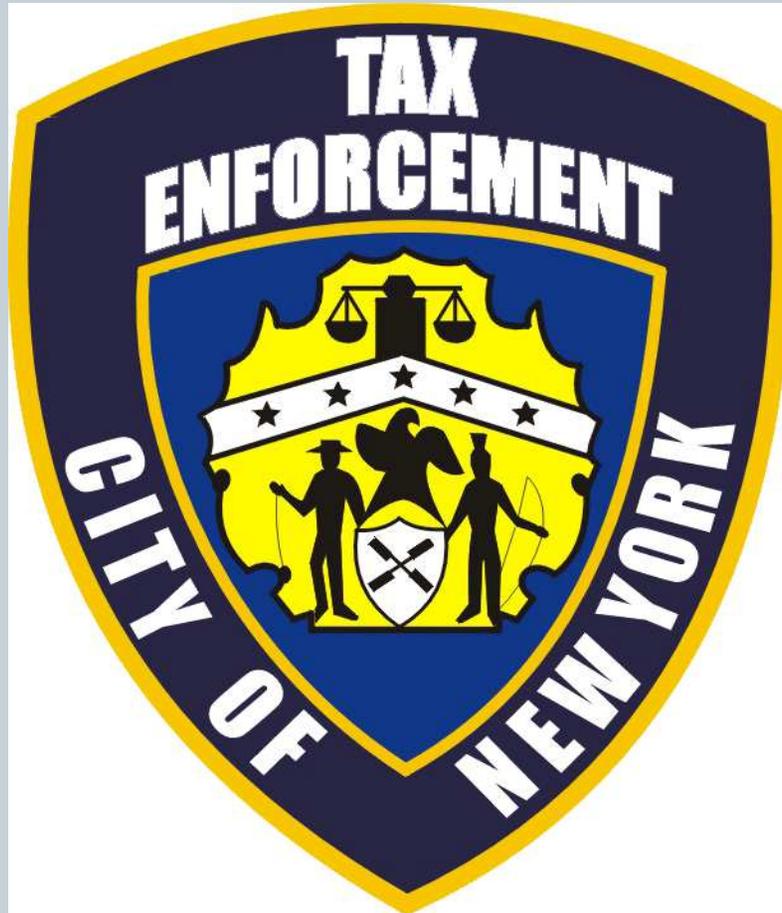


The Office of Tax Enforcement



An Enemy of the People: Independence and Internal Control



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KEYNOTE PRESENTATION

Introduction



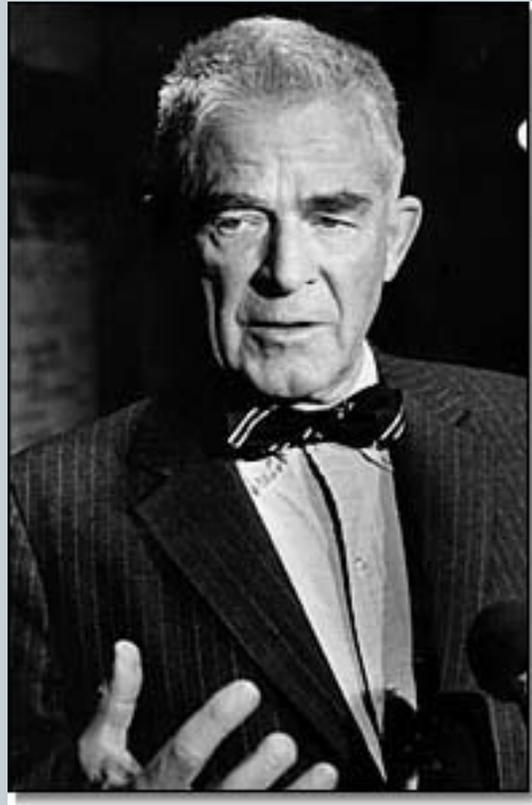
- This lecture will focus on a variety of topics, including the investigation of tax fraud; change management; and the problem of the independence of anti-corruption, internal control, and compliance agencies.
- In conducting this lecture, I will be drawing upon over 26 years of experience in conducting investigations of corruption and tax fraud for the New York City Department of Investigation, the New York State Department of Taxation and Finance, and the New York City Department of Finance, as well as my experience as an Anti-Corruption Advisor in the Republic of Azerbaijan.
- My commentary on anti-corruption practices, change management, and internal control are personal, and do not represent the policies or opinions of either the New York City Department of Finance or the City of New York.
- The slides in this power point presentation include an Appendix which consists of an introductory guide to the subjects of Change Management and Tax Fraud.

The Story of a Subpoena



- Once upon a time, there was a subpoena. It asked for the production of tapes of conversations between a Chief Executive and his staff concerning the commission of a crime.
- The Chief Executive was President Richard Nixon.
- The person who served the subpoena was Archibald Cox, the Special Prosecutor of the Watergate Task Force.

Archibald Cox



Motion to Quash



- The Watergate Tapes consisted of recordings of conversations between the President of the United States and his staff, including conversations about the burglary in the offices at Democratic National Committee that the White House had orchestrated.
- The President moved to quash the subpoena. The court ordered that it be enforced. The President appealed, and he lost the appeal.
- At the President's direction, the Attorney General, Elliot Richardson, entered into negotiations with the Special Prosecutor to produce less than the subpoena requested. The negotiations failed.

The Saturday Night Massacre



- On October 20, 1973, President Nixon ordered Attorney General Richardson to fire Special Prosecutor Archibald Cox.
- Richardson refused and resigned in protest.
- Nixon then ordered Deputy Attorney General William Ruckelshaus to fire Cox.
- Ruckelshaus refused and resigned in protest.
- Nixon then appointed Solicitor General Robert Bork to be the Acting Attorney General, ordered him to fire Cox, and he did.
- This event became known as the “Saturday Night Massacre,” and it marks a turning point in history, when three men stood up to the President of the United States to enforce the law.
- In the end, the subpoena was enforced, the tapes were produced, the President’s men were convicted, and the President resigned.

Elliot Richardson



William Ruckelshaus



A Difficult Job



- Inspectors General, Internal Control Officers, Internal Auditors, and other Compliance Officers all have a difficult, thankless job to perform.
- When they do their jobs well, they uncover the faults, flaws, and misconduct of their colleagues to protect the integrity of an agency that is often embarrassed by their findings.
- And when they do their jobs very well, they keep their charges out of trouble and no-one knows that they exist.
- The Saturday Night Massacre illustrates the pressures that compliance officials often face, when they must choose between performing their duties, protecting their charges, and protecting themselves.
- When faced with these choices, Archibald Cox, Elliot Richardson, and William Ruckelshaus all chose duty over self-interest.

The Challenge of Independence



- Inspectors General, Internal Control Officers, Internal Auditors, and other Compliance Officers do similar jobs and wrestle with similar problems. One of these problems is independence.
- There is no such thing as pure independence in government agencies and private organizations. Government officials are dependent on either their bureaucracy or their appointing authority or, as elected officials, their constituents, and all too often, their contributors. C.E.O.'s are dependent on their Boards of Directors, and their customers or clients. Everyone has to answer to somebody. And this “somebody” is naturally torn between conflicting needs, requirements, and missions, both professional and personal. And herein lies the conflict.
- Compliance and anti-corruption officials often face this dilemma when they report to, and are dependent on, their Chief Executives, because when this happens, the agency is essentially investigating itself.

An Enemy of the People



- 91 years before the Saturday Night Massacre, the great Norwegian playwright, Henrik Ibsen, published his play, “An Enemy of the People,” concerning corruption in a small town.
- The play is a perfect case study of the problem of independence and internal control.
- A brief summary of the play appears in the next slides.

The Baths Are Poisoned



- Dr. Thomas Stockmann is the Medical Officer of the public Healing Baths in a small town, which is a big source of revenue from tourism.
- Dr. Stockmann discovers that a design flaw in the pipes is causing waste from a tannery to infect the water. The baths are a fraud. They do not make people well, they make people sick. Dr. Stockmann drafts a report about the problem, with a recommendation to close the baths until they have been repaired.
- Dr. Stockmann initially gains the support of the local newspaper and a leading citizen, and they encourage him to publish his report.
- The Mayor, however, wants Dr. Stockmann to bury his report, due to the cost of repairing the baths and the loss of income to the town. Dr. Stockmann refuses, and the Mayor threatens to have him fired.
- The Mayor then pressures the newspaper and the leading citizen, who then withdraw their support from Dr. Stockmann when they learn that taxes will have to be raised and the baths closed for two years in order to repair them.
- The Mayor and the other powerful forces in the town question the accuracy of Dr. Stockmann's report, and then challenge his integrity and his judgment. They try to silence him, but he continues to speak out. He is eventually fired from his job.

Conflicts of Interest



- **The story is riddled with conflicts of interest:**
 - Dr. Stockmann and the Mayor are brothers, and their decision-making is influenced by their sibling rivalry. The Baths were Dr. Stockmann's idea, and he told his brother that the waters would be infected because of the way that the Baths were being constructed; his discovery that the waters are infected is a moment when he can tell his brother, "I told you so."
 - Dr. Stockmann's father-in-law owns the tannery that is infecting the waters, and they have a terrible relationship, and this colors how he handles the problem of the infected waters.
 - The leading citizen represents the landlords, and his position is influenced by how the crisis of the Baths will affect the value of real estate and a raise in taxes.
 - The leading citizen of the town owns the newspaper, and the editor cannot divorce himself from his publisher's financial interests.
 - The leading citizen and the newspapers editor initially want to co-opt the crisis with the baths as a means of starting a movement to overthrow the Mayor and the powerful Baths Committee.
 - The editor's initial support of Dr. Stockmann is also influenced by his affection for Dr. Stockmann's daughter, and when she rejects the editor, he withdraws his support for her father.

The Enemy of the People



- Dr. Stockmann then organizes a public meeting to give his report about the Baths directly to the people. But he loses control of the meeting, and instead of making a speech about the Baths, he talks about his “new discovery,” that the real problem is not the disease in the water, but the disease in the town. The majority, the common people, are not always right, they are always wrong, and it is only the minority that is right. The common people are ignorant and destructive, and it is they who have to be extinguished, not the bacteria in the water. The meeting, outraged, then passes a resolution that Dr. Stockmann is an “Enemy of the People.”
- Dr. Stockmann’s father-in-law, who owns the tannery that infected the water, feels guilty, and buys up the stock in the baths and offers to give it to his family as an inheritance. Dr. Stockmann is immediately corrupted, as he realizes that he is now financially secure and he wonders if there is some way of cleaning the waters so that the Baths do not have to be shut down. But of course, this is impossible, and he recovers and rejects the gift.
- By the end of the play, Dr. Stockmann is evicted from his home, loses his medical practice, becomes the town pariah, and concludes that, “the strongest man in the world is he who stands most alone.”

Analysis



- Dr. Stockmann is essentially playing the role of an Inspector General or an Internal Control Officer who reports directly to the head of an agency. Dr. Stockmann discovers that the waters are poisoned, and the Mayor's first reaction is not to protect the public interest, but to protect the agency, and by extension, himself, because he is ultimately responsible for the poor construction of the baths that has caused this problem.
- Here, we see the essential problem of independence and compliance officers, whether we call them Inspectors General, Internal Control Officers, or Internal Auditors. Executives often do not want bad news, especially bad news that will embarrass them, or result in a loss of money, or will otherwise hold them up to criticism or cause other problems. And some Executives will act just like the Mayor in Ibsen's play—they will bluster, challenge the report, seek to minimize it, or bury it, and then attack the person who did the work.
- Dr. Stockmann's fatal flaw is that he does not understand his role as a change agent and the problems that it will cause. He assumes that everyone will agree with his recommendations and dub him a hero; never considers the practical problem of implementing his recommendations for change; and blows an opportunity to educate the public with an angry rant. He is arrogant, stubborn, and an intellectual snob. And then, when he has an opportunity to take control of the Baths so that they can be repaired, he stands on principle and isolates himself.
- I highlight all of this, because it demonstrates the second problem that I want to address in the world of compliance —the failure of change agents to practice change management.
- But before we address the problems of independence and change management in internal control systems, it would be helpful to review a governmental system where there is no internal control system— the Republic of Azerbaijan.

On the Road to Ganja and Other Stories



- In Azerbaijan, where there is no Rule of Law, private individuals must fend for themselves.
- On the Road to Ganja
 - Stopped by the police without probable cause, even the anti-corruption reformers are forced to pay bribes.
- Sevinj Gets Stopped at the Airport
 - Solicited for a bribe because she was traveling alone, a young lawyer stands up to the police and wins.
- The Hunger Strike
 - Students take over a building to demand their rights.
- The Anti-Corruption Legal Action Centers
 - Helping citizens make complaints against the government.

The Land of Fire



- The Republic of Azerbaijan is a former State of the Soviet Union. It borders Russian and Georgia to the North; Iran to the South; the Caspian Sea to the East; and Armenia to the West. It is 9 time zones to the East of New York City. It has a population of over 9 million people, and is about the same size of South Carolina. It's capital City is Baku, and the Baku-Tbilisi-Ceyhan oil pipeline has made it very wealthy since independence.
- Azerbaijan is also one of the most corrupt countries in the world. Transparency International ranks it 123 out of 176 countries on its 2016 Corruption Perception Index. (Denmark is 1 and the U.S. is 18.) Global Integrity, another watchdog organization, gives Azerbaijan high marks on its anti-corruption laws, but very low marks on enforcement. There is no independent anti-corruption entity, including the Attorney General. Government employees are paid very little and often solicit bribes to supplement their income. Bribery is a form of taxation by other means.
 - Police officers solicit bribes from motorists during traffic stops.
 - Judges solicit bribes from attorneys to settle cases in their favor.
 - Teachers solicit bribes from their students in exchange for grades.
- President Ilham Aliyev and his family are prominently featured in the Panama Papers, which describes a network of secret financial holdings throughout the world.
- Journalists risk their lives to tell the truth, and political opponents are imprisoned.

Promoting the Rule of Law in Baku



- The United States Agency for International Development and the American Bar Association undertook a variety of initiatives to promote the Rule of Law in Baku, which included:
 - The distribution of law books and the creation of a law library.
 - Providing legal training to lawyers and judges.
 - Creating a free legal services organization for the public.
 - Implementing a Street Law Project.
 - Sponsoring Anti-Corruption Legal Action Centers in the cities of Baku and Ganja.
 - Hiring an Anti-Corruption Advisor for government agencies.
 - Providing anti-corruption training for government officials, journalists, and students.
 - Participating in an intergovernmental anti-corruption working group to draft new laws.
- The missing piece was an independent enforcement entity, like an Inspector General's Office, that could enforce the Rule of Law. Part of the resistance to an I.G. was a backlash to the Soviet experience in which law enforcement was an instrument of oppression. The absence of such an entity like an I.G. is one of the principal reasons why Azerbaijan remains one of the most corrupt countries in the world today.

Reform from the Middle



- Generally, change in government can be initiated “from the top” by Executives creating new policies, or from the “grass roots” by members of civil society advocating for reform. In Azerbaijan, I found that reform can also be initiated from “the Middle” by supporting middle managers in governmental agencies in small reform initiatives. This was exemplified by my work with the Ministry of Education.
- Due to rampant bribery within all levels of the Azerbaijani educational system, undergraduate and graduate degrees were not being accepted by other countries, and the Minister of Education was under pressure to combat corruption. In addition, reform of the educational system was a pre-condition to Azerbaijan being accepted into the Council of Europe and the European Union.
- Given this pressure, the Minister of Education and his deputies were amenable to adopting various anti-corruption measures. This included:
 - Requiring all teachers in all schools throughout the country to read an anti-bribery statement to their classes.
 - The establishment of an anti-corruption hotline in the Ministry of Education.
 - Cooperation on conducting a series of surprise anti-corruption inspections of final examinations in a university
 - Participation of senior officials in anti-corruption training.
 - The peaceful resolution of a hunger strike in which one hundred students who took over a university building .
- The key to gaining the cooperation of the Ministry was building relationships with middle managers, and being responsive to the pressure that they were under by assisting them.
- Reform from the Middle did not work in other sectors of government because there was no such pressure, and, when combined with the lack of an independent outside agency to foster reform, corruption continued.

Independence Under the Internal Control Act



- The Internal Control Act does not provide for sufficient independence for the Internal Control Officers, and the standards for the agencies and other officials are different.
- The Governor's Office, the Comptroller, the Attorney General, the Legislature, and the Judiciary are only required to have internal audits conducted every three years, which is an insufficient amount of oversight. Despite this independence, the oversight officer has elements of independence, in that it is an independent certified public accountant who is selected by public bid, and has access to all of its charge's records. The Internal Control Act does not state how long the C.P.A. will remain in office, and how the C.P.A. will be removed.
- Although State Agencies and public authorities are required to create Internal Control Programs, they have the discretion to determine if they want to appoint Internal Control Officers. These Internal Control Officers are appointed by and dependent on the agency heads, and there are no provisions in the Act that requires the agencies to provide them with records; both of these matters affect their independence.

Independence and the Comptroller's Standards



- The State Comptroller's Standards for Internal Control in New York State Government do not adequately address the problem of independence.
- When describing the importance of internal controls, it lists a variety of good government goals, but also adds "Avoid bad publicity" and "Protect all employees" among them. Bad publicity and the termination of an inefficient or corrupt employee are two possible outcomes of an internal audit that uncovers misconduct or loss, and the goals of avoiding bad publicity and protecting all employees are inconsistent with an internal control system, and highlight how the independence of that system can be compromised.
- Although the Standards require I.C.O.'s to report control failings and weaknesses to management, it does not address what the I.C.O. should do if this report is ignored, or if management takes adverse actions against the I.C.O. as a result of the report.
- Rather, the Standards provide that the Executive or governing board is ultimately accountable for the success or failure of an Internal Control System. Although Standards also provide for a Risk Management Committee made up of Senior Level managers provides I.C.O.'s with some additional oversight, and in so doing, spreads accountability over a larger group of people, this Committee is insufficient to provide the I.C.O. with sufficient independence to go outside of his or her chain of command or to an outside agency to address an internal control problem that is not being addressed by the agency.

Working with Inspectors General



- Internal Control Officers who are government employees are required to report corruption to their Inspectors General like other employees. However, I.G.'s often focus on criminal investigations, and with limited staffs, they are unable to handle many of the control failings encountered by I.C.O.'s. In addition, the I.C.O. may choose to handle a matter within his/her own agency for a variety of reasons, both positive and negative, ranging from a desire to handle a matter quickly, to a desire to not expose a problem to an outside agency.

Inspectors General and Independence



- The New York City Department of Investigation houses the City's I.G. system, and is one model of how some measure of independence can be maintained by an anti-corruption agency.
- The D.O.I. Commissioner is appointed by the Mayor with the advice and consent of the City Council; no other Commissioner requires this approval to be appointed.
- The Mayor may only remove the D.O.I. Commissioner for cause, and must provide him or her with an opportunity to respond.
- D.O.I.'s jurisdiction is broad, and covers any matter that is in "the best interests of the city," including "the affairs, functions, accounts, methods, personnel or efficiency of any agency."
- D.O.I. has subpoena power, and all government agencies and vendors must provide them with access to records.
- Nevertheless, the D.O.I. Commissioner still serves at the pleasure of the Mayor, and historically, the relationship between the two offices has occasionally come under scrutiny and criticism.
- Anti-corruption and compliance agencies can be controlled by an Executive failing to follow a recommendation to eliminate a risk; or by an Executive ordering that an action not be taken, or a report buried; or by more subtle means, such as reducing a budget; or not filling staff vacancies; or by repeatedly changing the leadership.

Strengthening Independence



- The following is a list of some of the stratagems that can be used to strengthen the independence of compliance officials:
 - Provide the I.C.O. with a term of office.
 - Require that the I.C.O. may only be removed for cause for specific acts of misconduct, with a written explanation to an outside anti-corruption or ethics agency, or for the private sector, an outside law firm, or an accounting firm, or an I.P.S.I.G.
 - Give the compliance agency control over its budget by ensuring that it has sufficient staffing and resources, and by prohibiting reduction in its budget.
 - Create a requirement that all staff cooperate with the compliance agency as a condition of employment.
 - Provide the compliance agency with the authority to inspect and seize all agency records that it needs to perform its work.
 - Ensure that the compliance agency has strong ties to an outside agency for assistance, such as anti-corruption or ethics agency, or for the private sector, an outside law firm, or an accounting firm, or an I.P.S.I.G.

Change Management and Independence



- Change is Risk, and compliance officials must be aware of the problems of Change Management.
- The independence of an I.C.O. can be affected by changes in leadership and policies in his/her agency.
- In addition, I.C.O.'s who encourage their agencies to practice good Change Management techniques will find that employees will have a greater ability to adapt to new policies and comply with existing ones.
- Hence, if change is managed well, a change in leadership or a change of the I.C.O. will not affect the risk management policies and procedures that have been adopted by the staff; compliance will continue.

Promoting Voluntary Tax Compliance



- The principal mission of Tax Authorities is the collection of tax through voluntary compliance. The vast majority of taxes are collected by taxpayer filing their tax returns and paying their taxes on time.
 - For Fiscal Year 2017, it is projected that the New York City Department of Finance will collect \$7.2 in City Business taxes, \$6 Billion of which is through voluntary compliance, and \$1.2 Billion of which is through audits.
- In order to promote voluntary compliance, Tax Authorities must ensure that tax returns remain secret. Tax returns contain a lot of private information that taxpayers would not want disclosed to the public, and they would not give this information to Tax Authorities if they did not think that their tax returns would remain confidential. For example, the private information that appears on a Personal Income Tax return includes:
 - the home address and S.S.N.'s of the taxpayer, his spouse, and his children'
 - the taxpayer's income, medical expenses, and gambling winnings;
 - the name and address of the babysitter for the taxpayer's children.
- It is a crime for employees of Tax Authorities to violate tax secrecy.
- Tax Authorities also promote voluntary compliance by ensuring that audits and tax assessments are conducted in a fair and transparent manner.

Tax Administration and Internal Control



- Tax Authorities use a variety of systems to ensure the integrity of our voluntary tax system, including:
 - Maintaining the security of tax information, including tax information received from other agencies.
 - ✦ Employees of tax authorities may only view tax returns for a business purpose, and Inspectors General and Internal Auditors often focus their efforts on combatting illegal browsing of returns.
 - Ensuring that audit selection is fair and based on objective criteria.
 - ✦ The I.R.S., State Tax, and City Finance all have units separate from the Audit Units that use modeling to identify candidates for audit.
 - Ensuring the integrity in the tax assessment process by providing for a system of checks and balances before tax assessments are issued, and ensuring that taxpayers have a means of protesting assessments before they are issued.
 - ✦ Separate quality control units vet tax assessments before they are issued.
 - ✦ In State and City cases, taxpayers may protest tax assessments at informal conciliation hearings or at formal Tax Appeals tribunals.

Tax Fraud and Internal Control



- As is detailed in the slides below, Tax Authorities often have criminal investigative units to combat tax fraud, which includes the failure to file tax returns and pay tax; the filing of false tax returns; the theft of trust taxes; and smuggling to evade excise taxes.
- Other governmental agencies and private industry should also be concerned with how tax fraud affects the integrity of their operations.
- A government vendor whose fees are paid with tax revenue should be compliant with the tax law, and government agencies should not give contracts to tax cheats.
 - Government agencies often conduct tax compliance checks on vendors before awarding contracts.
- Government employees whose salaries are paid with tax revenue should pay their income taxes, and government agencies should not hire people who fail to file their tax returns.
 - Tax compliance is often the subject of background investigations during the hiring process.
- Both private industry and governmental agencies should be concerned when employees who handle funds have high debts or who fail to pay their income taxes because this could be an indicator of an integrity problem that could result in theft.
- Vendors who use commercial check cashers rather than depositing checks in a bank, may be violating withholding tax requirements or prevailing wage laws. This involves the creation of false documents, which may be an indicator of other integrity problems that could affect performance on a contract

Tax Compliance and Internal Control



- Governmental agencies and private industry should make combatting tax fraud part of their internal control programs.
- Tax compliance checks can be conducted during the process to hire new employees and select vendors.
 - Tax compliance questions are already part of City VENDEX and background questionnaires.
 - Candidates for jobs and contracts can sign be required to provide copies of their tax returns, or they can be asked to sign waivers of tax secrecy that can be submitted to Tax Authorities in order to obtain filing histories and copies of tax returns. These waivers can also be used to obtain employment tax returns that contract managers can use to match the wages reported on the returns with prevailing wage reports.
 - Tax compliance checks can also be conducted for tax liens and tax warrants.
 - Governmental agencies and private industry can require that employees and vendors file delinquent tax returns and pay back taxes as a condition of employment or obtaining a contract.
 - Government agencies and private industry can also develop relationships with Tax Authorities in order to conduct these tax compliance checks. This already occurs on a regular basis with some government agencies.
 - In conducting tax compliance checks, please remember that evidence of a filed return or taxes paid is not evidence that the tax return was accurate or truthful, or that the total amount of taxes due was remitted; this can only be determined with an audit or an investigation.

Some Things to Look For



- Business entities, especially construction companies, that use commercial check cashers to negotiate checks paid to them by their clients, rather than deposit these funds in banks, as part of a tax evasion scheme.
- Cash businesses with poor accounting controls and that do not report all of their income and expenses on their tax returns.
- Tax return preparers who underreport income; or create fictitious expenses; or report fictitious dependents.
- Retail businesses that use Point of Sale systems (computerized cash registers) that use sales suppression software to alter receipts.
- A.T.M. machines that are used to launder cash receipts.
- Businesses that withhold taxes from their employees and do not remit them to tax authorities, or businesses that collect Sales Tax and do not remit them.
- Businesses, such as restaurants, that either pay employees “off the books” or pay a portion of their wages “off the books.”

Courage



- If Dr. Stockmann speaks for anything, it is courage.
- Independence in internal control agencies is not only based on the relationship with the Executive; or its various powers to perform its job; it is also based on the integrity of the internal control officer; and the courage to perform a difficult job in the sense of adversity.
- Dr. Stockmann said that the “strongest man in the world is he who stands alone.”
- If you do your job well, there will be times when you will feel alone; when you ask for change that will be expensive or difficult, and your office will question your abilities and your judgment, and it will feel like you are an enemy of the people.
- If this happens, remember that you are not alone. Organizations like this one, its members, and your colleagues in other agencies are there to support you.



Appendix

- 1. Change Management**
- 2. Tax Fraud**



Change Management

What is Change Management?



- Change Management is a discipline that focuses on how individuals and organizations adapt to change.
 - If you are in State government, I highly recommend that you take the G.O.E.R. course, “Navigating Transitions in the Workplace,” which was developed by Deborah Seeley and Deborah Berg. I was a certified G.O.E.R. trainer in this subject, and you can find some of the course materials online.
- The ancient Greek philosopher Heraclitus said that “*No man ever steps in the same river twice, for it's not the same river and he's not the same man.*” What he meant was that change is a constant. He said that, too: “*There is nothing permanent except change.*”
- Government programs strive for sustainability, but this is challenging due to the fluid nature of change in government.

The Change Continuum



- The Change Continuum describes the rate of change in different forms of government.
- On the extreme right, are forms of government in which change is rare over long periods of time, such as an absolute monarchy in which change occurs when the monarch dies and is succeeded by an heir; or a police state in which the ruling party or military junta is permanent over long periods of time and the leader occasionally changes.
- On the extreme left is a period of revolution or anarchy in which the leaders and form of government are constantly changing.
- In the middle are democracies, in which change is managed through periodic elections of the chief executive, as in the United States, or of the members of the legislature, as in parliamentary democracies such as the United Kingdom.

Change in the United States



- In the United States, change occurs at the Federal, State, and Local level at a rate of approximately every four to eight years, when a new President, Governor, or Mayor is elected.
 - Each change of government brings new leaders, policies, initiatives, and styles of management that affect how government operates.
- But if you are a career government employee, you learn over time that change occurs even more frequently.
 - When a Governor or Mayor changes, so do all of the Commissioners, and often the Deputy Commissioners, and lower ranking supervisors.
 - Each one of these new Commissioners has their own personnel to install; their own policy initiatives; and their own styles of management, each of which affects not only how the agency operates, but how individual employees perform their jobs on a day-to-day basis.
 - And with every change of leadership at every level of government there is a period of uncertainty, anxiety, and even slowed activity, in which the new leaders must learn their jobs, and the middle managers and line staff delay making certain decisions until the new system is in place.
 - The same can be said for policy changes.

Policy Changes in Government



- Policy changes in government agencies are also met with periods of uncertainty and anxiety among the staff, regardless of the merits of the changes.
- This can negatively impact the implementation of the new policy changes and also cause related internal control problems.
- Management needs to proactively encourage staff to be stakeholders in the proposed change, and to give them the tools that they need to help them adapt to it. This will enable the proposed change to be effectively implemented.

How Change Works



- Psychologist Kurt Lewin theorized that there are three stages to change which he called, “Unfreeze-Change-Refreeze.” Lewin conceptualized change as a cube of ice that is reshaped into a cone.
- In the **Unfreeze Stage**, the cube of ice is melted, representing the period when an organization prepares for change. This is a period of uncertainty, in which the reasons for change must be presented as a compelling problem, so that something old may be broken down and re-created into something new.
- In the **Change Stage**, the ice cube is now liquid, representing the period when the organization is ready for change and begins to implement it.
- In the **Refreeze Stage**, the liquid has been reshaped and refrozen into a cone, representing the period when the organization adapts to the change and is operating in a new way.
- It is incumbent upon leaders to help their staffs adapt to these three stages of change. To do so, it is helpful to understand and be responsive to the hopes and fears that are associated with any significant change.

Adapting to Change

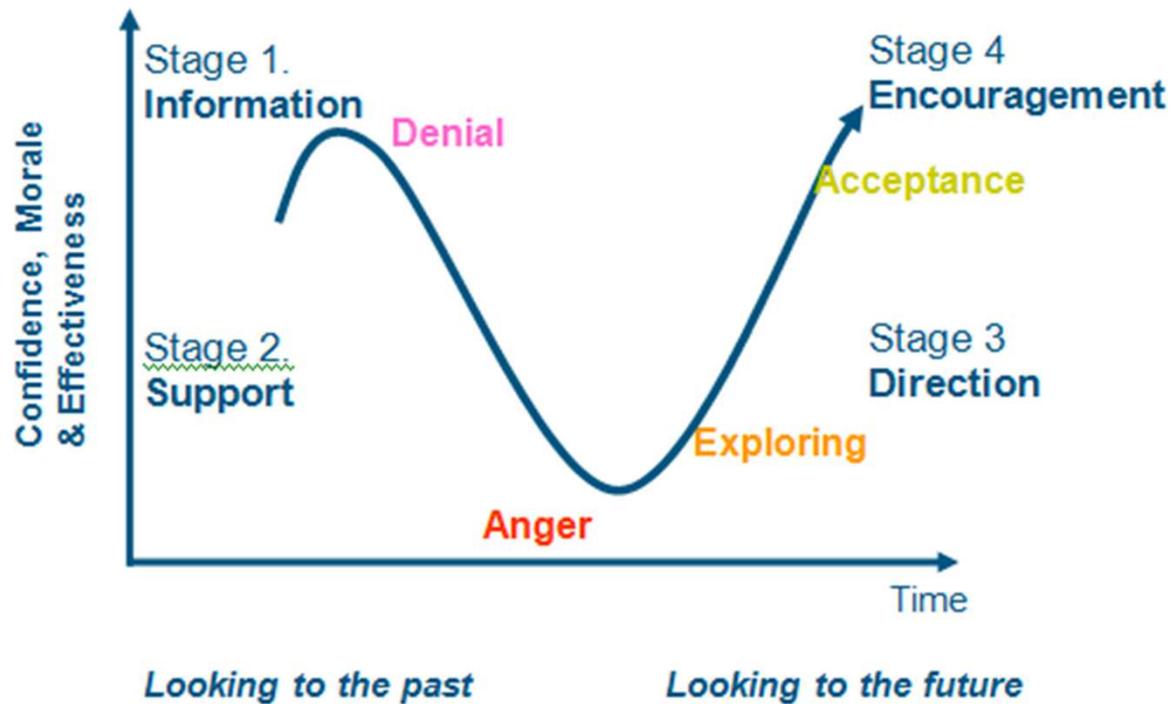


- To understand how people adapt to change, you first have to understand how people feel about change.
- The emotions associated with change range from resentment to changing something old and familiar; to fear of the unknown; to hope for the future; to elation about the change itself.
- Like Lewin's ice cube, which has three stages of change, individuals also have three stages of change:
 - Endings – When people feel a sense of loss.
 - Transitions – When people express doubt about the change.
 - Beginnings – When people begin to accept the change.
 - The William Bridges Change Curve and Transition Curve in the following two slides illustrate the emotional roller coaster that people experience during periods of change.

The William Bridges Change Curve



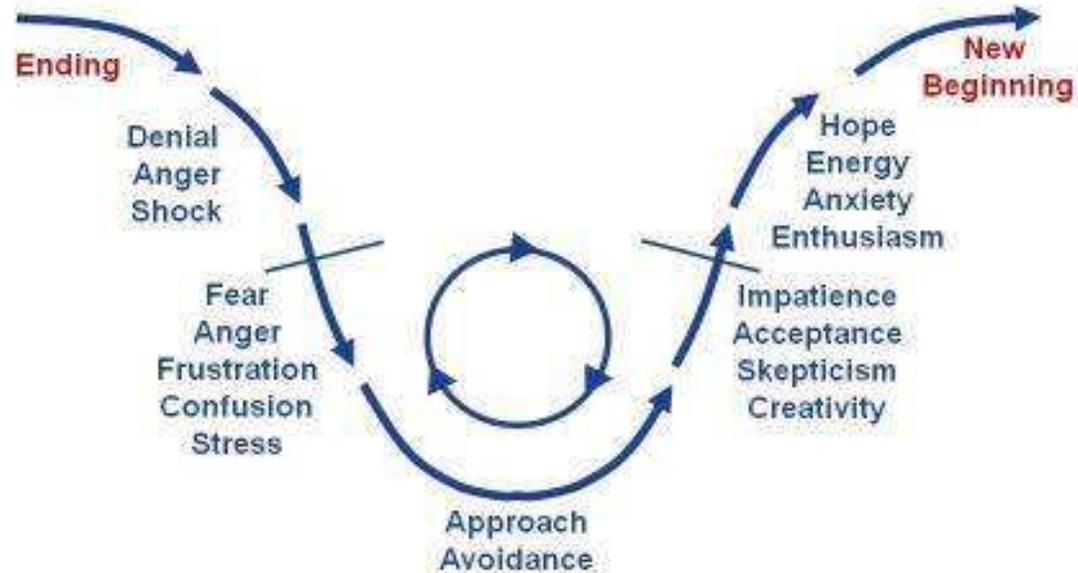
The Change Curve



The William Bridges Transition Curve



The Transition Curve



Endings-Transitions-Beginnings



- In the Endings Phase, managers should acknowledge the positive and negative implications of the change, and the challenges that the staff will have in adapting to it.
- In the Transitions Phase, managers should allay the fear and confusion about the change by responding to the staff's concerns with facts.
- In the Beginnings Phase, managers should encourage staff to be involved in the change process.
 - *“Change is a play– what role are you playing in it?”*

Who Adapts to Change First?



- In government agencies, the executives who initiated the change adapt to it first. They understand the reasons for the change and they are involved in creating it. It's their idea.
- The next group of people to adapt to change are the middle managers who must implement the change once they understand it.
- The last group of people to adapt to change are the staff, who accept the change once they anticipate and understand it, as well.

Strategies



- **Involve the middle managers and the staff in the development of the change, rather than merely imposing it on them.**
 - Create committees to study various means to develop and implement the change. This will not only create more stakeholders, but will also result in the development of better ideas.
 - The stakeholders, the people who created the change, will adapt first and be the most effective individuals to communicate with others about the reasons for the change.
- **Communication is the key. Agencies should use every means available to them to communicate with the staff about the change as often as possible at the Endings, Transitions, and Beginnings stages of the change.**
 - Meetings, e-mails, reports, repeat.
 - Explain what the change is; when the change will take place; how it will affect the staff; and what the staff will have to do.
 - The people who can anticipate the change are the people who will adapt.



Tax Fraud

Tax Administration

Tax Authorities in New York State



- There are three tax authorities that govern tax collections in New York State: the Internal Revenue Service, the New York State Department of Taxation and Finance, and the New York City Department of Finance.
- Each tax authority enforces its own unique taxes, as well as tax types that overlap with the other tax authorities, such as Federal and State Personal Income Taxes, and various forms of Federal, State, and City business taxes.
- In addition to raising revenue through taxation, the two New York tax authorities perform a variety of other functions.

New York City Department of Finance/Overview



- The Department of Finance is a Mayoral agency with a staff of 2,016 assigned to several divisions, and with a broad jurisdiction over tax collection and other matters.
- The Finance Commissioner is Jacques Jiha, Ph.D., and the agency's mission is to provide ***fair, efficient, transparent, exceptional customer service to the public.***
- The Department of Finance administers many different tax types, some jointly with the State, each with its own tax rates, forms, and filing deadlines. A list of the tax types appears in the following slides.
- In addition to administering business and excise taxes, the Department of Finance's jurisdiction also includes:
 - The City Sheriff's Office, which is a dual civil and criminal law enforcement agency.
 - The Parking Violations Bureau, which administers, enforces, and collects parking tickets.
 - Oversight of the recording of deeds and the maintenance of the ACRIS real estate database.
 - A Property Tax Division.
 - A Collections Division.
 - A Taxpayer Advocate's Office.

Department of Finance/Quick Facts



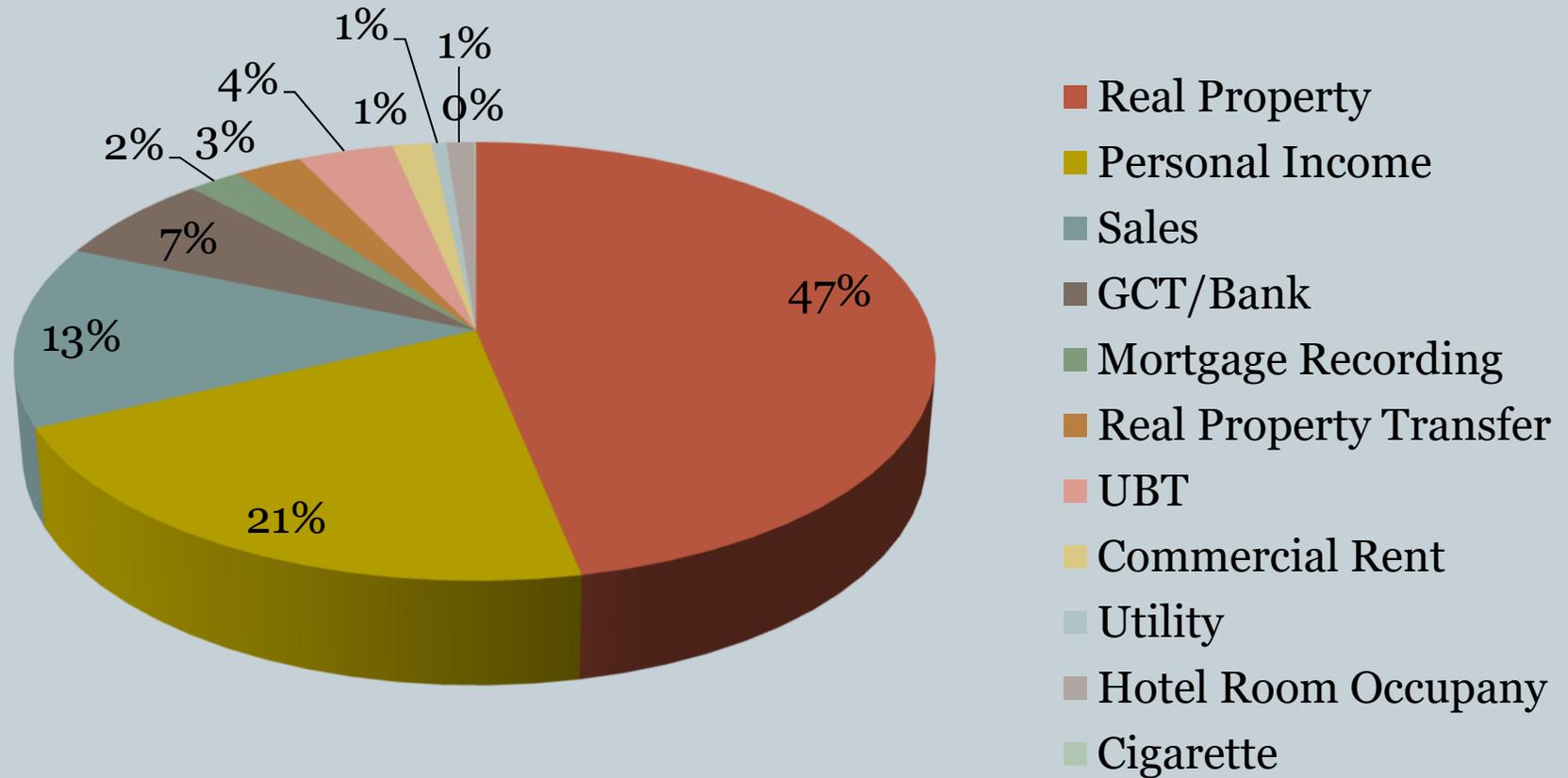
Projected FY 17 Revenue	\$54.6 Billion
Projected FY 17 Revenue W/O State Tax	\$36.1 Billion
Total Property Tax Revenue FY 17	\$24.4 Billion
Total Business Tax Revenue FY 17	\$7.2 Billion
Projected Revenue from Audits FY 17	\$1.2 Billion
Total Parking Summons Revenue FY 17	\$627 Million
Total Personnel Budget	\$156.8 Million
Total Personnel FY 17	2,016

Projected NYC Tax Revenue FY 17 (\$Millions)



Tax	Revenue	Percent of Total
Real Property Tax	\$24,475	47%
Personal Income Tax	\$11,064	21%
Sales	\$7,017	13%
G.C.T./Bank Tax	\$3,445	7%
U.B.T. Tax	\$2,005	4%
Real Property Transfer Tax	\$1,415	3%
Mortgage Recording Tax	\$1,118	2%
Commercial Rent Tax	\$816	2%
Hotel Room Occupancy Tax	\$579	1%
Utility Tax	\$371	1%
Cigarette Tax	\$37	0%

Projected NYC Tax Revenue FY 17



City Tax Types – Part 1



- **Banking Corporation Tax (BCT)**
A tax on banking corporations, commercial and savings banks, savings and loan associations, bank holding companies, and trust companies. Certain subsidiaries of banks that are owned by a bank or bank holding company are also taxed. (Repealed effective January 1, 2015.)
- **Cigarette Tax**
A tax paid by an agent or distributor and passed onto the cost of each pack of cigarettes.
- **Commercial Motor Vehicle Tax (CMVT)**
A tax on non-passenger motor vehicles principally used in New York City or by a business conducted in NYC. Motor vehicles used regularly in NYC for passenger transportation are also taxed.
- **Commercial Rent Tax (CRT)**
A tax charged to commercial tenants who occupy or use a premise for commercial activity in Manhattan, south of 96th Street.
- **E-911 Surcharge for Wireless Phone & Internet Voice Communication Services**
A fee used to improve the public safety communications network.
- **General Corporation Tax (GCT)**
A tax on corporations that have business activities, employ capital, own or lease property or maintain an office in New York City. (Repealed effective January 1, 2015.)
- **Business Income Tax (BIT)**
Successor tax regime to GCT and BTX, based in large measure on GCT principals with major reforms coordinated with corporate tax reforms enacted into New York State Law effective in 2014.

City Tax Types – Part 2



- **Horse Race Admissions Tax**
A tax on Horse Racing admissions.
- **Hotel Room Occupancy Tax (HTX)**
A tax on guests who occupy a hotel, motel, bed-and-breakfast, boardinghouse, or club/apartment room. The tax is based on the cost of the room rent.
- **Mortgage Recording Tax**
A New York City tax charged for mortgages recorded on property in the five boroughs,
- **Property Tax**
A tax on real property in the City of New York.
- **Real Property Transfer Tax (RPTT)**
An excise tax on the transfer of real property located in New York City.
- **Retail Beer, Wine and Liquor License Tax**
A tax charged on each retail licensee for selling liquor, wine, or beer within New York City.
- **Taxicab License Transfer Tax**
A tax charge on every transfer of a taxicab license.
- **Unincorporated Business Tax (UBT)**
A tax charged to every individual or unincorporated business carrying on a full or partial trade or profession in New York City.
- **Utility Tax (UTX)**
A tax on every utility and vendor of utility services doing business in New York City.

City Tax Types – Part 3



- **In addition, the State Tax Department administers the following taxes on behalf of the City of New York:**
 - **Personal Income Tax**
A tax on income earned within the City of New York by residents of the City or people domiciled in the City.
 - **Sales and Use Tax**
A tax on the sale of tangible personal property and certain services. State Tax also administers the Sales and Use Tax on behalf of all of the counties in the State.
 - **Beer and Liquor Excise Tax**
A tax charged to distributors and noncommercial importers of beer and liquor used or sold in New York City.
 - **Motor Vehicle Use Tax**
A tax charged to New York City owners or lessees who garage a motor vehicle in New York City.
- City Finance has a special unit of auditors who are cross-designated as State Tax auditors for the purpose of conducting Sales Tax and Personal Income Tax audits. They have access to State Tax records, use State Tax subpoenas, and are supervised by both the State and the City.



Tax Fraud

CRIME

What is Tax Fraud?



- Tax Fraud, also called Tax Evasion, is a crime that involves various actions to evade paying taxes, including failing to file tax returns; making false statements on tax returns or omitting information from tax returns; the failure to pay taxes; the misappropriation of taxes held in trust for the government, such as Sales Tax or taxes withheld from employees' wages; the failure to maintain required records; and, in New York, various smuggling activities to evade excise taxes on cigarettes, tobacco, and alcohol.
- There is a distinction between Tax Avoidance and Tax Evasion.

Tax Avoidance vs. Tax Evasion



- *Tax Avoidance* consists of strategies to use the tax laws to *legally* minimize the amount of tax that a taxpayer is required to pay. *Tax Evasion* is a crime
- *Example:* Making charitable donations to increase your itemized deductions, and thereby reduce your taxable income and tax liability on your Personal Income Tax return.
- *Tax Evasion* consists of various actions to *illegally* minimize tax liabilities, such as making false statements or omissions on a tax return to underpay tax.
- *Example:* Reporting fictitious charitable donations as an itemized deduction to falsely reduce taxable income and the tax liability reported on a Personal Income Tax return.

The Tax Fraud Crimes



- The Federal tax crimes are found in Chapter 75 of the Internal Revenue Code.
- In New York law, the tax fraud crimes are codified in Article 37 of the New York State Tax Law and Article 11, Chapter 40 of the New York City Administrative Code.
 - In 2009, New York amended these two statutes as part of an enforcement initiative that included an expansion of the number of State Tax auditors, investigators, and attorneys dedicated to conducting tax fraud investigations.
 - During the course of this initiative, the audit, collections, and criminal law enforcement divisions were grouped under one Deputy Commissioner so that the activities of all three divisions could be coordinated.
 - ✦ A series of Special Investigations Units were created throughout the State, each staffed by auditors and investigators and led by an attorney with experience in conducting fraud investigations.
 - The amendments to the Tax Law and the Administrative Code created an enforcement scheme that mirrored the other fraud provisions of the New York Penal Law, specifically, a series of “tax fraud act” crimes whose severity depends on the amount of harm done to the State, also known as the “tax effect.”

Tax Fraud Acts



- The Tax Fraud Acts found in New York Tax Law, Article 37, § 1801, and the City Criminal Tax Fraud Acts found in the New York City Administrative Code, Title 11, Chapter 40, § 11-4002 describe various types of tax fraud and mirror each other.
 - Crimes such as failure to file tax returns, failure to collect or remit taxes, and filing false tax returns are common to both codes.
 - Also common to both codes are the crimes of failing to comply with a subpoena; the cigarette smuggling crimes; and the crimes of violating tax secrecy.
 - In addition, both codes provide for the aggregation of different types of tax fraud in one year.
 - There are also crimes that are unique to each code. The State Tax Law has crimes concerning alcohol and motor fuel smuggling, for example, and the City Administrative Code has crimes relating to the hotel tax.
 - The Tax Law crimes of repeated failure to file personal and corporate tax returns were initially repealed and later re-enacted in the State Tax Law. The similar crime of repeated failure to file General Corporation Tax returns was repealed from the New York City Administrative Code and it has not been re-enacted.

Tax Fraud Acts: Excerpts



- Tax Fraud Acts under Administrative Code, Title 11, § 11-4002 (similar to Tax Law § 1801[a]):
 - “(2) knowing that a return...under any designated chapter of this title contains any materially false or fraudulent information, or omits any material information, files or submits that return...with the city or the state...”
 - “(3) knowingly supplies or submits materially false or fraudulent information in connection with any return, audit, investigation, or proceeding...”
 - “(4) engages in any scheme to defraud the city or the state...by false or fraudulent pretenses, representations or promises as to any material matter, in connection with any tax imposed...”
 - “(7) with intent to evade any tax...fails to pay that tax”

Tax Fraud Act Levels



- Tax Fraud Act in the 5th Degree, Tax Law § 1802 and Admin. Code, Title 11, § 11-4003, a misdemeanor. *Commits a tax fraud act.*
- Tax Fraud Act in the 4th Degree, Tax Law § 1803 and Admin. Code, Title 11, § 11-4004, a class E felony. *More than \$3,000 tax effect.*
- Tax Fraud Act in the 3rd Degree, Tax Law § 1804 and Admin. Code, Title 11, § 11-4005, a class D felony. *More than \$10,000 tax effect.*
- Tax Fraud Act in the 2nd Degree, Tax Law § 1805 and Admin. Code, Title 11, § 11-4006, a class C felony. *More than \$50,000 tax effect.*
- Tax Fraud Act in the 1st Degree, Tax Law § 1806 and Admin. Code, Title 11, § 11-4007, a class B felony. *More than \$1,000,000 tax effect.*
- Aggregation, Tax Law § 1807 and Admin. Code, Title 11, § 11-4008
- Tax preparer failure to sign a tax return or register, Tax Law § 1833, a misdemeanor.

Compare to Larceny, Penal Law Article 155



- When compared with the Tax Fraud acts, there is a lower threshold for an E felony and a D felony under the Larceny statute. Larceny may be charged in tax crimes cases when there is a theft of a trust tax, such as Sales Tax. Under the Larceny statute, the theft of at least \$1,000.01 is an E felony, and the theft of at least \$3,000.01 is a D felony. Under the Tax Fraud Acts, an E felony is a tax effect of at least \$3,000.01, and a D felony is a tax effect of at least \$10,000.01.
 - Petit Larceny, Penal Law § 155.25, A misdemeanor, \$.01 - \$1,000
 - Grand Larceny 4th, Penal Law § 155.30, E felony, \$1,000.01 - \$3,000
 - Grand Larceny 3rd, Penal Law § 155.35, D felony, \$3,000.01 - \$50,000
 - Grand Larceny 2nd, Penal Law § 155.40, C felony, \$50,000.01 - \$1,000,000
 - Grand Larceny 1st, Penal Law § 155.35, B felony, \$1,000,000.01 – No Limit

The Tax Fraud Acts & Penal Law Work Together



- Some criminal acts violate the Tax Law, the Administrative Code, and the New York State Penal Law. For example, if a restaurant corporation receives \$51,000 in gross receipts, including \$4,526.25 in Sales Tax, and reports none of it on State and City tax returns, the taxpayer may be guilty of four crimes:
 1. City Criminal Tax Fraud in the Fourth Degree, Administrative Code, Title 11, § 11-4004, a class E felony, for filing a false G.C.T. return that underreported \$51,000 in income in order to evade \$4,513.50 in G.C.T.
 2. Criminal Tax Fraud in the Fourth Degree, Tax Law § 1803, a class E felony, for failing to remit the \$4,526.25 in Sales Tax to the State;
 3. Offering a False Instrument for Filing in the First Degree, Penal Law § 175.35 a class E felony, for filing a false G.C.T. return with the City and a false Sales Tax return with the State, and;
 4. Grand Larceny in the Third Degree, Penal Law § 155.35, a class D felony, for misappropriating \$4,526.25 in Sales Tax.

Examples of Tax Fraud Crimes



- Filing false Personal Income Tax, Unincorporated Business Tax, or General Corporation Tax returns.
- Falsely claiming Property Tax exemptions.
- False re-sale certificates.
- False Qualified Enterprise Zone Tax credits.
- Failure to file tax returns and pay the taxes due.
- Theft of Sales Tax collected and not remitted to the State on behalf of the City.
- Selling untaxed cigarettes and alcohol.
- Submitting false information to D.O.F. in response to an audit or investigation.

Statute of Limitations



- N.Y. Penal Law misdemeanor – 2 years
- Civil Tax Audit – 3 years
- State and City Tax Law Misdemeanor – 3 years
- N.Y. Penal Law/Tax Law Felony – 5 years
- Non-violent offense under the U.S. Code – 5 years
- Civil Fraud under the C.P.L.R. – 6 years
- Failure to File a Return – No Statute of Limitations



Tax Fraud

CHOICES

Investigative Discretion



- As an independent law enforcement agency, Tax Enforcement has discretion to determine if and when to conduct a criminal investigation, or to handle a matter with a civil disposition, or to take no action at all.
- Tax Enforcement uses many factors in deciding whether to conduct a criminal investigation or to handle a matter civilly, including, but not limited to: the interests of justice; the best interests of the City; the alleged harm to the public, and; various mitigating factors in favor of the subject.
- Tax Enforcement has the freedom to choose which prosecutorial agency to work with on a particular case, depending on which prosecutor would be the best partner. A Manhattan restaurant owner who misappropriated Sales Tax could be referred to either: the New York County District Attorney's Office; the U.S. Attorney's Office, S.D.N.Y.; the N.Y.S. Attorney General's Office; the Albany County District Attorney's Office, or; the U.S. Attorney's Office, N.D.N.Y.

Policy Considerations



- Some of the matters that Tax Enforcement may consider on whether to commence a criminal investigation or refer a case to a prosecutor are:
 - The tax history of the taxpayer.
 - The estimated size of the alleged tax loss involved.
 - Whether the alleged fraudulent tax activity is combined with other alleged fraud or illegality.
 - Criminal intent.
 - The strength of the evidence.
 - The taxpayer's defenses.
 - The taxpayer's desire to cooperate with the investigation and enter into an agreement to pay any taxes due.

What is in the Best Interests of the City?



- The Best Interests of the City in criminal tax cases balances the administration of criminal justice with the administration of taxes and the fair treatment of taxpayers, with the ultimate goal of ensuring voluntary compliance with the law in the future.
- Because the same incident can give rise to both a civil audit and a criminal investigation, these goals occasionally compete with each other.
- A comparison between the advantages and disadvantages of conducting civil audits and criminal investigations reveals a variety of choices that tax authorities must consider.

Advantages of a Civil Audit



- Auditors must provide taxpayers with the Taxpayer Bill of Rights ensuring transparency in the audit process and the protection of the taxpayers' civil rights.
- Civil auditors can often gain the cooperation of taxpayer at the commencement of the audit because there is no threat of criminal sanctions.
- Sometimes civil audits can be resolved more quickly than a criminal investigation.
- There is a lower civil standard of proof.
- Civil auditors can extrapolate and do audit projections to issue tax assessments.
- The burden of proof is on the taxpayer.

Disadvantages of a Civil Audit



- Scope of the audit is limited to a particular tax for a particular period, resulting in the resolution of one tax problem, such as the payment of Sales Tax while related tax problems remain unresolved, such as the payment of Personal Income Tax.
- 3-year statute of limitations unless you can establish fraud.
- Limited use of subpoenas.
- Auditors do not usually get help from investigators.
- Civil auditors must act transparently, giving delinquent taxpayers opportunities to destroy records and influence witnesses.
- Taxpayer has protest rights.

Advantages of a Criminal Investigation



- Tax Fraud investigators can investigate all tax types and related taxpayers so that all of the tax issues are resolved in the same proceeding.
- 5-year statute of limitations, but continuing crime cases, such as Sales Tax fraud, can extend it.
- Tax Fraud investigators can act covertly and it is less likely that a delinquent taxpayer will destroy records or seek to influence witnesses.
- Tax Fraud investigators can use a broader range of investigative tools, such as undercover operations, surveillances, and search warrants.
- There is unlimited use of subpoenas, and occasionally search warrants are also available.
- Cases are conducted by 3 disciplines—auditors, lawyers, and investigators, each contributing their skills.
- Restitution Orders. A taxpayer risks prison if he does not pay the debt.
- There is a greater likelihood of changing the taxpayer's behavior due to threat of incarceration, and the prosecution may have a deterrent effect on other taxpayers.

Disadvantages of a Criminal Investigation



- Tax Fraud investigators do not control the outcome of a prosecution—it is controlled by the A.D.A., the Jury, and the Court.
- Criminal prosecutions can take a long time, and are very labor intensive.
- If the A.D.A. declines to prosecute after a civil statute has expired, the tax authority can not collect the tax.
- Restitution Orders only cover the tax, and tax authorities must still pursue collection of the penalties and interest.



Tax Fraud

PROVING IT

Criminal Investigative Tax Agencies



- The I.R.S., State Tax, and City Finance all have their own criminal investigative units to combat tax fraud.
 - The Office of Tax Enforcement (O.T.E.) is the criminal investigative arm of the Tax Audit & Enforcement Division of City Finance.
 - The City Sheriff's Office, which is a separate division of City Finance, investigates Deed Fraud and Cigarette Smuggling.
 - The I.R.S. and State Tax law enforcement agencies share the same name, the Criminal Investigations Division.
- The criminal investigative units are all staffed by investigators, who are armed peace officers, as well as forensic auditors, and attorneys.
- State Tax and City Finance both have subpoena authority, and State Tax's investigators can also apply for search warrants.

Tax Enforcement's Partners



- New York City District Attorney's Offices (and many other D.A.'s) receive grants from the Crimes Against Revenue Program (C.A.R.P.) to fund A.D.A.'s and other resources to work on State tax crimes cases.
 - The N.Y.S. Division of Criminal Justice Services administers the C.A.R.P. grant.
- New York City D.A.'s also receive budget credit for funds raised in tax fraud investigations pursuant to a Revenue Agreement with the Office of Management and Budget.
- O.T.E. sends cases to the New York State D.A.'s via referral letters.
- *Sales Tax and PIT referrals are made through State Tax, which must approve them.*
- We work with Federal U.S. Attorney's Offices via Hampers Orders.
- Tax Enforcement also works with the Sheriff's Office, State Tax CID, the IRS CID, the Dept. of Labor, the FBI, the El Dorado Task Force, HIDTA, the U.S. Postal Inspectors, and other law enforcement agencies.

How Tax Enforcement Works with D.A.'s



- All five of the City's District Attorney's Offices have designated units with A.D.A.'s and other personnel to work with State Tax and City Finance on criminal tax investigations and prosecutions.
- Generally, these investigations arise from modeling by the tax authorities; complaints received from the public; referrals from civil tax audit and collections units; information received from other law enforcement agencies; and requests from prosecutors for assistance in pending tax investigations.
- Referrals often result in joint investigations with prosecutors which are sometimes joined by other tax authorities and law enforcement agencies, such as the State Insurance Fund and the State Department of Labor.
- If the tax authority obtains Federal Tax Information from the I.R.S., the tax authority may share this information with an A.D.A. if authorized to do so.
- City Finance may share State Tax information with and A.D.A. after a separate State Tax referral.

How O.T.E. Works with Other Agencies



- O.T.E. and State Tax may not share confidential tax information with other agencies directly, making joint investigations very difficult.
- Prosecutors, however, may share tax information with third party law enforcement agencies after a tax referral if this sharing is necessary to conduct the investigation.
- Moreover, if another law enforcement agency is deemed an agent of the prosecutor after a tax referral, the tax investigators may discuss matters subject to tax secrecy with the other agents if the prosecutor is facilitating the conversation.

Investigate the Taxpayer, Not the Tax



- Tax Fraud is not an isolated act. Tax Fraud on one tax return flows through to Tax Fraud on other types of tax returns.
 - A store that underreports its gross receipts on a Sales Tax return, may also underreport its gross receipts on a General Corporation Tax return, and the owner may underreport his income on his Personal Income Tax return.
- In O.T.E., we often conduct multi-tax investigations of particular taxpayers, and these cases frequently evolve into a review of numerous related individuals and entities.
- Civil audits, by comparison, focus on particular tax types, tax periods, and taxpayers, and are not expanded to include other matters.

Failure to Comply with Tax Subpoenas is a Crime



- The Department of Finance and State Tax have subpoena authority, and the failure to comply with a subpoena may result in a contempt proceeding under the New York Civil Practice Law and Rules, or the commencement of a criminal proceeding under the New York Tax Law or the New York City Administrative Code.
- Failure to comply with a Department of Finance subpoena is a class A misdemeanor, punishable up to a year of incarceration, and a \$10,000 fine for individuals and a \$20,000 fine for corporations, pursuant to the New York City Administrative Code § 11-4010. The penalties for failing to comply with State Tax subpoenas are the same. *See New York State Tax Law § 1831.*

Required Records



- Required records are another tool in the arsenal of both civil tax auditors and criminal tax investigators.
- The Tax Law and many other provisions of the Law require taxpayers and business owners to maintain particular books and records.
- Sales Tax and Withholding Tax are two examples where business owners are required to maintain particular records.
- Tax Return Preparers are also required to maintain certain records, and these records are not privileged.
- Under the New York City Administrative Code, it is as misdemeanor to fail to keep required records for:
 - Commercial Rent Tax
 - Horse Race Admissions Tax
 - Tax on Transfer of Taxicab Licenses
 - Real Property Transfer Tax
 - Tax on Owners of Motor Vehicles
 - Tax on Retail Licenses of the State Liquor Authority
 - Annual Vault Charge

Tax Return Preparers as Witnesses



- One tactic that O.T.E. uses is to treat the tax return preparer as an important witness.
- Tax Return Preparers often have information about the true income, expenses, and assets of a taxpayer.
- Statements that a taxpayer makes to his accountant or tax return preparer are not privileged in criminal investigations and State/City civil audits under the law.
 - Accountants can be questioned about confidential conversations with this client, including advice about tax planning or tax evasion.
- Testimony subpoenas can be used to compel compliance with requests for interviews.
- Civil tax auditors can also use this tactic in rare circumstances where a taxpayer or a representative have created obstacles to obtaining information needed to complete an audit.

Tax Authorities and Cooperating Witnesses



- The criminal investigative units of Tax Authorities are audit and police agencies, not prosecutors, and therefore, they do not have the ability to offer a witness prosecutorial immunity or a “Queen for a Day” agreement in exchange for a witness’s cooperation.
- However, Tax Authorities have investigative discretion and may agree to resolve a criminal investigation with a civil disposition on the condition that a taxpayer cooperates with investigators and auditors by voluntarily disclosing information and agrees to pay any taxes due and owing. In so doing, Tax Authorities afford taxpayers some of the benefits of a Voluntary Disclosure Program.
 - Such agreements are usually memorialized in contracts called, “Closing Agreements,” and are not binding on prosecutors.

Significant Cases



- Construction company owner convicted and paid \$1,000,000 in G.C.T. taxes, P. & I. and was sentenced to prison.
- A C.R.T. case on a strip club resulted in \$354,000 collected.
- U.B.T. non-filer paid \$550,000 in taxes, P. & I.
- G.C.T. false filer paid \$632,974.36 in taxes, P. & I.
- P.I.T. false filer paid \$1,048,953 in taxes collected
- Joint Sales Tax Case with State Tax of kitchen equipment supplier resulted in over \$4,600,000 in taxes collected
- Federal conviction of Westchester Entrepreneur for Bank Fraud and Tax Fraud.
- State conviction of demolition contractor in joint investigation with State Tax for non-filing.



Tax Fraud

PUNISHMENT

State Sentences of Imprisonment



- Local Jail – Definite Sentence or Probation
- B misdemeanor: Up to 3 months or 1 year Probation.
- A misdemeanor: Up to 1 year or 3 years Probation.

- State Prison - Indeterminate Sentences with a minimum and maximum sentence set by the court. Below are the minimum and maximum sentence ranges.
- E felony: min 1 to 1 $\frac{1}{3}$ yrs to max 4 yrs
- D felony: min 1 to 2 $\frac{2}{3}$ yrs to max 7 yrs
- C felony: min 1 to 5 yrs to max 15 yrs
- B felony: min 1 to 8 $\frac{1}{3}$ yrs to max 25 yrs

- An attempt reduces the degree of the crime by one level. Penal Law § 110.05.

Criminal Fines, Penal Law § 80.00 et seq



- Fines for a Felony – Up to \$5,000 or double the amount of the defendant's gain from the crime. \$10,000 for a corporation.
- Fines for a Misdemeanor – Up to \$1,000 for an A misdemeanor (\$5,000 for a corporation), and up to \$500 for a B misdemeanor (\$2,000 for a corporation).
- There are also civil fines for tax return preparers.

Tax Law Civil Penalties for Preparers



- Failing to register as a preparer, Tax Law § 32(g)(1): \$250.
- Failing to pay registration fee, Tax Law § 32(g)(2): \$50 per return, up to \$5,000.
- Failure to furnish taxpayers with copies of return, failure to maintain copies of returns, Tax Law § 685(u)(3)-(4): \$50 per violation up to \$25,000.
- Understatement of liability (Reasonableness Standard), Tax Law § 685(aa)(1)(C): \$1,000 per return
- Understatement of liability (Recklessness Standard), Tax Law § 685(aa)(2)(B): \$5,000 per return
- Aiding or assisting in the giving of a fraudulent return, Tax Law § 685(r): \$5,000 per return.



Tax Fraud

COLLECTIONS AND COMPLIANCE

How Tax Prosecutions are Resolved



- Generally, tax prosecutions are usually resolved with a Plea Agreement, in which the defendant agrees to plead guilty to a crime and pay back taxes, or perform other undertakings, such as filing delinquent tax returns.
 - Tax prosecutions often include a Grand Jury presentation, but rarely result in a trial. Sometimes, defendants will waive indictment by a Grand Jury and plead guilty to a complaint.
 - The form of the Plea Agreement is dependent on the practice of the District Attorney's Office. Some are in writing and read like a formal contract; others are made orally before a judge.
 - Plea Agreements must be approved by the court, and judges have the discretion to amend them upon consultation with the parties.
 - The enforcement of Plea Agreements is the responsibility of the District Attorney's Offices and the court, with assistance from tax authorities. Probation Officers play an important oversight role, as well.
 - A violation of a Plea Agreement can result can result in the incarceration of the defendant.

What Are in the Plea Agreements?



- The content of Plea Agreements is dependent on negotiations between the defendant and an A.D.A., and tax authorities play a role in the final result as both the investigative agency and the victim.
- A.D.A.'s are not permitted to settle tax matters without the approval of the tax authority.
 - In combined City and State tax cases, the A.D.A.'s will have to include both agencies in the negotiations. State A.D.A.'s have no jurisdiction over Federal tax matters, although I.R.S. liabilities are sometimes a consideration in negotiations because a State settlement can affect a Federal liability.
- The issues that arise during plea negotiations include:
 - Which defendant should plead guilty? The corporation? The owner?
 - What crime should the defendant plead guilty to? Felony plea? Misdemeanor plea?
 - How will the guilty plea affect any professional licenses held by the defendant?
 - What should the recommended sentence be? Should it include a period of incarceration? If so, for how long? Should there be a period of probation, as well?
 - How will any period of incarceration affect the defendant's business?
 - Who should the defendant make restitution of unpaid taxes to? DOF? DTF? State Insurance Fund? Worker's Comp?
 - How will the debt be paid? What will be paid at sentencing? What will be paid over time?
 - What other undertakings does the defendant need to perform to ensure future compliance?

Think of the End at the Beginning



- O.T.E. considers the problems of collection at the beginning of our investigations, rather than at the end. This also helps us to trace the proceeds of criminal activity for forfeiture, and to develop evidence of tax fraud.
 - Where does the taxpayer maintain her money and assets?
 - How could a taxpayer claiming \$15,000 in income have been able to afford to purchase a new house?
 - Was the taxpayer's new car purchased with stolen Sales Tax?
 - What are the taxpayer's other liabilities that will interfere with collection? State Tax liens? IRS tax liens?
- During the course of plea negotiations, or negotiations to settle a case with a civil agreement, O.T.E. may require a taxpayer to complete a Financial Statement that describes his income, assets, and debts.
- O.T.E. also pursues the Fraud Penalty (200% of tax) where appropriate.
- Civil auditors can leverage some of these same tactics to determine tax liability.

How Tax Enforcement Collects Money



- **In disagreed cases that are resolved before referral to a prosecutor, O.T.E. uses the same tools as civil Audit:**
 - Notices of Proposed Audit Adjustment (“NOPAA”), then;
 - Notices of Determination (“NOD”), then;
 - Referral to the Collections Division for the issuance of tax warrants and levying on property
- **In agreed cases settled before a referral, O.T.E. uses:**
 - Consents and Waivers or;
 - Closing Agreements, and then;
 - Referral to the Collections Division for the enforcement of payment arrangements and warrants
- **In criminal cases with a Plea Agreement, O.T.E. uses:**
 - Plea Agreements or;
 - Confessions of Judgment or;
 - Closing Agreements or;
 - Orders of Restitution or;
 - Criminal Forfeiture.
- **In criminal cases where the defendant is convicted after a trial, O.T.E. uses:**
 - Orders of Restitution and/or;
 - Criminal Forfeiture and/or;
 - Tax warrants.

Closing Agreements vs. Consents



- There are two basic documents that can give a taxpayer finality concerning a tax liability:
 - *A Consent to Field Audit Adjustment* – This is a *pro forma* document in which the parties merely agree to the amount of taxes, penalties, and interest due. This is the appropriate tool where the liability is being remitted in a lump sum, or has already been paid, or the parties agree to delegate the negotiation of the payment arrangement to the Collections Division, the Sheriff's Office, or the State Civil Enforcement Division.
 - *A Closing Agreement* – This is a contract between the taxpayer and a tax authority that is intended to resolve all of the taxpayer's issues, including not only the amount of the liability, but the payment arrangement, the disposition of Driver's Licenses in State cases, and Certificates of Authority issues, and the payment of future taxes.

Orders of Restitution



- Orders of Restitution are court orders that are like judgments, in that they determine the amount of funds that the defendant has to pay to the victim.
 - The State and the City are victims in tax prosecutions
- Although the failure to comply with an Order of Restitution has a severe penalty– the possibility of incarceration– they have the same enforcement problems as other civil judgments.
 - What are the sources of the defendant’s income?
 - How much can the defendant afford to pay per month?
 - Sometimes these questions are answered during plea negotiations, and other times they are delegated to the Probation Officer to resolve.

Interest and Penalties – The Second Case



- Orders of Restitution never include interest and penalties due under the Tax Law and the New York City Administrative Code, because it is not the amount that was the subject of the crime; the amount of tax underreported, or the amount of trust tax stolen is the subject of the crime.
- For these reasons, Plea Agreements often do not include provisions for interest and penalties, but rather, direction to the defendant to resolve these matters with the tax authority in the future.
 - Some defense attorneys will seek to resolve the interest and penalties issues at the time that they are negotiating a Plea Agreement, and on rare occasions, the results of these negotiations are memorialized in the Plea Agreements.
 - Ironically, it is to the benefit of the District Attorney's Offices to seek to re-coup interest and penalties, because they receive credit under the C.A.R.P. grant and the O.M.B. Revenue Agreement.
- As a result, at the conclusion of a successful criminal prosecution, tax authorities often have to commence a second case to re-coup interest and penalties.
- This second case is unnecessary if a tax authority uses a Closing Agreement to resolve this issue at the time that the Plea Agreement is being negotiated. This is one of the uses of a Global Settlement in criminal tax prosecutions.

A Footnote About Criminal Forfeiture



- Criminal Forfeiture is a tool that District Attorney's Offices use to seize property that constitutes:
 - The proceeds of a crime (i.e. the stolen Sales Tax);
 - The substituted proceeds of a crime (i.e., the thing purchased with the stolen Sales Tax);
 - An instrumentality of a crime (the vehicle used to transport untaxed cigarettes or real property);
 - Or to obtain a money judgment in the same amount as the proceeds of a crime.
- The procedure for criminal forfeiture is governed by Article 13-A of the N.Y.S. Civil Practice Law and Rules. There are also special forfeiture laws for cigarette cases that are in the Tax Law and the New York City Administrative Code.
- Generally, a District Attorney's Office, acting as a Claiming Authority, can commence a forfeiture action against a defendant or a third party.
- The Sheriff's Office acts as the Claiming Agent for the purpose of enforcing a forfeiture order.
- District Attorney's Offices have special units that handle forfeiture matters, and City Finance often benefits from Federal forfeiture matters that arise from our involvement in HIDTA and El Dorado investigations.
- The link between the crime and the proceeds or instrumentality of a crime must be proven for an A.D.A. to obtain a forfeiture order and to defend against a defendant or third party's motion to retrieve the property from the government.
- The settlement of a forfeiture matter can also be the subject of a Global Settlement.

Suspending Driver's Licenses



- State Tax civil enforcement has a powerful tool to encourage taxpayers to enter into payment arrangements to pay their debts—suspending their Driver's Licenses.
- If a taxpayer has more than \$10,000 in tax liabilities and no payment arrangement with State Tax, pursuant to Tax Law § 171-v, State Tax may notify the DMV about this matter, and DMV may suspend the defendant's Driver's License.
- The DMV program has netted hundreds of millions of dollars in tax revenue for State Tax.

What are Global Settlements?



- Global Settlements are agreements that parties to an action use to resolve multiple issues simultaneously.
- These issues can arise from both criminal and civil matters that may be related, but which are not necessarily settled at the same time.
- Global Settlements are usually memorialized in writing, either in a letter, or some form of contract, such as a Stipulation of Settlement or a Closing Agreement.
 - In criminal tax cases, O.T.E. often uses a combination of written Plea Agreements and Closing Agreements to memorialize Global Settlements.
 - In addition, O.T.E. uses Global Settlements to try to change the behavior of taxpayers to ensure voluntary compliance in the future. In so doing, we draw from the best practices of both anti-corruption agencies and compliance programs.

Why Taxpayers Like Global Settlements



- First, Global Settlements give taxpayers finality to the matters under investigation– they do not have to worry about a second civil audit to collect interest and penalties, or to defend against an investigation of new issues that were not resolved in the first case.
- Second, it permits them to limit their legal and accounting costs because all of the matters are being resolved at once.

Why Tax Authorities Like Global Settlements



- Tax authorities also like Global Settlements as a means of resolving multiple issues simultaneously, making for a more efficient administration of tax.
- Global Settlements also engage the taxpayer in a way that Plea Agreements or routine Closing Agreements do not reach, such as changing their behavior to ensure future compliance.
- Global Settlements also permit tax authorities to balance the competing interests of criminal tax cases while working in favor of the Best Interests of the City.
 - To do this, we use Closing Agreements in the same way that Inspectors General and Compliance Programs use contracts and monitors to ensure legal compliance.

How I.G.'s Use Contracts and Monitors



- The City has bridges– and it needs to paint them. But what do you do if the City's only bridge painting company was convicted of tax fraud? What should the City do if it has no choice but to give a contract to this vendor?
 - Generally, Inspectors General use the following two types of contracts to balance the government's interest in law enforcement with its interest in fulfilling its municipal responsibilities.
 - Vendors enter into these contracts as a condition to doing business with the government.
 - ✦ *Certification Agreements*, in which the contractor agrees to particular undertakings as a condition for being awarded the City contract, such as amending its business practices to ensure that it files accurate tax returns in the future.
 - ✦ *Independent Private Inspectors General ("IPSIGS")*, created by monitoring agreements, in which the vendor must hire an expert in ethics and internal investigations, such as a former prosecutor, to provide internal oversight of the vendor, and report any fraud uncovered to the Inspector General.

Using Closing Agreements Like an I.G.



- Tax authorities use Closing Agreements to settle tax cases.
 - Taxpayers like them because it fixes the tax liability and does not permit the case to be re-opened.
 - Tax authorities like them because they fix the liability; provide for payment arrangements; and often include tax compliance clauses, such as the requirement to pay taxes in the future.
- Tax Enforcement uses Closing Agreements to not only close the gap between the Plea Agreement and the taxpayer's liability to pay interest and penalties, but to change the behavior of the taxpayer in the future. In so doing, Tax Enforcement uses Closing Agreements like an I.G. uses a Certification Agreement.
- In addition, Tax Enforcement uses Closing Agreements to resolve cases prior to a referral to a prosecutor, when the interests of justice merit both a civil settlement, in addition to changing the behavior of the taxpayer.

Compliance Provisions in Closing Agreements



- Tax authorities may enter into negotiations with taxpayers for a wide variety of compliance provisions to be included in Closing Agreements, both with and without the assistance of prosecutors. Here are some examples:
 - Appointing an independent monitor to act like an IPSIG to ensure tax compliance.
 - Prohibiting the use of commercial check cashers if this was an element of the tax evasion.
 - Requiring periodic financial disclosure to be used for the purpose of collection.
 - Depositing trust taxes, like Sales Tax, in a segregated account, so that it can be monitored.
 - Requiring full cooperation during an investigation, including the disclosure of records and making employees available for interviews.
 - Requiring payment of the fraud penalty in the event of a default in the agreement.
 - Requiring the beneficial owner of an entity to accept responsibility for the tax.
 - Creating a hotline so that third parties can report fraud to the tax authority.
 - Requiring a taxpayer to close a business that has been used for tax fraud.

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