I. BACKGROUND

The City Tax laws authorize the imposition of a number of civil penalties for the failure to meet certain tax compliance responsibilities. Some of these failures, however, may be excusable under certain circumstances. The following is a list of the Administrative Code sections imposing penalties for the taxes subject to desk or field audit in the Audit Division.

<table>
<thead>
<tr>
<th>TAX</th>
<th>ADMINISTRATIVE CODE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unincorporated Business</td>
<td>Section 11-525</td>
</tr>
<tr>
<td>General Corporation</td>
<td>Section 11-676</td>
</tr>
<tr>
<td>Banking Corporation</td>
<td>Section 11-676</td>
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<tr>
<td>Real Property Transfer</td>
<td>Section 11-2114</td>
</tr>
<tr>
<td>Commercial Rent</td>
<td>Section 11-715</td>
</tr>
<tr>
<td>Utility</td>
<td>Section 11-1114</td>
</tr>
<tr>
<td>Hotel Room Occupancy</td>
<td>Section 11-2515</td>
</tr>
</tbody>
</table>

The criteria for imposing or abating these penalties are established in these Administrative Code sections. In addition, auditors may consult all applicable City Rules and case law. Federal or New York State law, rules, regulations, procedures, bulletins or case law, although not necessarily binding, may also provide guidance. For example, section 2392.1 of the New York State regulations (20 NYCRR 2392.1) deals with what constitutes reasonable cause. Auditors interested in researching these criteria may consult these sources.

Many of the penalties require the consideration of specific facts and circumstances by the auditor before the penalty may be properly imposed. Imposition of penalties is a process. It is the responsibility of the Taxpayer during
this process to present to the auditor all relevant facts that explain its failure to
meet its compliance responsibilities. It is the auditor’s responsibility to ensure that
the Taxpayer is alerted to the potential imposition of penalties and has a
reasonable opportunity to address potential penalties before they are asserted.

II. SCOPE

This Statement of Audit Procedure (“SAP”), in Part III, Section A, provides
guidance to auditors concerning the process for asserting penalties. Part III,
section B, of this SAP provides additional guidance on imposing the penalty for
the negligent or intentional disregard of the tax law or for a substantial
understatement of tax. This SAP is limited to the process of imposing penalties.
It will not specify the legal criteria for applying any particular penalty.

In addition, the Revenue Operations Division may have asserted certain penalties
prior to the field or desk audit process. For example, a penalty may have been
imposed as part of the returns processing function because the Taxpayer failed to
file the return by the due date. The Revenue Operations Division is responsible
for the administration of penalties it may assert. The Audit Division will not re-
evaluate the Taxpayer’s responsibility for such Operations Division penalties
during the audit process. This SAP does not address such Operations Division
penalties.

III. PROCEDURE

A. General

After evaluation of the information gathered during the course of an audit, the
auditor may judge that it would be appropriate under the Administrative Code to
impose one or more penalties. In such case, the auditor will advise the Taxpayer
in a letter (“Penalty Letter”) of his or her intention to include such penalties in the
proposed audit adjustments. The letter will also offer the Taxpayer an
opportunity to explain why the proposed penalty or penalties should not be
imposed. The Taxpayer will generally be allowed up to 30 days to reply. The
Taxpayer will be given a specific Administrative Code citation for each proposed
penalty. The letter should direct the Taxpayer to respond in sufficient detail to
allow the auditor to evaluate the applicability of the proposed penalty to the
Taxpayer’s specific facts and circumstances. In the case of a field audit, the
auditor will include a statement in the audit workpapers explaining how he or she
resolved the issue of penalties.

If the Taxpayer does not make a timely response or the response does not provide
an appropriate basis for abating or avoiding the proposed penalty, the penalty or
penalties will be included in the Notice of Determination.
The Penalty Letter may be separately mailed to the Taxpayer at any time during the course of an audit. Alternatively, in the case of a field audit, it may be included in the cover letter forwarding the audit workpapers to the Taxpayer. In the case of a desk audit, it may be included in the Notice of Proposed Adjustments.

This general procedure will not be followed when less than 90 days remains before the expiration of the statute of limitations or where the Taxpayer has failed to cooperate during the audit. Where the general procedure is not followed because the statute of limitations is close to expiring, the Unit Manager or Field Manager will be consulted on how to proceed.

B. Substantial Understatement of Tax Penalty and the Negligence Penalty

In the case of the penalty for a substantial understatement of tax, the auditor should direct the Taxpayer to the statutory rules governing the imposition of this penalty. To avoid the imposition of a penalty, the Taxpayer must show the auditor that it meets one or more of the following standards:

1. The understatement is not substantial
2. The Taxpayer had substantial authority for the treatment of an item included in the amount of the substantial understatement
3. The Taxpayer adequately disclosed in the return, or in a statement attached to the return, relevant facts affecting an item’s tax treatment included in the amount of the substantial understatement.
4. The Taxpayer had reasonable cause for the understatement (or part thereof) and that the Taxpayer acted in good faith.

In the case of the negligence penalty, the auditor will identify in the Penalty Letter the issue or issues for which the Taxpayer is alleged to have been negligent. The auditor will describe in the Penalty Letter the specific circumstances that form the basis for the auditor’s finding of negligence or intentional disregard of the tax statute. The Taxpayer in its response must explain why its tax deficiency did not arise out of negligence or an intentional disregard of the law.

Generally, negligence and substantial understatement penalties will not be imposed where the proposed audit change is based upon a discretionary adjustment by the Commissioner. If, however, at the time of filing its return, the Taxpayer was on notice that the Commissioner would exercise his discretion in this type of situation, e.g., this issue was discussed in a prior audit of the Taxpayer by the Finance Department or the Commissioner had issued a Statement of Audit
Procedure on this issue, then the negligence or understatement penalty may be imposed on a discretionary adjustment, if such a penalty would be otherwise appropriate.