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Identifying and Resolving a New York Tax Problem Just Got Tougher

by Timothy P. Noonan and Joseph N. Endres

Let's face it, tax statutes are extremely complex and difficult to understand. Moreover, government agencies charged with administering tax laws frequently exacerbate the problem by imposing confusing "interpretations" of the law. This is the reason tax practitioners have jobs, and why columns like Noonan's Notes get written. To help befuddled taxpayers understand their obligations under the New York Tax Law, the New York State Department of Taxation and Finance has provided various methods for taxpayers to seek guidance. Also, for those taxpayers who have failed to comply with the tax law's requirements, the department offers a voluntary disclosure program that can limit past due liability. Recently, the department made significant changes to those programs, so it's a good time to revisit those important practice issues.

Seeking Guidance From the Tax Department

The tax department recently published a technical service bureau memorandum detailing new policies for taxpayers seeking guidance.[1] Before the memorandum was issued, taxpayers could seek guidance from the department in a few different ways. A taxpayer could submit a request for an advisory opinion, submit an informal letter to the department's office of counsel (often referred to as "advice of counsel"), or submit a request for a formal opinion of counsel. According to the memorandum, the department has consolidated those three options by eliminating the informal advice of counsel and the formal opinion of counsel.[2] Thus, taxpayers now only have *one option* for seeking advice from the department: the advisory opinion.

The tax law requires the commissioner of taxation to render advisory opionions regarding all taxes administered by the commissioner.[3] Thus, taxpayers have a statutory right to obtain advisory opinions. The New York state tax regulations indicate that advisory opinions will be issued at the request of any person who is or may be subject to a tax or liability under the tax law, or any person claiming an exemption from that tax or liability.[4] The regulations also allow advisory opinion requests to be submitted by attorneys and accountants representing taxpayers.[5]

The memorandum published by the department made a substantial change to how taxpayers request advisory opinions. The memorandum says, "Effective August 8, 2008, Advisory Opinion petitions will no longer be accepted from any person or entity acting on behalf of unidentified persons or entities."[6] As a result of that policy change, taxpayers can no longer submit anonymous advisory opinion requests.

That is a significant change. Indeed, if you scan the list of advisory opinions issued over the past few years, you'll see that many of them come from folks like us -- that is, from practitioners representing clients. And in most cases, those advisory opinions set forth a hypothetical set of facts, something that is permitted under the current regulations.[7] For many practitioners, that was an effective tool for helping clients to solve difficult legal questions and plan for the future, especially because it allowed clients to do so without revealing their identities. That feature of the advisory opinion process was important. Often clients questioning whether sales tax applied to their sales or whether specific tax provisions applied to them do not want to proclaim to the tax department that they have a problem in the first place. Unfortunately, that feature will no longer exist. And because of that, the number of advisory opinions issued by the department will diminish, which perhaps is one of the reasons behind the change.

Despite the lack of anonymity of the requester, under the department's new policy, all identifying information will be redacted before publication of the opinion. Thus, in that way, the department is seeking to protect the confidentiality of taxpayers against disclosure of their tax questions or problems to the entire Internet-surfing world. But again, that wasn't usually the type of anonymity that taxpayers were seeking -- most also didn't want the department to know who they were.

Again, that change likely would reduce the number of advisory opinions released on an annual basis. However, the department, in the same memorandum discussing the new advisory opinion policy, also indicated that it will be issuing "Tax Guidance Bulletins," which the department explains "will help taxpayers find guidance on a broad variety of tax subjects."[8] According to the memorandum, each bulletin will be listed on the department's Website and will explain the general application of a tax law provision to a specific business or transaction, but will not be binding on the department.

Other states have similar information on their Websites, so something like that is probably a good step toward making the department more transparent when it comes to some tax interpretation or policy issues. On balance, however, with the loss of opinions and advice of counsel, as well as the limitation on the use of advisory opinions, taxpayers and practitioners are probably on the losing end of these recent changes. In the future, it may be more difficult to get information about the department's position on questionable tax issues.

New York's Revised Voluntary Disclosure and Compliance Program

Another recently issued Technical Service Bureau memorandum also affects an important compliance issue involving New York's voluntary disclosure program. Unlike the change in the advisory opinion area, however, this one was actually mandated by law. Under the recent budget bill introduced by Gov. David Paterson (D), there was a provision designed to statutorily set forth the terms and conditions of the department's voluntary disclosure program. Under the old rules, there was no specific program set forth in the law or the regulations. Nor was there guidance describing the program in taxpayer publications, on the department's Website, or anywhere else. Despite that, many practitioners (ourselves included) found the department's "old" program workable and beneficial. Under the old program, taxpayers could contact the department anonymously through their tax practitioners to discuss a settlement of a past-due liability. The tax practitioners would negotiate with department personnel to arrive at a mutually acceptable disclosure agreement. Generally, that resulted in a limited lookback period (usually three years) and, in some cases, absolution of criminal issues. After all the terms of the disclosure agreement were determined, the taxpayer would reveal its identity, submit tax returns, schedules, and so forth, and pay the liability. In other words, taxpayers would not have to reveal themselves until they had a clear understanding of the terms of their disclosure.

Chart 1.

Circumstance	Lookback Period With Full Payment Requirement
Collected sales and withholding tax (trust taxes) not remitted to the state	The shorter of six years or the period that begins with the earliest date on which the tax was collected or withheld and ending with the most recently completed tax period
Tax fraud or tax evasion (other than collected trust taxes)	Six-year lookback period
Mistake, confusion, ignorance of the law, inability to comply, or some other similar explanation (other than cases involving collected trust taxes)	Three-year lookback period

The department's new program is quite different, on a number of levels.[9] There are three significant changes:

- the process is now automated, with applications submitted via the Internet;
- taxpayers must disclose their identities at the *beginning* of the application process; and
- the benefits of the program's limited lookback clause are reduced.

Moreover, the new program also is pointed toward criminal behavior, and with bringing into the fold those taxpayers who previously may have been intentionally underpaying their liabilities.

Thus, now the disclosure process starts with an online application. And more importantly, on this online application, taxpayers must reveal their identities during the initial application process. Under the old system, taxpayers would not have to reveal their identities until they were comfortable with the terms of the agreement. Under the new process, if the department imposes terms that are unacceptable to the taxpayer, or if the department rejects the taxpayer's application, the department still receives the benefit of learning the identity of a noncompliant taxpayer. Yikes!

We suspect that change may lead many taxpayers to avoid the program altogether. Indeed, almost every other state's voluntary disclosure program allows taxpayers to come forward anonymously. The implicit quid pro quo is that the taxpayer gets a break for coming forward because, absent its coming forward, the state would have no reason to know about the noncompliance. If taxpayers are now forced to show their hands before a deal is in place, they may be chill to the prospect of coming forward. And in some cases, maybe that's OK. A person who has been intentionally avoiding his tax liabilities for many years and engaging in criminal conduct doesn't deserve any special deal, nor does he deserve anonymity in the disclosure process. New York's approach makes sense as applied to those taxpayers. But in practice, those aren't the types of taxpayers who seek to make use of voluntary disclosure programs. In our experience, most taxpayers who take advantage of voluntary disclosure programs are considerate taxpayers who, for many legitimate reasons, fell into noncompliance with the tax law and are looking to make things right. Those folks deserve some protection and the benefits that a voluntary disclosure program might offer. Without the ability to come forward anonymously, many may rethink their decision to come forward, especially in situations in which their potential liability for taxes in the first place is uncertain. In overhauling the voluntary disclosure program in this fashion, New York might be throwing the baby out with the bath water.

As noted, the department also changed the limited lookback provision of the voluntary disclosure program. Under the new program, as was the case in the old one, penalties are still abated. But the lookback period functions differently. The lookback period now follows a more rigid format that appears to eliminate the flexibility of the old program. Chart 1 can be found on the department's Web site.[10] It details when the department will allow the different limited lookback periods.

Chart 2.

Full Voluntary Disclosure Protections	Limited Lookback Clause Protections
No New York state prosecutor or district attorney can bring criminal tax prosecution against you for a fully disclosed and paid tax liability under this program.	You will receive the full voluntary disclosure protections for the lookback period.
The department cannot share any disclosure you make with any other agency or use it against you as evidence in any criminal action or proceeding brought against you.	You will receive the department's promise that it will: o limit its review to the look-back period; o not look back beyond that period for anything else for the tax issue being disclosed; and o not refer you for criminal prosecution for conduct disclosed.
	Because you will not be granted full voluntary disclosure protection, you will not receive protection from criminal prosecution brought by other agencies or prosecutors for the periods before the lookback period.

Finally, as has been previously reported in this column, the department is pursuing tax fraud and tax evasion more vigorously.[11] For example, the department recently established the new Special Investigations Unit to target tax crimes.[12] Moreover, the department has been working closely with local district attorneys to prosecute alleged tax criminals.[13] And that new stance has also affected the voluntary disclosure program. The department now emphasizes that taxpayers who participate in a voluntary disclosure with a limited lookback period may still be prosecuted for tax crimes that occurred before the lookback period. In other words, if a taxpayer engaged in tax fraud for the previous 10 years, but requested the 6-year lookback period, prosecutors could still charge the taxpayer with a crime for the 4 years not covered by the voluntary disclosure.[14] Once again, the department has created a chart (Chart 2) detailing the relative benefits and burdens of using a limited lookback disclosure:[15]

That is not as painful or as shocking, however, as many practitioners initially feared. If you have a client who is concerned about potential criminal sanctions, you will need to participate in the "full" voluntary disclosure program, with no limited lookback period. But is that really so bad? Should those taxpayers -- who otherwise are engaged in potentially criminal conduct -- get a special deal for coming forward? As a tax policy matter, cracking down on them isn't all that hard to stomach. Indeed, as noted above, in many of the voluntary disclosure situations we have been involved in, issues of criminal prosecution are rarely prevalent. Most voluntary disclosures involve gray areas, in which there are questions about the applicability of specific taxes, the taxability of specific items, or the jurisdiction to tax a particular taxpayer. And maybe the "new" tax department will start pursuing those cases criminally, but we doubt it. So losing an outright absolution of criminal prosecution might not be all that big a deal in many voluntary disclosure situations. The problem, however, comes for cases "in the middle," in which a reasonable person would conclude that a taxpayer's mistake is not criminal, but a less than reasonable tax department might disagree. And that's when practitioners need to be paying special attention, and when some difficult decisions may need to be made.

**New York State Voluntary
Compliance Initiative**

Finally, the department has reopened a limited amnesty for taxpayers who have engaged in a tax avoidance transaction (commonly known as a tax shelter). As noted, those taxpayers are prohibited from participating in the Voluntary Disclosure and Compliance Program detailed above. However, New York will offer those taxpayers an amnesty program that will allow them to avoid criminal prosecution and some of the civil penalties that could arise as a result of their participation in the tax shelter. Below is a brief overview of that program.

The New York State Tax Shelter Voluntary Compliance Initiative (VCI) runs from November 1, 2008, to January 31, 2009.[16] The VCI covers only corporate, franchise, and personal income taxes for tax years beginning before January 1, 2005.[17] Essentially, by reporting the tax avoidance transaction and paying the tax that was not reported on the original return, qualifying taxpayers will be entitled to pay the tax and interest alone, with most or all penalties waived. Participation in the VCI also eliminates the threat of a civil, administrative, or criminal enforcement proceeding relating to the transaction.

To qualify for the VCI, all of the following must apply:

- the taxpayer filed a tax return using a tax shelter to underreport its tax liability or failed to file a tax return because of the use of a tax shelter;
- the taxpayer is not under criminal investigation regarding the underreporting or underpayment of tax;
- the taxpayer has not been convicted of a crime regarding the tax that is the basis of the penalty for which relief is sought for any period or assessment for the tax;
- the taxpayer is not a party to any administrative proceeding or civil or criminal litigation regarding the tax that is the basis of the penalty for which relief is sought; and
- the taxpayer was not eligible to participate in the 2003 New York Offshore Voluntary Compliance Initiative.

Taxpayers who wish to participate in the VCI must submit Form DTF-672, "Election to Participate in the Tax Shelter Voluntary Compliance Initiative," for each tax year or tax return at issue. Taxpayers must also submit an original or amended return for each tax year covered by the VCI. Taxpayers can choose to retain appeal rights from the VCI determination. However, if a taxpayer chooses that option, additional penalties could be imposed. For additional information regarding the operation of the VCI (including which transactions qualify as tax shelters), see department Publication 672, available on the department's Web site at
http://www.tax.state.ny.us/pubs_and_bulls/publications/pub_numeric_list.htm.[18]

Conclusion

The department has indicated that these compliance changes are designed to make the process more transparent and efficient. But it remains to be seen if that will be the case. For both the advisory opinion request application and the voluntary disclosure program, it seems that it is the *taxpayers* who bear the burden of that increased transparency and efficiency. As a result, these changes could have the effect of reducing compliance by scaring taxpayers away from what were previously very beneficial programs.

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Noonan's Notes on Tax Practice is a column by Timothy P. Noonan, a partner with Hodgson Russ LLP, Buffalo, N.Y. This column was cowritten by Joseph N. Endres, an associate with Hodgson Russ LLP.

FOOTNOTES

[1] *See* TSB-M-08(10)C (Aug. 27, 2008); TSB-M-08(8)S (Aug. 27, 2008); TSB-M-08(5)I (Aug. 27, 2008); TSB-M-08(5)M (Aug. 27, 2008); and TSB-M-08(3)R (Aug. 27, 2008).
[2] Taxpayers may be able to request formal opinions of counsel for a limited time. Opinions of counsel are authorized by the New York State Tax Regulations. *See* 20 NYCRR 2375.4. Thus, to eliminate that option, the department must formally amend or rescind the regulation. The memorandum indicates that the department will promulgate revised regulations. However, as of the date of this article, no such revisions have occurred. It is important to note that the regulations indicate that "the promulgation of an Opinion of Counsel is also discretionary with the counsel." 20 NYCRR 2375.4(a)(2)(i). As a result, it appears that the Office of Counsel could, and probably will, simply choose not to issue or publish any future opinions.
[3] Tax Law section 171.
[4] 20 NYCRR 2376.1.
[5] 20 NYCRR 2376.2(b)(3).
[6] *Supra* note 1. The memorandum also indicates that advisory opinions will now be drafted by the Office of Counsel, rather than the Taxpayer Guidance Division. According to the memorandum, that will allow the Taxpayer Guidance Division to issue more general guidance about subjects of interest to a wider audience.
[7] 20 NYCRR 2376.1(b) ("advisory opinions may also be utilized for purposes of tax planning. Thus, they may be requested with respect to a hypothetical or projected future set of facts").
[8] *See supra* note 1.
[9] *See* TSB-M-08(6)I (Sept. 3, 2008); TSB-M-08(11)C (Sept. 3, 2008); TSB-M-08(6)M (Sept. 3, 2008); TSB-M-08(4)R (Sept. 3, 2008); and TSB-M-08(10)S (Sept. 3, 2008). Taxpayers can also review the details of the revised program on the department's Web site at http://www.tax.state.ny.us/e-services/vold/program_info.htm.
[10] Chart available at http://www.tax.state.ny.us/e-services/vold/lookback.htm.
[11] Jack Trachtenberg and Michelle Merola-Kane, "Noonan's Notes: New York's Less Kind and Gentle Tax Department -- Preparing for Criminal Investigations," *State Tax Notes*, Mar. 31, 2008, p. 1041, *Doc 2008-5935* [**PDF**], or *2008 STT 63-3* .
[12] *See* department's Web site at http://www.tax.state.ny.us/enforcement/otehomepage.htm. The Web site states, "Increased criminal enforcement is a department priority. Recently, we more than quadrupled our fraud fighting forces by deploying specially trained multi-disciplinary investigations units statewide. Teams of auditors, investigators and attorneys are using all the enforcement tools at their disposal to stop those engaged in tax evasion and fraud at the expense of other taxpayers and their communities." *See also* Criminal Prosecution of Tax Fraud Cases SUI Guidelines, available on the department's Web site at http://www.tax.state.ny.us/enforcement/crim_actions.htm.
[13] *See* November 14, 2007, press releases, available on the department's Web site at http://www.tax.state.ny.us/press/pr2007.htm.
[14] That assumes that the underlying statute of limitations for prosecution has not expired.
[15] Chart available at http://www.tax.state.ny.us/e-services/vold/lookback.htm.
[16] January 31, 2009, falls on a Saturday. As a result, VCI applications postmarked by February 2, 2009, will be considered as timely received.
[17] That includes taxes contained in articles 22, 30, 30-A, 30-B, 9, 9-A, 32, and 33 of the Tax Law.
[18] *See also* TSB-M-05(4)I (June 1, 2005), TSB-M-05(2)C (June 1, 2005), TSB-M-05(4.1)I (July 28, 2005), and TSB-M-05(2.1)C (July 28, 2005).

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