FOCUS: TAXATION

New York Voluntary Tax Disclosure and Compliance program

Every few years, state tax governments adopt amnesty programs to meet budget shortfalls by triggering the acceleration of tax revenue. However, tax agencies know that amnesty programs convey a risky message… that the benefit of current revenue collection exceeds the cost to the system of allowing wrongful conduct to go unpunished. Oftentimes, taxpayers who know they are skirting the law wait for amnesty opportunities to arise in lieu of stepping forward to resolve their tax issues. Their wait may now be over.

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What is it?

Recently, Chapter 57 of the Laws of 2008 added section 1700 of Article 36 to the New York State Tax Law which establishes the Voluntary Disclosure and Compliance (VDC) program. As indicated in the New York State tax guidance "the program is designed to encourage eligible taxpayers who owe back taxes, regardless of the reason, to voluntarily disclose tax liabilities that are not known to the Tax Department. The significant incentives provided by the VDC program to eligible taxpayers who participate and comply with its requirements include protection from possible criminal tax prosecution and the avoidance of all civil penalties."[1] Unlike traditional amnesty programs, the VDC program also applies to taxpayers engaged in fraudulent or criminal conduct. It should be noted that interest owed on the original taxes are not waived under the VDC program. Moreover, payment in full or via an installment payment agreement (IPA) is required. IPA's can be arranged after disclosure of the taxpayer's financial condition to NYS.

In order to understand the VDC program, a distinction must be clarified. "Amnesty" programs include relief for taxes already assessed and owed. The new "VDC" program is for the taxes that New York State does not yet know are owed. The VDC program is viewed by the state as a mechanism for avoiding the policy dilemma faced when adopting an amnesty program. Under the VDC arrangement, the amnesty policy decision doesn't come into play because any tax dollars obtained would have likely otherwise gone undetected anyway.

Who qualifies?

The VDC program applies to several eligible taxpayers, including (but not limited to) individuals, partnerships, estates, trusts, corporations, limited liability companies, joint stock companies, trustees, receiverships or any other entity responsible to pay tax to New York State. However, applicants can not submit anonymous applications to "test the waters." The program applies to unpaid corporate franchise tax, excise tax, sales & use taxes and to any other tax administered by the Commissioner of Taxation & Finance.

Criteria

In order to qualify, eligible taxpayers need to approach the Tax Department before the state approaches them. The taxpayer could not currently be under criminal investigation or audit for any tax and the liability could not have already been determined, researched or identified by New York State at the time of disclosure. Disclosure of participation in listed transactions ("tax shelters") would not qualify either. Taxpayers seeking relief for tax shelter activity could apply for limited amnesty under a separate NYS Voluntary Compliance Initiative (VCI Program).

How does it work?

Under the VDC program, the taxpayer completes an online application comprised of only four questions (about the nature of the liability, periods covered, etc.). If the taxpayer withdraws the application, is determined to be ineligible for the program or if an agreement is not reached with the New York State, the system is purged of the record. Disclosures are kept confidential, and in fact the statute prohibits the Department from subsequently using the information obtained as evidence against the taxpayer or from sharing it with other agencies. Note, that in order to verify the accuracy of the disclosure, New York State may audit and examine any tax returns filed by the taxpayer as part of the VDC program.

Compliance Agreement

The ultimate goal for the Tax Department is to bring noncompliant taxpayers back into the system. The Compliance Agreement is the component of the VDC application for executing that function. It sets forth the scope of the Tax Department's review and expectations for operating in accordance with the tax laws in the future. These terms are critical and compliance with them is key. Failure to abide by an executed Agreement

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frees the state to move forward with prosecution. Acceptance into the VDC program is contingent upon the execution of the Agreement.

The Look Back Clause

Sometimes, taxpayers who had been deficient for an extended period (more than three years) cannot withstand the economic burden of undertaking a complete payment for their entire history of noncompliance. Formerly, the term "Look-Back period" was solely a creature of Elder Law. No longer. When taxpayers complete the VDC application, they may request to have a limited look-back which will relieve the taxpayer from the obligation to extinguish taxes for all prior tax periods. This enables taxpayers to disclose the entire tax liability but to only file returns and pay tax with interest (penalties are waived) for the limited duration of the look back period itself. For NYS Tax purposes, the protection (from prosecution) runs to the extent of the disclosure. Tax returns prior to the look-back period would not have to be filed, however New York State may audit taxes unrelated to the disclosure for periods prior to the look back period.

Electing to limit compliance to the extent of the look-back period may reduce the tax payable but it comes at a cost as well. Although the Tax Department would not refer to other agencies or prosecute for pre-look-back deficiencies, protection could not be granted from criminal prosecution brought by other agencies for those periods. Clients may otherwise choose to roll the dice and wait out the expiration of the statute of limitations on collection.[2] However, for failure to file, failure to correct a state return due to changes on a federal tax return and for false or fraudulent returns with intent to evade tax, the statute of statute of limitations does not apply.[3]

How long is the look-back period?

The length of the allowable look-back period depends on the circumstances. Deficiencies stemming from Tax Fraud, Tax Evasion and Trust fund deficiencies (from sales, use and withholding taxes) will have a look-back of up to six years. Typical tax shortfalls relating to mistake, ignorance of law, inability to comply, etc. carry a three-year look back period. The Tax Department reviews each look-back request with the accompanying VDC request. If not accepted, taxpayers are provided the opportunity to proceed without the look-back provisions in place.

Revisions to Advisory Opinion Requests

The administration of New York State Tax Law differs from federal tax in many respects. IRS Private Letter Rulings are expensive and time consuming to obtain. However, the state equivalent, known as a Technical Services Bureau Advisory Opinions (TSB-A or "AO") are provided free by the tax department. The issue of importance here is that the VDC program is being set forth in conjunction with a revised Advisory Opinion process and updated petition form.

Taxpayers who are uncertain about the tax treatment for a particular activity can now step forward to ask without incurring a penalty or prosecution risk by asking. As of August 8, 2008, "Advice of Counsel," a back-door method of requesting an Advisory Opinion anonymously or based upon a hypothetical set of facts is no longer available. All future guidance will be published in redacted form. Revised regulations governing the issuance of Advisory Opinions are forthcoming.

The economic recession has had a significant impact upon businesses in New York State. Reduced business profits have translated to a reduction in state tax revenue. Out of necessity, the Tax Department has increased its enforcement efforts. Former prosecutor William Comiskey, Esq. has been nominated Deputy Commissioner for the Office of Tax Enforcement. He has coordinated teams with local District Attorney's offices statewide to prosecute tax offenders. In the face of these threats, clients should be advised that a statutory open invitation has been established. Finally, noncompliant taxpayers who've gone astray have been given a safe path back home.

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1. New York State Department of Taxation & Finance TSB-M-08(6)I
2. 10-years for Real Estate and 20-years for Personal Property
3. Recently, in *Matter of Mulderig v. NYS Department of Taxation and Finance*, 500685, decided 10/30/08, the court held that, there is no tax deadline to the assessment of the New York State tax if based upon failure to report a federal audit change.