and to determine the impact of tax and penalty reductions in comparison with the overall cost of the process. Our audit of the Department's unregistered vendor identification process determined there was need to establish Departmentwide procedures for handling identified unregistered vendors. We recommended that these policies include centralized monitoring responsibilities.

Although only three of our recommendations have been implemented, as a result of the action taken to implement our recommendations related to unregistered vendors, the Department produced over \$30 million in new revenue in the first year of its pilot program. We encourage officials to further consider our previous recommendations and take steps to implement them to improve operations.

### **Summary of Status of Prior Audit Recommendations**

Department officials fully implemented three of our prior audit recommendations, partially implemented one recommendation, and have not implemented five recommendations.

## **Follow-up Observations**

### **Recommendation 1**

*Assign an oversight role to an independent unit to monitor the efficiency and effectiveness of the entire enforcement process.*

Status - Not Implemented

Agency Action - The Department continues to disagree with this recommendation. However, officials told us that during 1998, as part of their performance measurement program, they will begin to take steps to improve the coordination of all Departmental processes that cross divisional lines.

Auditors' Comments - We maintain that an oversight role for the entire sales tax enforcement process is needed. Each organizational unit that has a role in the process seeks to accomplish its individually stated objectives without always considering the eventual impact of its actions on the achievement of the Department's overall goals. Department management does not ensure that the collective efforts of this process meet the Department's goals or taxpayer expectations.

### **Recommendation 2**

*Establish time standards for the sales tax audit and resolution process. Use these standards to control the length of the enforcement process.*

Status - Not Implemented

Agency Action - The Department continues to disagree with this recommendation. Officials told us that any overall time standards adopted would be arbitrary and counterproductive, resulting in an increased number of disagreed audits and a possible compromise of taxpayers' rights. Officials further advised us that as part of their performance measurement program, they are looking at all key measurement areas, including the consideration of time frames, for various services that they provide to their internal and external customers.

Auditors' Comments - Standards are guidelines against which progress can be measured. A standard, when properly used, should not prevent any taxpayer from producing relevant documentation nor hinder the completion of any audit. However, without standards the Department is not able to effectively measure progress or identify cases that are not progressing at a satisfactory rate. We noted that the Tax Compliance Division has established a benchmark of 180 days to resolve cases. We encourage other units to follow the lead provided by Tax Compliance in order to control the length of the entire process.

### **Recommendation 3**

*Review and evaluate collection activity as part of the analysis of the overall effectiveness of the tax enforcement process.*

Status - Partially Implemented

Agency Action - The Tax Compliance Division has instituted Total Quality Management measures that center around timeliness. In June 1997, the Tax Compliance Division completed its initial analysis of performance measures related to collection services. Division officials concluded that there probably should be an overall measure of the elapsed time from the point of liability accrual to case collection/closure. However, they stated their belief that such an overall measure would cut across many areas of responsibility within the Department, including the Processing and Revenue Management Division, the Audit Division, the Bureau of Conciliation and Mediation Services, the Tax Compliance Division and Information Systems Management. Division officials told us that they do not expect to have measures that cut across organizational boundaries.

Auditors' Comments - Collection is an integral part of tax enforcement. Therefore, collection operations should be included when evaluating the overall enforcement process.

### **Recommendation 4**

*Establish procedures to determine and monitor the cost of the Department's entire enforcement effort.*

Status - Not Implemented

Agency Action - The Department continues to disagree with this recommendation. Officials from the Tax Compliance Bureau told us that they are developing cost data for their operation; District Office costs are under development. Tax Compliance Bureau officials further advised us that eventually they expect to associate cost measures across each business process.

Auditors' Comments - We encourage the other Department units to follow the lead of the Tax Compliance Division to determine the cost of their enforcement efforts.

**Recommendation 5**

*Evaluate the reasons for the substantial reduction in taxes and penalties.*

Status - Not Implemented

Agency Action - Department officials told us that the conditions found during the original audit remain unchanged. More cases are now being settled by the Department's Counsel's Office to speed settlement and avoid costly litigation.

Auditors' Comments - As stated in our audit report, officials provided us with general statistical information on the reasons for the reductions in taxes. We continue to believe that the Department needs to critically evaluate the reasons for such reductions.

**Recommendation 6**

*Sponsor legislation, as appropriate, to establish specific time requirements in which vendors can provide documentation.*

Status - Implemented

Agency Action - In 1993 the Department proposed legislation to establish specific time requirements in which vendors can provide documentation. The bill met resistance in legislative committees, and therefore was not introduced in the legislature.

**Recommendation 7**

*Determine the impact of tax and penalty reductions in comparison with the overall cost of the enforcement process to ensure Department practices are cost-effective.*

Status - Not Implemented

Agency Action - The Department continues to disagree with this recommendation. The officials stated that we have equated what is cost-effective with what is fair and equitable. The officials further stated that producing accurate assessments and providing taxpayers every opportunity to obtain a fair resolution constitute their highest priorities.

Auditors' Comments - We agree that it is important that the Department produce accurate assessments and provide taxpayers with the opportunity to have their cases resolved fairly. However, the extent to which assessments are canceled does impact the cost-effectiveness of the program.

**Recommendation 8**

*Establish Departmentwide policies and procedures for handling identified unregistered vendors. These policies should include specific centralized monitoring responsibilities.*

Status - Implemented

Agency Action - In September 1992, the Department instituted a pilot project within the Office of Tax Operations Revenue Opportunity Division (ROD) to investigate, register, assess and track all known or possible unregistered sales tax vendors. This project resulted in the Department having one centralized location to follow up on tips received from the public and possible leads derived from other Department or governmental sources. As a result of this project, the Department, in the first year of operations, produced over \$30 million in new revenue with less than \$600,000 invested in direct costs; a 5,400 percent return on investment. The pilot project led to the formation of a new bureau (Filing Enforcement) to continue the responsibilities that ROD had under the pilot project. This unit continues to communicate and track correspondence and action in dealing with potential non-filers.

**Recommendation 9**

*Expedite the review of the registration requirements of the remaining potential filers identified during the non-filer identification program. Ensure timely registration of vendors where appropriate.*

Status - Implemented

Agency Action - The Department now has a mainframe computer application that tracks the action taken with potential non-filers, including those previously identified.

Major contributors to this report were Richard Loveless and Arthur F. Smith.

We would appreciate your response to this report within 30 days, indicating any action planned or taken to address the unresolved matters discussed in this report. We also wish to thank the management and staff of the Department for the courtesies and cooperation extended to our staff during this review.

Very truly yours,

Kevin M. McClune  
Audit Director

cc: Robert L King