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TAX NEWS & COMMENT MEMORANDUM

TO: Certified Public Accountants

FROM: David L. Silverman
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DATE: December 11, 2009

RE: Revised New York Criminal Tax Statutes

CC: Clients & Associates

Tax professionals preparing 2009 New York State corporate, income, employment and sales tax returns should be alert to statutory changes which create new tax offenses and which impose stricter criminal penalties for existing offenses. In some cases, tax professionals may be prosecuted under an accomplice theory for aiding or abetting dishonest taxpayers. This memorandum summarizes the new legislation, whose objective is to improve tax compliance and prevent tax evasion by drastically increasing penalties for serious acts of tax evasion and tax fraud. For more information about the new statute, and for legal guidance, please contact this office.

I. Introduction

New criminal tax legislation enacted into law on April 7, 2009 marks a sea change in the manner in which New York addresses tax evasion and tax fraud. Under the new law, serious acts of tax evasion will attract far more severe felony charges. The new law also gives the Department of Taxation new resources with which to identify and prosecute those engaging in tax evasion. The new law revises Sections 1800-1848 of the Tax Law, which will continue to apply to criminal acts

committed before April 7, 2009. Under former law, the failure to file a tax return constituted a felony if the taxpayer willfully and with an intent to evade tax failed to file for three consecutive years. A taxpayer who failed to file for a single year could be charged only with a misdemeanor for not filing regardless of the amount of tax involved. Conversely, a taxpayer who filed a false return by failing to report income could face prosecution for a class E felony, even if the amount of unreported income involved were small. Similarly, under former law, taxpayers obtaining refunds by filing fraudulent returns were treated more harshly under the tax law than taxpayers who filed false returns and underpaid their taxes. **Tax Law § 1801(a) creates a new crime, that of “tax fraud,” which applies to all forms of tax evasion, whether accomplished by non-filing, false filing or other fraudulent scheme. The new law creates eight categories of tax fraud, starting with a class A misdemeanor, rising to a class B felony.**

Under former (as well as revised) law, taxpayers were generally required to have acted “willfully” in order to have committed a crime. However, most tax statutes did not define the term. Under the new tax law, the term “willfully” is defined; and it creates a uniform minimum mental state required to commit a tax crime. Tax Law § 1801(c), adopting the federal standard, defines the term “willfully” as “*acting with an intent to defraud, intent to evade the payment of taxes or intent to avoid a requirement of [the tax law], a lawful requirement of the commissioner or a known legal duty.*”

II. Eight Categories of Tax Fraud

A. Tax Law § 1801(a)(1) Willful Failure to File a Return or Other Required Document

As noted above, under former law the failure to file income or corporate tax returns constituted a felony only if the taxpayer failed to file for three consecutive years. Under the new law, felony liability arises if the taxpayer (i) fails to file (even for a single year); (ii) intends to evade tax; and (iii) underpays in an amount that meets the monetary threshold. Accordingly, any willful non-filer who intends to evade tax and evades more than \$3,000 in tax liability may now face felony prosecution.

**B. Tax Law § 1801(a)(2),(3)
Willfully and Knowingly Making or Filing a
False Return or Report or Supplying False Information**

New Tax Law § 1801(a)(2), which addresses the filing of false documents, provides that tax fraud occurs when a person willfully, while

knowing that a return, report, statement or other document under this chapter contains any materially false or fraudulent information, or omits any material information, files or submits that return, report, statement or document with the state or any political subdivision of the state. . .

New Tax Law § 1801(a)(3) addresses the submission of false information to the Department of Taxation and Finance. Thus, it is tax fraud if a person willfully and

knowingly supplies or submits materially false or fraudulent information in connection with any return, audit, investigation, or proceeding or fails to supply information within the time required by or under the provisions of [the tax law or regulations].

The scope of the new law is vast: Nearly every conceivable materially false tax filing or submission would fall within § 1801(a)(2) and (3). Section 1801(a)(3), which addresses submissions to the Department, include oral submissions made in connection with an audit or investigation. Thus, the intentional submission of false documentation by the taxpayer or by his representative in order to justify a position would constitute a false submission. So too would the false assertion by the taxpayer (or his representative) made to an auditor or investigator concerning the existence or non-existence of records. **New Tax Law § 1832(b) makes clear that tax professionals who knowingly provide false documents or who make false assertions on behalf of taxpayers during audit face accomplice liability and will be subject to the same penalties as the taxpayer.**

Under former law, knowingly filing a false income or corporate tax return with intent to evade tax constituted a class E felony if the filing resulted in a “substantial understatement” of tax. Under the new law, the threshold for a substantial understatement was increased from \$1,500 to \$3,000. Under the new law, felony liability will arise in all cases where a materially false submission has been made with an intent to evade a tax or to defraud where the false submission results in a tax evasion of more than \$3,000.

Note that the new provisions of the Tax Law complement, but do not supersede, existing

Penal Law provisions. Under the Penal Law, knowingly filing a false document with any public office or public servant constitutes a misdemeanor, which rises to felony status if the false filing is made with an intent to defraud the state or any political subdivision. No minimum monetary threshold applies to the Penal Law statute. Thus, a taxpayer who files a false income tax return which defrauds New York of less than \$3,000 would be exposed to misdemeanor liability under the new tax law, but felony liability under the Penal Law.

**C. Tax Law § 1801(a)(4)
Willfully Engaging in a Scheme to Defraud the State
in Connection With Any Matter Under the Tax Law**

Tax Law § 1801(a)(4) supplements §§ 1801(a)(2) and (a)(3) by ascribing tax fraud status to acts which do not involve filing a false document or making a false submission to the Department. Thus, § 1801(a)(4) provides that a person (not necessarily a taxpayer) commits tax fraud when he willfully

engages in any scheme to defraud the state or a political subdivision
... by false or fraudulent pretenses, representations or promises as to
any material matter, in connection with any tax imposed. . .

Although similar to language in Penal Law statutes, the Tax Law is more strict than its Penal Law analogue in that it does not require a “systemic ongoing course of conduct,” as does the Penal Law. However, the Tax Law is less strict than the Penal Law in that false representations must be with respect to a “material” matter. The new tax statute is intended to reach persons engaging in schemes such as cigarette tax evasion which involve persons who are not required to file returns or remit taxes. Tax Law § 1801(a)(4) is intended to act synergistically with new classes of tax felonies, described below.

**D. Tax Law § 1801(a)(5)
Willfully Failing to Remit Taxes Collected on Behalf of the State**

Withholding taxes collected from employees and sales taxes collected from customers constitute trust fund taxes. While fiduciaries who misappropriate these funds have always subject to prosecution under the Penal Law for larceny, prosecution under the Tax Law has been

problematic, as liability for employers who failed to remit employment taxes was limited to a misdemeanor under the Tax Law, regardless of the amount of payroll taxes collected and not remitted; and the failure of a tax vendor to remit collected sales tax was not a criminal act under the Tax Law. Under new Tax Law § 1801(a)(5), tax fraud occurs when a person willfully “fails to remit any tax collected in the name of the state or on behalf of the state . . . when such collection is required under this chapter.” Therefore, resort to the Penal Law is no longer necessary to seek felony prosecution for crimes involving failure to remit sales or withholding taxes.

E. Tax Law § 1801(a)(6)
Willfully Failing to Collect a Sales, Excise or
Withholding Tax That is Required to Be Collected

Under former Tax Law § 1817(c), the failure of employers to collect employment tax, and the failure of vendors to collect sales tax, constituted a misdemeanor. Tax Law § 1817(c)(2) provided that the failure to collect \$10,000 in sales tax or the failure to collect \$100 in sales tax on ten or more occasions constituted a class E felony. Under revised Tax Law § 1801(a)(6), the willful failure to collect tax when required constitutes tax fraud. If taxes not collected exceed \$3,000 in one year, felony liability attaches; otherwise, the tax fraud constitutes a misdemeanor.

F. Tax Law § 1801(a)(7)
Willfully and With an Intent to Evade Any Tax, Failing to Pay a Tax Due

Under new Tax Law § 1801(a)(7), the taxpayer who willfully and with intent to evade tax fails to pay such tax commits tax fraud. The new law imposes a stricter standard for prosecution than the former law in that the failure to pay must be both willful *and* with an intent to evade tax. Thus, those taxpayers who file but cannot pay the tax will not be subject to criminal liability. However, for those taxpayers whose failure to file does meet the more exacting standard, felony liability may attach if the amount of the underpayment meets the monetary limits in the felony tax fraud sections (described below). This tax law provision will provide prosecutors with an avenue of recourse to address those taxpayers who file accurate sales or income tax returns but who unjustifiably fail to satisfy those reported tax liabilities, though not without the means to do so.

G. Tax Law § 1801(a)(8)
Issuing False Exemption Certificates

New Tax Law § 1801(a)(8) provides that a tax fraud act includes one where a party willfully

issues an exemption certificate, interdistributor sales certificate, resale certificate, or any other document capable of evidencing a claim that taxes do not apply to a transaction, which he or she does not believe to be true and correct as to any material matter, which omits any material information, or which is false, fraudulent, or counterfeit.

The primary difference in the new law is that (i) a willful omission in exemption certificate constitutes a violation of law and (ii) felony liability can attach (previously only misdemeanor liability arose) if the taxpayer possesses the intent to evade tax and as a result of the fraudulent act underpays an amount which meets the monetary thresholds specified in the felony tax fraud sections.

III. Felony Tax Fraud Classifications

For an act of tax fraud to constitute a felony under the new tax law, three separate requirements must be met: First, the taxpayer must act willfully; that is, the taxpayer must intend to commit the prohibited act. Second, the taxpayer must possess an intent to defraud New York State. The new law attempts to distinguish between those who choose not to pay tax liabilities and those who are without the means to pay their tax liabilities. It would appear that those who are simply unable to pay their tax liability cannot be guilty of tax fraud. Therefore, a taxpayer who reports income and files a return, but fails to pay tax by reason of an inability to do so, has not committed tax fraud. The third requirement for felony tax liability consists of meeting the monetary thresholds. The chart below indicates the monetary threshold for various classes of tax felonies, and compares them to other felonies. Note that for the lower two classes of tax felonies, the monetary threshold is higher for tax fraud than for crimes arising under the Penal Law. Perhaps most significant in the new felony tax fraud classification system is the fact that those persons proven to have engaged income or corporate tax evasion in amounts exceeding \$10,000 will for the first time be exposed to serious felony liability. Those committing sales or withholding tax evasion charges have long been subject to serious felony prosecution for larceny under the Penal Law. Similarly,

those taxpayers filing a false return, but who fail to reach the monetary threshold for felony tax fraud may continue to be prosecuted under the Penal Law for “Offering a False Instrument for Filing,” which is a class E felony.

Felony Classification	Degree	Tax Fraud/ Health Care Fraud	Larceny/Welfare/ Insurance
E	4 th	> \$3,000	> \$1,000
D	3 rd	> \$10,000	> \$3,000
C	2 nd	> \$50,000	> \$50,000
B	1 st	> \$1,000,000	> \$1,000,000

IV. Aggregation

In determining the class of felony, tax liabilities evaded within a single-year period may be aggregated, but not those occurring over more than one year. However, this rule applies only with respect to aggregation under the Tax Law. Aggregation of sales tax or withholding tax liabilities over multiple years may occur where larceny prosecution is commenced under the Penal Law.

V. Monetary Penalties

New Tax Law § 1800(c) increases monetary penalties for tax felonies to the greater of (i) double the amount of the underpaid tax liability or (ii) \$50,000 for individuals or \$250,000 for corporations. Fines for misdemeanors relating to tax fraud remain unchanged at \$10,000 for individuals and \$20,000 for corporations.

VI. Venue

Under new subsection (m) of N.Y. Criminal Procedure Law § 20.40(4), the taxpayer may be prosecuted in the county where the economic activity to prosecute the tax crime arose. This

statutory change results from the recognition that taxpayers may be involved in economic activity in one county that results in the filing of a tax return in a different county.

VII. Subpoenas

New Tax Law § 1831 makes the willful failure to comply with a subpoena issued by the Department of Taxation a misdemeanor. Previously, misdemeanor liability attached to the willful failure to comply with some, but not all, administrative subpoenas issued by the Department. This is significant in that the number of subpoenas issued in criminal fraud investigations rose from 349 in fiscal year 2007-2008 to 1,320 in fiscal year 2008-2009.

VIII. Tax Preparers

New Tax Law § 32 requires tax preparers who are not licensed attorneys or certified public accounts to register with the Department as tax preparers and to sign every return which they prepare. Under new Tax Law § 1833, the failure to register or to sign a return is a misdemeanor.

IX Conclusion

In fiscal year 2008-2009 the Department opened 2,078 criminal fraud investigations, up from 928 cases in 2007-2008. Criminal fraud prosecution referrals saw a commensurate increase. The new Tax Law provisions provide prosecutors and the Department with a vast arsenal of new weapons with which to counter tax fraud at all levels. In light of New York's current fiscal situation, tax professionals should be prepared to defend taxpayers not liable for tax fraud against possible acts of overreaching under the new law by the Department, the Attorney General, or by local prosecutors.

Very truly yours,

/s/

David L. Silverman